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Report

Evaluation of the Senior Managers and Certification Regime

December 2020

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Foreword

The need for senior management accountability is evident to well-run firms; indeed it supports their success. However, during the 2008 global financial crisis and the years that followed, it became clear that a new legislative and regulatory framework was necessary to ensure senior management could be held to account for significant business and conduct failures that occurred on their watch. In response, Parliament introduced the Senior Managers and Certification Regime (SM&CR) for banks and insurers, which was launched in 2016.[1] Central to this was a requirement that the most senior decision-makers in firms should have clearly assigned responsibilities and be accountable for actions within their remit. These reforms complemented other reforms which ensure that senior individuals are also held accountable for their actions through their remuneration.

At the time, the International Monetary Fund called the SM&CR a 'major and welcome improvement', and commented that the new individual accountability regime was 'an important step towards bolstering public confidence in the banking system'.[2] It also builds on internationally recognised regulatory standards, to put the UK at the forefront of emerging regulatory practice in this area. Since implementation, both firms and regulators have gained considerable experience of how the regime is working in practice. To make sure the SM&CR is delivering against its original objectives, the PRA recently carried out an evaluation to assess progress and to see if any further action was necessary.

The evaluation findings set out in this paper confirm that the introduction of the SM&CR has helped ensure that senior individuals in PRA-regulated firms take greater responsibility for their actions, and has made it easier for both firms and the PRA to hold individuals to account. As with any new regime, there were some upfront implementation costs for firms and regulators, but the work involved in introducing the regime is now bearing fruit and it is being employed in a range of areas to support better prudential outcomes. It is also welcome that a large majority (around 95%) of the firms surveyed said the SM&CR was having a positive effect on individual behaviour.

Furthermore, while individual accountability is crucial to good decision-making (and is the focus of this report), it does not substitute for the responsibility a firm's board has for overseeing the firm. Approached correctly, individual and collective accountability are complementary. It is welcome too that the evaluation has found broad support for this view.

Notwithstanding this broadly positive start, we are keen to continue to embed the regime, to ensure it is anchored in the need for good decision-making, and to ensure it remains a key tool for firms and regulators. There are also some areas, such as the use of conduct notifications and regulatory references, where it is not yet clear whether the regime is working fully as intended. To progress this, the evaluation identifies nine follow-up actions and recommendations to help refine the way in which the regime operates in practice.

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1 The FCA has also extended the SM&CR to most solo-regulated firms.

2 Financial System Stability Assessment, United Kingdom, International Monetary Fund, June 2016, page 30: https://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2016/_cr16167.ashx; and the IMF's assessment of the UK against Basel Core Principles, page 9: https://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2016/_cr16166.ashx.

The PRA encourages stakeholders to comment on these findings using its dedicated e-mail address (available in the Introduction section). In considering next steps, the PRA will continue to work closely with the FCA.

Sam Woods

Deputy Governor, Prudential Regulation

Introduction

The SM&CR was introduced in March 2016, and from the end of 2018 both deposit-taking institutions and insurers were covered by the framework.[3] In essence, the new regime has sought to underpin the link between seniority and accountability following instances of firm failure and misconduct that arose during the global financial crisis and afterwards (see Box 1). In the light of increased experience of working with the SM&CR, the PRA decided to undertake an evaluation of the regime to determine whether the SM&CR was achieving its original aims. These aims were to 'create a new framework to encourage individuals to take greater responsibility for their actions' and to 'make it easier for both firms and regulators to hold individuals to account'.[4]

This report sets out the work and conclusions of the PRA evaluation, which reviewed the operation of the SM&CR against its original objectives. It also examined whether the SM&CR has resulted in unintended consequences. In doing so, it reviewed the policies that underlie the SM&CR and the way in which they have been implemented by both the PRA and firms.

The PRA gathered evidence to support the evaluation between 2019 and 2020. The evidence came from a number of internal and external sources, including:

- a review of regulatory data;
- a survey of PRA supervisors on how the SM&CR had been employed and its effects;
- structured interviews with practitioners, advisers, and supervisors;
- a survey of a balanced sample of 140 PRA-regulated firms (see Annex 1) and individual senior managers on their experience of the SM&CR; and
- a review of external publications (eg by UK Finance and the Banking Standards Board).

The evaluation examined each component of the SM&CR: the Senior Managers Regime, the Certification Regime, conduct rules, and regulatory references. In doing so, it looked at all aspects of dual-regulated firms, for which the PRA acts as the prudential regulator, but not at FCA solo-regulated firms (eg asset management companies, intermediaries, non-bank mortgage lenders, and financial advisors). While this work was led by the PRA, and has focused on its objectives, the SM&CR is a joint regime, which provides supervisory tools to address both prudential and conduct of business risks. Given this, the evaluation team benefited from discussions with the FCA on a number of issues. The evaluation also examined the application of the SM&CR across the cycle of firm and supervisory activity: from authorisation and the determination of fitness and propriety, to the role of accountability in business as usual conditions, to enforcement action (recognising though that from a PRA perspective the regime is supervisory-led rather than enforcement-led). The high-level metrics used in assessing the SM&CR are outlined in Annex 2.

3 The SM&CR was extended to a majority of FCA solo-regulated firms in December 2019.
4 PRA Consultation Paper 14/14 'Strengthening accountability in banking: a new regulatory framework for individuals', July 2014, page 5: https://www.bankofengland.co.uk/prudential-regulation/publication/2014/strengthening-accountability-in-banking-a-new-regulatory-framework-for-individuals.

In adopting the SM&CR, the UK was a leader in the field of individual accountability. The evaluation team was therefore unable to benchmark the UK against a number of other jurisdictions that had several years' experience working with such an approach. There is, however, growing international interest in individual accountability regimes. Other jurisdictions have adopted or are looking closely at similar, broad-based accountability frameworks. In addition, international standard setting bodies – such as the Financial Stability Board, the Basel Committee on Banking Supervision, and the International Association of Insurance Supervisors – have pointed to the use of clearer roles and responsibilities as a supervisory tool (see Box 2).

This is the first PRA evaluation to examine a broad area of domestic policy. It is not a formal consultation and does not set out specific proposals for amending either the PRA Rulebook or Supervisory Statements, but it does include nine high-level follow-up actions and recommendations. The PRA welcomes further feedback on the issues outlined in this document, which has drawn on the views of many but by no means all external stakeholders. On the basis of this, and having consulted the FCA (and as appropriate HM Treasury), the PRA will consider if there is a case for proposing changes, which if taken forward would be subject to the usual consultation process. In addition, the PRA will continue to give feedback to firms individually or at a sector-level if it identifies areas in which firms can improve their implementation of the regime.

Please address any comments or enquiries by email to PRASMCREvaluation2020@bankofengland.co.uk.

Responses are requested by Friday 26 February 2021.

Summary of evaluation

The key findings of the evaluation are outlined below, along with proposed follow-up actions and recommendations (see Table 1):

Theme 1: Holding individuals to account through the SM&CR

- New fitness and propriety requirements are supporting higher professional standards. Alongside these, supervisors are using the regime to clarify responsibility for new business risks and to hold senior individuals to account.

- Most senior managers (94%) who participated in the survey observed that the SM&CR had brought about positive changes to behaviours, and nearly all firms reported integrating to some extent the SM&CR with internal practices.

- At the same time, the initial nervousness that accompanied the introduction of the SM&CR has reduced as practitioners have become familiar with it.

- Executive pay is being adjusted in response to adverse events and new PRA rules on remuneration, although the additive effect of the SM&CR is unclear. However, conduct notifications are being used to a limited extent only.

Theme 2: Myth busting and clarifying expectations

- Concerns have been expressed that risk aversion might prompt some firms to appoint senior managers with similar profiles to existing executives. It is important to affirm the PRA's commitment to ensure the SM&CR does not impede steps by firms to improve diversity of skills, experience and backgrounds among their senior management, and to dispel any misconception that the Senior Managers Regime (SMR) favours simple 'replication'.

- Most stakeholders saw individual accountability and board responsibility as complementary, and the PRA should continue to promote these in ways that are mutually reinforcing.

Theme 3: Application of the SM&CR to different business models

- The SM&CR has been successfully implemented across different business models. Most respondents believed that the regime is proportionate. However, medium-sized and smaller firms held this view less strongly. The PRA would welcome further feedback on options for enhancing proportionality.

- Approving senior managers on a time-limited and conditional basis has been used much less than envisaged, and options to support the more flexible use of these tools should be examined.

- While the PRA has issued guidance on senior management responsibilities to mitigate new risks (such as those presented by algorithmic trading and crypto assets), there are advantages in applying the existing set of Senior Management Function (SMF) responsibilities wherever possible to limit the growth of new expectations.

Table 1: Summary of findings, follow-up actions and recommendations		
Summary findings		**Follow-up and recommendations**
Theme 1: Holding individuals to account through the SM&CR Fitness and propriety requirements are being deployed to control entry to the system. PRA supervisors are making extensive use of the SM&CR, which gives them additional traction with firms. Firms report the SM&CR is having a material effect on behaviours. At the same time, there is more that can be done to embed the SM&CR further. Some firms report challenges in using regulatory references, and conduct notifications are being used to a limited extent only. Pay adjustments are a means of reinforcing individual accountability, but it is not apparent that the SM&CR has resulted in larger or more frequent adjustments. Those assigned responsibility for the SM&CR within firms have a key role to play in further embedding it.	**1**	**Conduct and regulatory references**: Examine the scope for clarifying expectations related to misconduct reporting in notifications and regulatory references. Engage with industry so that regulatory references are used in an appropriate manner.
	2	**Remuneration**: Seek feedback on the benefits of further articulating the link between the SM&CR and remuneration adjustments: while this is mentioned in speeches, it could be stated more clearly in policy documents (eg relevant Supervisory Statements).
	3	**Senior manager expectations**: Underline the responsibility of those holding Prescribed Responsibilities for the SMR and the Certification Regime to embed these (eg ensuring quality of Statements of Responsibilities).
Theme 2: Myth busting and clarifying expectations There was a strong message from stakeholders that significant changes to the SM&CR were not desirable. There was more mixed feedback on the extent to which additional guidance on the responsibilities of senior managers would be helpful, and there were concerns that this could detract from need for senior managers to exercise judgment. The evaluation also identified some specific cases in which there was interest in the PRA reviewing expectations or guidance to address potential misconceptions about the regime. Prior to its introduction, there was a concern the SM&CR might have the unintended consequence of impeding diversity by reducing the attractiveness to external candidates of senior roles in the regulated sector. A number of stakeholders also noted a potential risk that firms might be tempted to put forward candidates with similar characteristics to past candidates to facilitate regulatory approvals. It is therefore important to underline that the SMR's fitness and propriety requirements in no sense require firms to simply replicate the personal characteristics of existing jobholders. Greater emphasis on individual responsibility has generally worked successfully alongside the collective responsibility of the board for determining strategy. PRA documents could usefully reinforce the complementarity of the two approaches when implemented appropriately. Some stakeholders asked for clarification on the operation of the 12-week rule on interim senior manager appointments.	**4**	**Diversity**: Reaffirm the PRA's appetite for diverse skills and experience among senior management teams through policy and expectations, and/or communications. Examine options for improving data collection and analysis of diversity among the senior management population.
	5	**Collective accountability**: Seek further views on whether board responsibilities and individual accountability are mutually reinforcing.
	6	**Interim appointments**: The PRA and FCA are consulting on clarifying regulatory expectations in cases where a senior manager takes temporary leave for longer than 12 weeks (long-term leave).[5] Stakeholders with an interest in this subject are encouraged to respond directly to that paper.

5 The chapter 'Clarifying our expectations for temporary, long-term absences' is contained in the FCA's Quarterly Consultation No. 30 (CP20/23): https://www.fca.org.uk/publications/consultation-papers/cp20-23-quarterly-consultation-paper-no-30.

Theme 3: Application of the SM&CR to different business models The SM&CR provides a flexible tool that can be used across a range of different firms and business models – and has been implemented in firms ranging from large international players to small insurers and credit unions. A majority of firms reported that the SM&CR had been implemented in a proportionate manner. However, that majority was more substantial in the case of large firms than those in the next tiers by size. The evaluation identified a number of areas where it would be timely to obtain further views from stakeholders on the flexible application of the regime and on the need for additional guidance. There was also a sense that greater use of time-limited and conditional SMF approvals would give the SM&CR the additional flexibility envisaged when the regime was first established. Practitioner feedback also suggested that it would be helpful if the PRA listed the various senior management expectations created in respect of new and evolving risks in a single section of its website.	7	**Allocation of responsibilities:** Seek further views on: • the usage of the Head of Key Business Area (SMF6) designation at insurers to see why this is used less than at banks; • the way in which the designation of certain individuals as Key Function Holders works alongside the SM&CR; • the case for further guidance in allocating Prescribed Responsibilities; and • an option for smaller firms to submit SM&CR documentation less frequently.
	8	**Time-limited and conditional approvals**: Explore options for making time-limited and conditional approvals more readily used in the appointment of senior managers.
	9	**New senior manager expectations**: The PRA should consider adding an inventory of guidance and expectations in respect of senior manager responsibility for new and emerging risks to the individual accountability section of the Bank of England website. Looking ahead, supervisors should seek to work with the existing set of senior manager policy expectations wherever possible, to limit their growth.

Box 1: Rationale for the SM&CR and key components

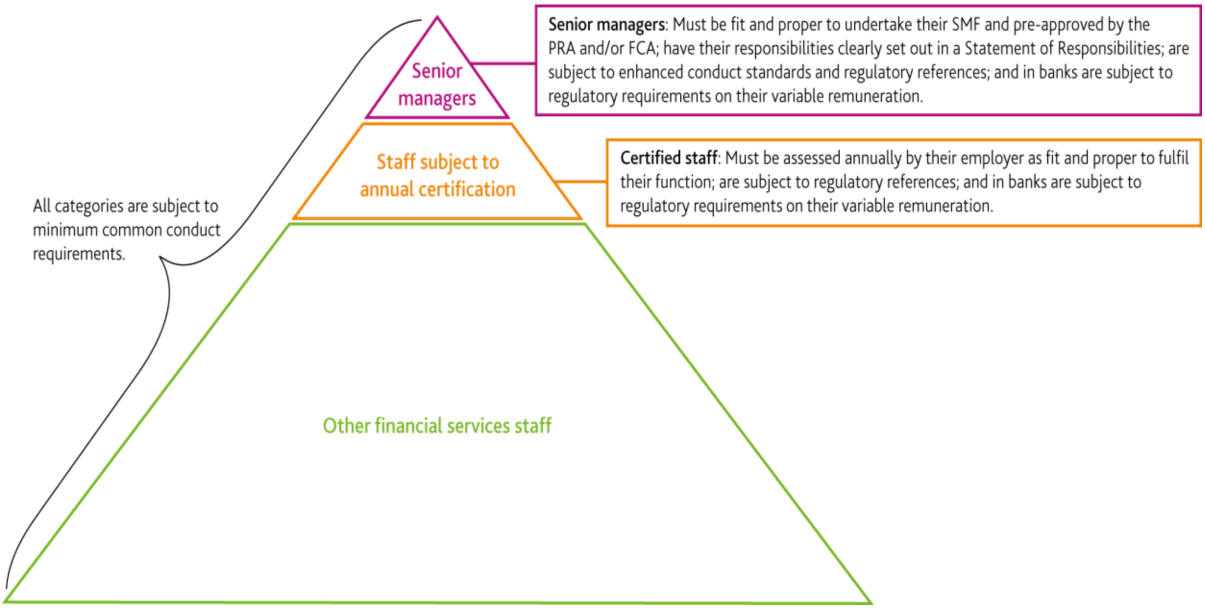

Diagram 1: Stylised presentation of staff responsibilities under the SM&CR.

The Senior Managers and Certification Regime (SM&CR) was established to address a number of shortcomings identified by the Parliamentary Commission on Banking Standards (PCBS), which published its findings in 2013. The PCBS was concerned that in the years around the global financial crisis, senior bankers had avoided accountability 'for failings on their watch by claiming ignorance or hiding behind collective decision-making'. It therefore recommended that regulators establish an individual accountability regime directed to the decisions and competence of 'Senior Persons'. As the PCBS noted, this was not aimed at limiting the role of the board or to prevent delegation, but to 'reflect the reality that responsibility that is too thinly diffused can be too readily disowned: a buck that does not stop with an individual stops nowhere'.[6]

Subsequently, the PRA and FCA, together with HM Treasury, developed the SM&CR. This was rolled out to banking institutions (including credit unions) in March 2016, and was fully extended to insurers in December 2018.[7]

The SM&CR comprises the following elements, which are illustrated in diagram 1:

Senior Managers Regime (SMR): The most senior decision-makers, or senior managers, who undertake one or more Senior Management Function (SMF) at a firm must be assessed as fit and proper, have clearly defined responsibilities, and be subject to enhanced conduct requirements, including the duty to take reasonable steps in fulfilling their responsibilities. Individuals seeking to hold SMFs must be approved by the PRA and/or the FCA. Senior managers include those that hold specific executive roles (such as CEOs and heads of finance and operations), and also non-executives holding particular oversight roles (such as board chairs and those chairing audit, risk, and remuneration committees).

Certain responsibilities are essential in particular SMFs. Hence, for example, the individual holding the Chief of Finance Function (SMF2) has responsibility for management of the financial resources of a firm, and reporting directly to the governing body of the firm in relation to its financial affairs; and the individual assigned the Chief Operations Function (SMF24) has responsibility for the internal operations and technology of a firm. In addition, there are several Prescribed Responsibilities that must be allocated across the team of available senior managers. These include, for example, responsibilities covering the adoption of the firm's culture, the effectiveness of its approach to whistleblowing, and its approach to outsourcing.

To ensure appropriate accountability, those holding SMFs must have a clearly articulated Statement of Responsibilities outlining the duties for which they are responsible. In addition, firms need to produce Management Responsibilities Maps, which consolidate information on a firm's management and governance arrangements into an accessible and comprehensive source.

Certification Regime:

Applies to significant risk-taking individuals outside the group identified as senior managers. Such individuals do not require approval by the regulators; rather, it is for firms to determine on

6 Report of the Parliamentary Commission on Banking Standards, volume 1, pages 8 and 37: http://www.publications.parliament.uk/pa/jt201314/jtselect/jtpcbs/27/2702.htm.

7 In the interim, senior individuals at insurers were covered by the Senior Insurance Managers Regime (SIMR), which was similar to the Senior Managers Regime, but Certification for the next tier of staff was not introduced until the end of 2018.

appointment and then certify annually that they are fit and proper to undertake their roles. One criticism of the Approved Persons Regime, which preceded the SM&CR, was that it required regulators to take too many approval decisions, distracting attention away from key decision-makers.

Regulatory references: As part of the hiring process for senior managers and key risk-taking employees, firms must exchange mandatory employment references, containing information on prior conduct. Such 'regulatory references' aim to prevent the 'recycling' of individuals with poor conduct records between firms. They must cover the previous six years of employment and be sought from all relevant former employers. Due to local legal restrictions, the PRA recognises that there can be constraints on obtaining information regarding the conduct of individuals from overseas firms.

Conduct Rules: All financial services staff are subject to minimum conduct standards requiring that they: (i) act with integrity; (ii) demonstrate due skill, care, and diligence; and (iii) are open and cooperative with the FCA, the PRA, and other regulators. There are additional conduct rules that are applicable to senior managers, such as taking reasonable steps to ensure the business of the firm for which they are responsible is controlled effectively and complies with the relevant regulatory requirements. Moreover, they must take reasonable steps when delegating their responsibilities, and should disclose appropriately any information of which the FCA or PRA would reasonably expect notice.

Fitness and propriety: Senior managers and those performing roles within the Certification Regime must be found fit and proper to undertake their roles. In deciding whether a person is fit and proper, a firm must be satisfied that the person has the appropriate qualifications, training, competence, and personal characteristics needed to perform their function effectively and in accordance with any relevant requirements, and to enable sound and prudent management of the firm.

Remuneration rules: Regulatory requirements directed to the remuneration of senior individuals were introduced prior to the SM&CR, but they reinforce individual accountability in ways that complement the regime. In the case of banks, senior individuals – including senior managers – whose professional activities could have a material impact on the risk profile of their firm are known as material risk-takers (MRTs). The variable pay of MRTs is subject to quantitative requirements, which include the deferral of variable pay for a specified period, and the payment of a substantial proportion of such remuneration in the form of financial instruments rather than cash. The deferral of pay allows employers to establish contracts that allow them to withhold payment of amounts of unvested instruments (known as 'malus') and, if necessary, to 'clawback' remuneration already paid.

Detailed findings and recommendations

Theme 1: Ensuring firms use the SM&CR to hold individuals to account

Central to the SM&CR is the need to maintain a credible link between seniority, decision-making, and accountability. There are a number of tools that can be deployed by both firms and supervisors to achieve this end:

- clarity in the allocation of responsibilities;
- clarity as to the criteria for fulfilling those responsibilities;
- accountability of decision-makers for their actions;
- and the creation of incentives (eg through variable remuneration and HR policies) that give accountability traction.

Recommendations	
1	**Conduct and regulatory references** Examine the scope for clarifying expectations related to misconduct reporting in notifications and regulatory references. Engage with industry so that regulatory references are used in an appropriate manner.
2	**Remuneration** Seek feedback on the benefits of further articulating the link between the SM&CR and remuneration adjustments: while this is mentioned in speeches, it could be stated more clearly in policy documents (eg relevant Supervisory Statements).
3	**Senior manager expectations** Underline the responsibility of those holding Prescribed Responsibilities for the SMR and the Certification Regime to embed these (eg ensuring quality of Statements of Responsibilities).

General application – supervisors and firms

The SM&CR is being used widely as a supervisory tool. An internal survey conducted in 2019 showed that around 70% of supervisors found the SM&CR had helped them hold individuals to account. This can be observed in the extent to which supervisory discussions make explicit reference to the regime, and is evidenced in letters to regulated firms following key meetings with the PRA, which increasingly ask for a senior manager to be identified as responsible for addressing key risks that have been identified. In doing so, supervisors seek to promote better prudential outcomes across a range of issues, including capital, credit, liquidity, and operational risk.

This approach is one that PRA senior management has been keen to reinforce. Speaking on the SMR component of the regime, Sam Woods (Deputy Governor for Prudential Regulation) said in his 2018 Mansion House Speech:

> Firms should therefore expect us to make more use of the SMR to deliver supervisory priorities. There is no magic to this: we will simply ask, when we set

out those priorities, which senior manager is on the hook to deliver them, and what will happen if they do not?[8]

For the PRA, the SM&CR acts principally as a supervisory tool. Supervisors and firms are mindful of the importance the SMR attaches to individuals discharging their responsibilities effectively, and of the possibility of enforcement action against individuals in the event of significant failures. As with other areas of regulation, enforcement action for breaches remains an option in the event of significant failures to comply with regulatory requirements.[9]

While most of the success in the SMR has come from ensuring that firms and individuals have a clear view of their responsibilities, and discharge them appropriately, there have been several instances of enforcement action involving individual accountability and misconduct since the PRA was established. Individual findings are published, and are summarised in the PRA's Annual Reports.[10] Due to the lead times involved in bringing cases, those that have occurred to date have principally involved breaches of standards in place prior to the SM&CR. With time, new cases will provide practitioners with further legal precedents. The PRA has reported that, since January 2016, it has opened investigations into 26 individuals, with six of those individual cases being opened within the financial year 2019/20. It currently has 16 investigations into individuals open, with one additional matter pending before the Upper Tribunal.

Chart 1: Do you think the SM&CR has brought about meaningful change in behaviours among regulated financial institutions?

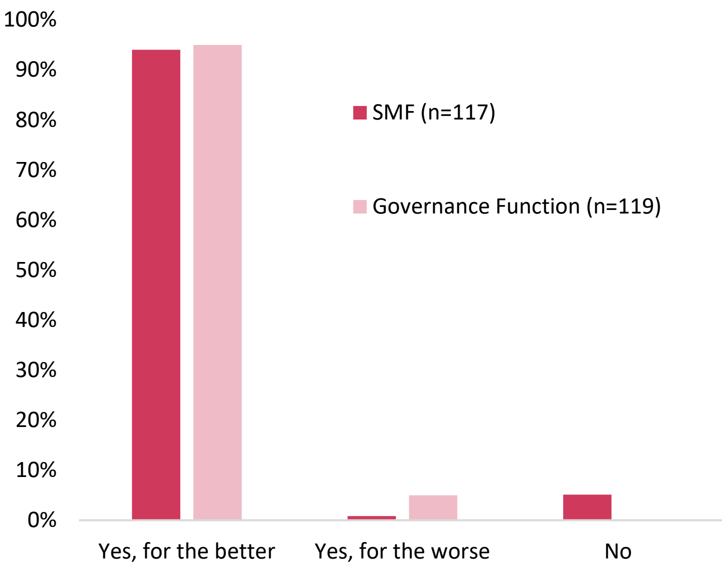

Chart 1 shows the percentage of SMFs and firm Governance functions that consider the SM&CR to have brought about meaningful change in behaviours among regulated financial institutions.

At the same time, the SM&CR was not designed simply as a tool for regulators, but as one to help firms strengthen internal processes. This is consistent with the PRA's view that it is for boards and senior management to understand which behaviours will deliver acceptable levels of safety and soundness, and to follow policies in line with their spirit and intended outcome.[11] In conducting the evaluation, it was important to gauge the extent to which firms felt the

8 Mansion House speech by Sam Woods, 'Good cop/bad cop', October 2018: https://www.bankofengland.co.uk/speech/2018/sam-woods-mansion-house-city-banquet .

9 Speech by Miles Bake, 'The PRA's approach to enforcement', July 2019: https://www.bankofengland.co.uk/speech/2019/the-pras-approach-to-enforcement-speech-by-miles-bake .

10 See: https://www.bankofengland.co.uk/prudential-regulation/publication/pra-annual-report-and-business-plan

11 'The PRA's approach to banking supervision', October 2018, page 14: https://www.bankofengland.co.uk/prudential-regulation/publication/2018/pra-approach-documents-2018.

SM&CR to be effective, and to understand how they were building on the regime for their own purposes (the 'use test').

Results from the survey of banks and insurers showed that 94% of senior managers and 96% of firms that responded reported that the SM&CR had brought about positive and meaningful changes to behaviour in industry, which is shown in Chart 1[12]. Some respondents who did not attribute improved behaviours to the SM&CR said they already placed considerable emphasis on individual accountability, and therefore the additive effect of the new requirements was not material.

A large majority of respondents surveyed considered the Senior Managers Regime (95%) and Certification Regime (89%) to capture the appropriate individuals in their firm, although 10% of responses suggested that the Certification Regime captured too many individuals (see Chart 2 below). The population covered by the Certification Regime is indeed a large one – and covers persons whose actions could have a material effect on a firm's conduct through customer-facing sales activity, as well as on its safety and soundness.

Chart 2: Are the appropriate individuals captured in your firm?

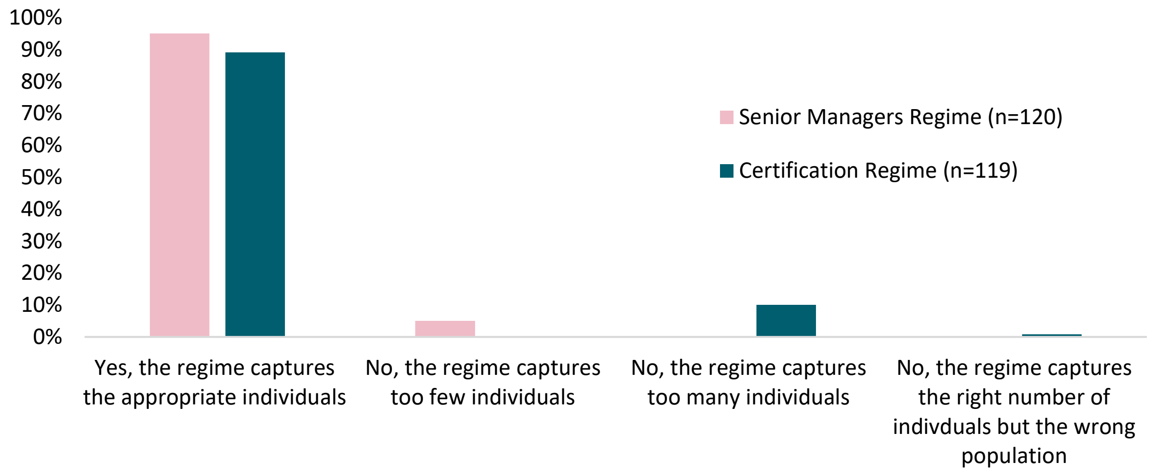

Chart 2 shows whether firm Governance functions consider the Senior Managers Regime and Certification Regime to capture the appropriate individuals in their firm.

The SM&CR was designed to be applicable to a wide range of business models and firms, which had considerable discretion in how to implement the regime administratively. Some firms reported the following actions had helped them embed the SM&CR:

- having senior individuals and/or committees to oversee implementation;
- setting up a central team to provide expert advice on the application of the regime;
- training and workshops for senior staff assuming new responsibilities (such as senior managers); and
- broad-based training on conduct issues, consistent with FCA requirements, for a wider set of employees.

12 The term 'Governance function' refers to the unit or individual within a firm responsible for supporting its implementation of the SM&CR.

It was notable that 97% of firms reported integrating (to some degree) the SM&CR in their business as usual practices in ways that went beyond the simple requirement to demonstrate regulatory compliance, as shown in Chart 3 below. Some firms provided specific examples of how the SM&CR had prompted improvements in internal processes. Examples included better handover arrangements between senior staff, improved clarity of board responsibilities, and improved compliance and ethics training.

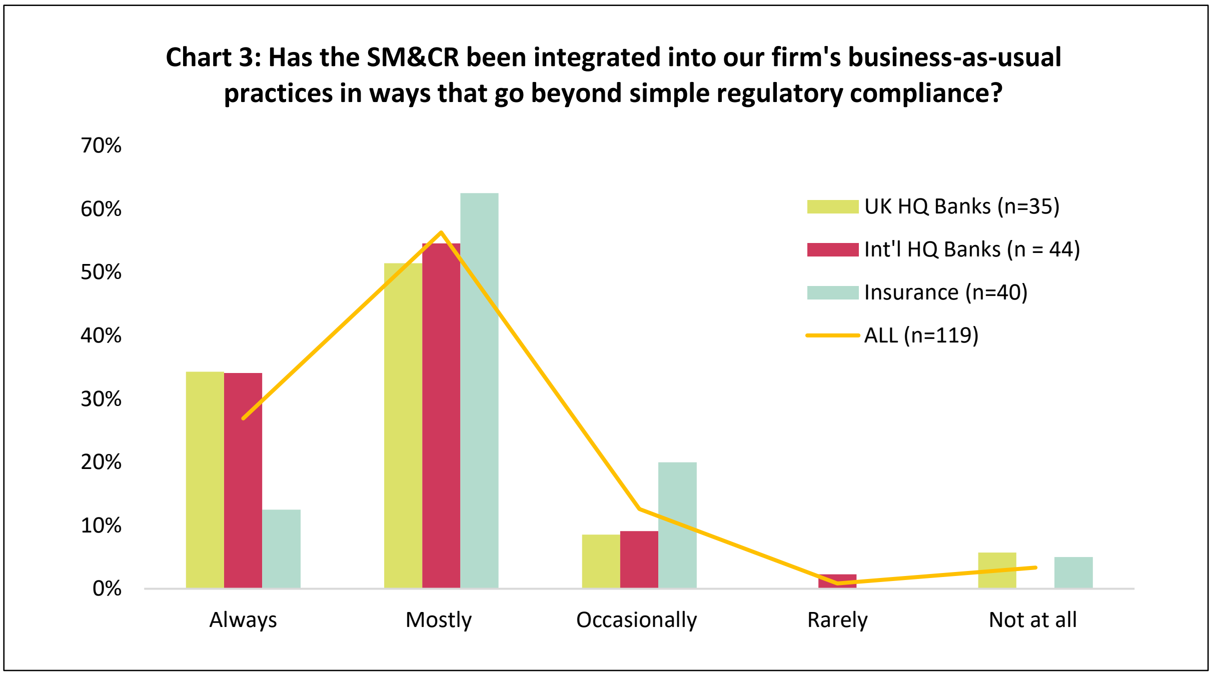

Chart 3 shows whether firm Governance functions consider the SM&CR to have been integrated into their firm's business-as-usual practices in ways that go beyond simple regulatory compliance, broken down by UK headquartered banks, internationally headquartered banks and insurers.

There are naturally challenges in interpreting a survey of regulated firms that was conducted by the regulator. In this sense, it is necessary to exercise a degree of caution, rather than declare the 'job done'. At the same time, significant positive feedback suggests the SM&CR is seen by a wide group of practitioners as offering a sound framework for enhancing governance, even if there are still questions about how the regime could be made more effective.

On the question of whether behaviours are changing, it is also possible to point to independent work undertaken by the Banking Standards Board (BSB). As part of its annual survey targeted at employees of member firms, the BSB asks individuals to respond to the statement: 'I believe senior leaders in my organisation take responsibility, especially if things go wrong'. In 2019, 66% of respondents agreed (strongly or somewhat) with this statement; this was up from 58% in 2016.[13]

To investigate factors that encourage improved behaviours, the evaluation looked at a number of tools underpinning the SM&CR. In this regard, fitness and propriety standards supported by regulatory references play a key role in addressing suitability of senior personnel. Meanwhile, the application of regulatory requirements on variable remuneration and conduct standards also helps align individual incentives and behaviours.

13 The BSB survey captures a broad (and widening) population of bank and building society employees.

Fitness and propriety and misconduct reporting

Those seeking to become a senior manager must be approved by the PRA and/or the FCA prior to assuming their role, although firms should make applications only after they themselves have judged the candidate to be suitable. Within the Certification Regime, individuals must be assessed as fit and proper by their employer. The distinction reflects the view that prior to the SM&CR, regulators were responsible for scrutinising too many hiring decisions and would be more effective if they focused on key decision-makers.[14]

Experience to date shows that the approval process offers an effective tool for screening prospective senior managers. Desk-based reviews and interviews allow the PRA, working with the FCA, to test applicants' suitability. Supervisors are supported by PRA senior advisors and other specialist resources in arriving at decisions, and a number of senior manager candidates (around 5%) are interviewed as part of this process. In the year to September 2020, there were 1360 applications for approval, while 1146 applications were approved, and 98 applications were withdrawn.[15] Firms are able to withdraw applications before a decision is taken, and to date the PRA has not provided a formal rejection notice.

All professional services staff at PRA and FCA-regulated financial firms are covered by conduct rules. Senior personnel are covered by three additional rules. Firms are required to notify the regulators if they take action against individuals found to have been in breach of these rules. In the approximately 4.5 years leading up to October 2020, the PRA received 16 conduct notifications in respect of senior managers, and 104 conduct notifications in respect of persons under the Certification Regime. To put this in context, there are approximately 7,850 PRA SMFs in total.[16] It is difficult to form an estimate as to what constitutes an appropriate level of notifications but the number of notifications received to date appears modest.

The key facts that should result in a notification are set out in section 64C of the Financial Services and Markets Act 2000 (FSMA), and are clear: the regulators must be notified where 'disciplinary action' has been taken against an individual, evidenced by any of the following:

- the issuing of a formal written warning;
- the suspension or dismissal of the person; or
- the reduction or recovery of any of the person's remuneration.

The obligation to make a notification under section 64C applies notwithstanding any arrangements entered into by a firm and an employee. Consequently, the PRA should continue to review the

14 See Parliamentary Commission on Banking Standards, 2013 (page 35).
15 Some approvals will have been for applications received in the previous year and therefore the number of approvals and withdrawals will not equal the figure for applications received.
16 The total number of SMFs is not the same as the total number of senior managers, who may hold more than one SMF role (subject to regulatory approval). Under the Approved Persons Regime, the number of individuals pre-approved to hold PRA Significant Influence Control Functions at banks or Control Functions at insurers prior to the Senior Insurance Managers Regime was close to 14,800.

available statistics, and use relevant communications to remind firms of the requirements set out in Chapter 11 of the Notifications Part of the PRA Rulebook.[17]

The annual certification of senior managers and staff under the Certification Regime aims to ensure the assessment of fitness and propriety is an ongoing rather than a one-off process. Regulatory references support this by requiring that hiring firms request a reference from previous employers (covering a six-year period) on the suitability of senior individuals seeking to move between firms.[18]

Survey evidence showed a large majority of firms (85%) either mostly or always considered the regulatory references they received to be of sufficient quality to inform their assessment of an individual's suitability, as referenced in Chart 4 below. There was some variation between banks and insurers, with around a quarter of banks noting that regulatory references received were always of sufficient quality, while the comparable figure for insurers was only 15%.

Chart 4: Are the regulatory references your firm receives of sufficient quality to inform your firm's assessment of an individual's Fitness and Propriety?

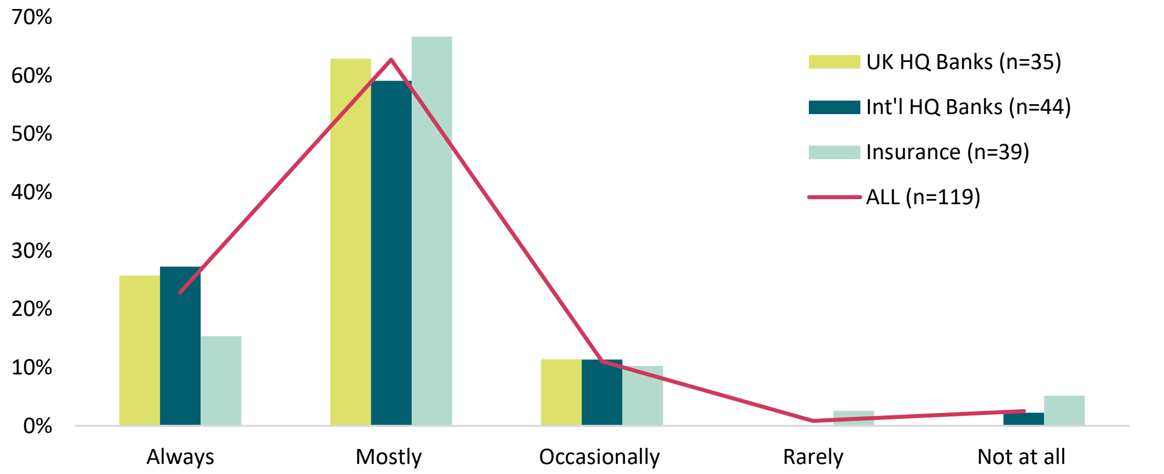

Chart 4 shows whether firm Governance functions consider regulatory references their firm receives to be of sufficient quality to inform their firm's assessment of an individual's Fitness and Propriety, broken down by UK headquarter banks, internationally headquartered banks and insurers.

It was also the case that some firms that were regular recipients of regulatory references were cautious about their utility, and some stakeholders noted the challenge involved in deciding what information to include in a regulatory reference.

One point that was apparent from discussions with firms was nervousness about hiring individuals who had an adverse comment on their reference, and a corresponding sensitivity on the part of employees to such comments. It is clearly for firms to exercise judgment in dealing with the information they receive. The SM&CR was not established to eliminate all mistakes or errors of judgment, especially as individuals can learn from these. There is therefore a case for the PRA to

[17] The notification requirements complement and do not override other requirements for firms to report information to the PRA, for example under Fundamental Rule 7, which states that 'a firm must deal with its regulators in an open and cooperative way and must disclose to the PRA appropriately anything relating to the firm of which the PRA would reasonably expect notice'.

[18] Regulatory references are relevant to those applying for senior manager roles, a Certification Function, and to notified non-executive directors as well as Key Function Holders who are not senior managers.

engage with external stakeholders to determine if there is a danger that regulatory references, in some cases, may be being used in ways that are unnecessarily punitive.

The link between SMR and remuneration

Banks and insurers are subject to regulatory remuneration requirements that seek better alignment between the financial incentives of senior executives and the long-term interests of their employer. The ability to adjust variable pay to reflect performance – including the ability to stop the payment of deferred bonuses – is central to this approach (see Box 1). The PRA's rules on variable remuneration were, however, introduced some years before the SM&CR. While there are links between the two areas, they are not fully integrated in terms of Supervisory Statements. Nonetheless, senior managers (as well as many who come under the Certification Regime) fall within the definition of material risk-takers, and are subject to the requirement that variable pay should be adjusted to reflect performance.

Chart 5: Are senior managers' Statements of Responsibilities linked to their objectives and decisions on their variable remuneration?
(n=119)

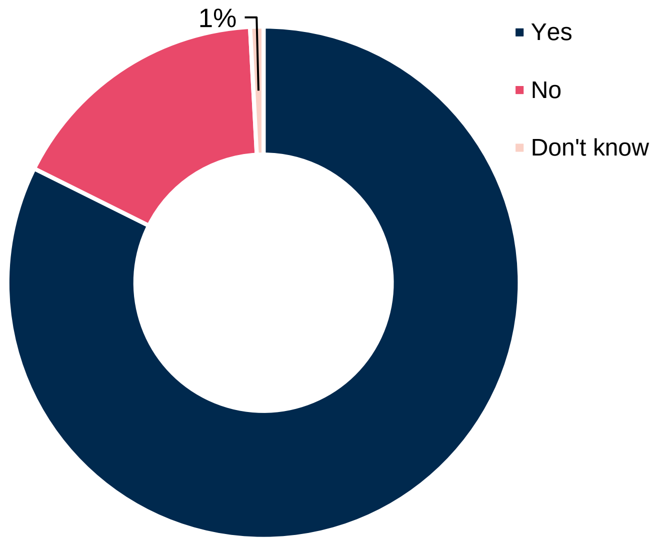

Chart 5 shows the proportion of firms that link their senior managers' Statements of Responsibilities to their objectives and decisions on their variable remuneration.

There is evidence of firms holding individuals to account through adjustments to variable pay. In the period 2014–2018, the available data shows that firms reported nearly 400 material risk events that prompted them to adjust downwards the variable remuneration of a responsible individual. However, the data on such adjustments for material events does not confirm an additive effect of the SM&CR on remuneration practices. Firms surveyed report that SM&CR responsibilities are considered in remuneration arrangements, as shown in Chart 5. However, qualitative feedback suggests that the responsibilities of senior managers are generally reflected in objectives and appraisals as part of a balanced scorecard, rather than a one-for-one link between meeting SMR responsibilities and variable pay.

Given that the SM&CR and remuneration requirements are set out separately in PRA policy documents, there is a case for making the link between these two approaches to individual accountability clearer, aligning with the view expressed by Sam Woods in his 2018 Mansion House speech:

> But we are going to ask more pointedly and regularly than before: how is the pay of that senior manager who is tasked with delivering a major supervisory priority going to be affected by their success or failure in that task?

Senior manager responsibility for embedding the SM&CR

Significant progress has been made in implementing the SM&CR. It is important that supervisors and firms continue to build on this progress. Senior management at regulated firms have a major role to play in this, and among the Prescribed Responsibilities that must be held by one or more senior managers, there are two, in particular, that relate to the effective implementation of the SM&CR:

- responsibility for the firm's performance of its obligations under the SMR; and
- responsibility for the firm's performance of its obligations under the Certification Regime.

These responsibilities provide another mechanism for anchoring the regulatory requirements for individual accountability. Hence the senior manager with responsibility for the SMR itself has a particular responsibility for ensuring that firms exercise diligence in assessing applicants for SMF roles as fit and proper; have Statements of Responsibilities that reflect their key duties; and ensure that incentives do not undermine the SMR operationally. Given this, the PRA will consider whether further expectations around these Prescribed Responsibilities and/or raising their profile might be worthwhile.

Box 2: International developments

The question of individual accountability is receiving more attention internationally as a mechanism for addressing both conduct and prudential risks.

In its Financial Sector Assessment Program review of the UK in 2016, the International Monetary Fund (IMF) commented that the introduction of the Senior Managers Regime was a 'major and welcome improvement', and that the new individual accountability regime was 'an important step towards bolstering public confidence in the banking system'.[19]

In 2018, the Financial Stability Board published a 'toolkit' for firms and supervisors which looked at the use of individual accountability requirements as one of a number of tools for addressing misconduct risk. It noted that one consequence of the growth in fines and settlements incurred by firms was a heightened interest in addressing misconduct by holding individuals accountable for their actions, which could be reinforced by clearly identifying key responsibilities and assigning them to individuals. Such an approach could support cultural change at firms by dispelling notions that fines were the cost of doing business.[20]

Additionally, the Basel Committee on Banking Supervision (BCBS) addresses the role of senior management in its 'Corporate governance principles for banks'. The document notes that the organisation, procedures, and decision-making should be clear, transparent, and designed to promote effective management of the bank, including clarity on the role, authority, and

[19] Financial System Stability Assessment, United Kingdom, International Monetary Fund, June 2016, page 30: https://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2016/_cr16167.ashx and the IMF's assessment of the UK against Basel Core Principles, page 9: https://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2016/_cr16166.ashx.

[20] Strengthening Governance Frameworks to Mitigate Misconduct Risk: A Toolkit for Firms and Supervisors, Financial Stability Board, April 2018, page 22: https://www.fsb.org/2018/04/strengthening-governance-frameworks-to-mitigate-misconduct-risk-a-toolkit-for-firms-and-supervisors/.

responsibility of the various positions within senior management.[21] The 'Insurance Core Principles' adopted by the International Association of Insurance Supervisors (IAIS) note that governance frameworks should define the roles and responsibilities of persons accountable for the management and oversight of the insurer, clarifying who possesses legal duties and powers to act on behalf of the insurer and in what circumstances.[22]

A number of countries have taken steps to support improved accountability. To date, accountability regimes that look to identify a range of key decision makers have been adopted in Australia (Bank Executive Accountability Regime), Hong Kong (Manager-in-Charge Regime), Singapore and, prospectively, Ireland (Senior Executive Accountability Regime). Financial regulators in Malaysia have explored this approach. At the same time, there are other approaches to addressing improved conduct within the financial sector. A notable example is the one taken by the De Nederlandsche Bank in monitoring and supervising governance, behaviour and culture to promote better prudential outcomes.

Theme 2: Myth busting and clarifying expectations

While industry largely reports constructive engagement with the SM&CR and reduced anxiety compared to when the regime was first introduced, some misconceptions remain. The evaluation identified a few areas where it would be helpful to clarify the PRA's expectations to support consistent implementation and avoid unintended consequences.

Recommendations	
4	**Diversity** Reaffirm the PRA's appetite for diverse skills and experience among senior management teams through policy and expectations, and/or communications. Examine options for improving data collection and analysis of diversity among the senior management population.
5	**Collective accountability** Seek further views on whether board responsibilities and individual accountability are mutually reinforcing.
6	**Interim appointments** The PRA and FCA are consulting on clarifying regulatory expectations in cases where a senior manager takes temporary leave for longer than 12 weeks (long-term leave). Stakeholders with an interest in this subject are encouraged to respond directly to that paper.

Recruitment and diversity

There was some concern prior to the introduction of the SM&CR that firms might find it increasingly challenging to find people to undertake senior roles (including non executive director roles) given the new responsibilities entailed. However, most firms reported that the SM&CR had not hindered them from recruiting individuals with the skills they needed. Some stakeholders did, however, feel there were challenges in recruiting from certain areas outside regulated financial services, such as information technology and digital services. This was, in part, due to the high level of demand for these particular skills. There is some evidence that while those working in financial services have adapted to the SM&CR, it is less familiar to those working in other sectors. This may carry some

21 Corporate Governance Principles for Banks, Basel Committee on Banking Supervision, July 2015, Page 20, https://www.bis.org/bcbs/publ/d328.htm.

22 Insurance Core Principles, International Association of Insurance Supervisors, page 50: https://www.iaisweb.org/page/supervisory-material/insurance-core-principles-and-comframe/file/91154/iais-icps-and-comframe-adopted-in-november-2019.

weight in recruitment decisions, even if it is not the only consideration. The regulatory responsibilities that are attached to working under the SM&CR are necessarily tangible and intended to support high standards. At the same time, regulatory responsibilities are judged against the standard of having taken reasonable steps. While the PRA has pointed this out previously, it might be useful to reinforce this in future.

Relatedly, the PRA has emphasised that more diverse leadership teams support better decision making and prudential outcomes by challenging 'groupthink'.[23] Anna Sweeney (Executive Director, Insurance Supervision) highlighted this in her speech, 'Making impactful change':

> The lack of intellectual diversity, including from the lack of gender, race and other diversity, we believe contributed to the severity of the crisis through confirmation bias. Leading policymakers and practitioners have since paid greater attention to the dangers of groupthink.[24]

When the SM&CR was being developed, there was some concern that greater emphasis on senior management accountability might discourage some candidates from outside the UK-regulated financial services sector from applying for a senior manager role, with implications for the skills and diversity of firms' senior management. The evaluation found no evidence to support or reject this due to the lack of quantitative data available. A number of those interviewed, however, noted the need to guard against this, and the possibility that some firms might be tempted to adopt a 'safe' approach to meeting SM&CR suitability requirements by replacing one senior manager with another from a similar background. Anecdotal intelligence gathered from PRA supervisors also suggests a varied picture. Some firms report that from time to time they believe SM&CR may have affected their ability to attract senior management candidates from outside the UK, but others report that this has not been the case in their experience, and that SM&CR has had no negative impact.

It is important to dispel any misconceptions that may exist. When deciding whether senior individuals are fit and proper, a firm must be satisfied they meet this standard as regards: honesty, integrity, and reputation; competence and capability; and financial soundness.[25] But it is not a standard that requires simple 'replication' in terms of the personal characteristics of the appointees. If firms were to do this, they would be adopting an overly narrow view of the PRA's position. When the PRA wrote to chairs of UK banks and insurers in March 2020 regarding board diversity, it noted that in satisfying themselves that their firm had met the PRA's requirements, they should consider the extent to which diversity policy was embedded in recruitment and succession planning for the board.[26]

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23 See the PRA's Approach to supervision for banks and insurers, October 2018, see page 14 in both documents: https://www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors. Supervisory Statement 5/16 'Corporate governance: Board responsibilities' also notes the need for a mix of skills and experience, March 2016: https://www.bankofengland.co.uk/prudential-regulation/publication/2016/corporate-governance-board-responsibilities-ss.

24 Making Impactful Change, Anna Sweeney, June 2019: https://www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors.

25 See para 4.4 of Supervisory Statement 28/15 'Strengthening individual accountability in banking', February 2020: https://www.bankofengland.co.uk/prudential-regulation/publication/2015/strengthening-individual-accountability-in-banking-ss and para 4.3 of Supervisory Statement 38/15, Strengthening individual accountability in insurance, February 2020: https://www.bankofengland.co.uk/prudential-regulation/publication/2015/strengthening-individual-accountability-in-insurance-ss

26 March 2020: https://www.bankofengland.co.uk/prudential-regulation/letter/2020/pra-rules-on-board-diversity.

Review guidance on collective responsibility and individual accountability

The requirements of the SMR exist alongside the statutory and fiduciary duties of directors under UK company law and relevant corporate governance codes.[27] The responsibilities that exist under the SMR are designed to be additional and complementary to the duties that directors have as members of the board. This reflects the fact that while boards are responsible for the strategic direction of the firm, they are reliant on senior executives to implement their decisions and to provide them with information. In the past, some observers have asked if a requirement to specify individual responsibilities undermines the collective responsibilities of the board. The PRA has published a Supervisory Statement which describes, among other things, its view on how collective and individual responsibility interact at Board level.[28]

In the survey of firms, the PRA asked whether specific accountabilities complemented the responsibilities of the board. The results show that respondents found that the SMR complements board responsibility (see Chart 6). Nonetheless, a few survey respondents reported some tension. In addition, directors have in the past expressed concern that the SMR might encourage two-tier

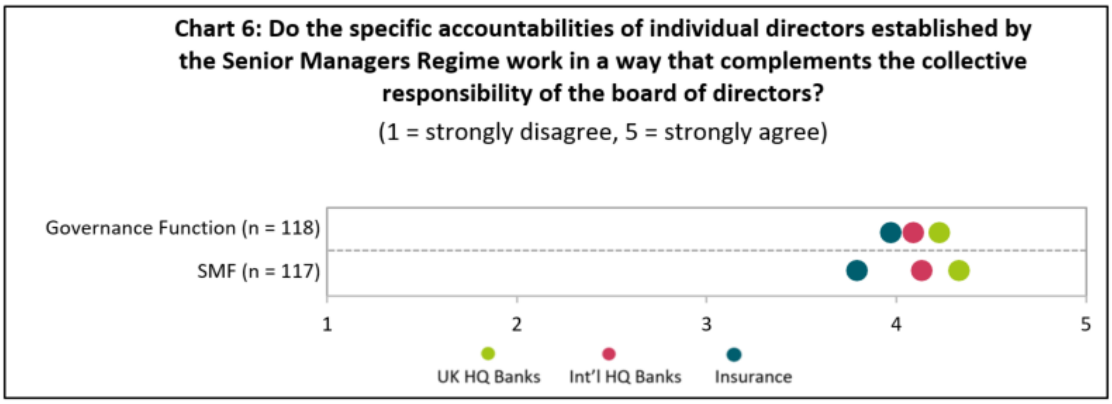

Chart 6 shows whether firm Governance functions, on a scale from strongly disagree to strongly agree, believe that specific accountabilities of individual directors established by the Senior Managers Regime work in a way that complements the collective responsibility of the board of directors, broken down by UK headquartered banks, internationally headquartered banks and insurers.

boards, in which the status of SMFs and non-SMFs were viewed differently. The PRA has not identified any trend in this direction.

We would welcome further views on this subject from interested stakeholders.

Review existing guidance on the application of the 12-week rule

Under the SMR, firms are able to appoint an individual to cover an SMF role without regulatory approval as long as this is for a period of up to 12 weeks during the course of a one-year period where a vacancy is both temporary and reasonably unforeseen. This is known as the '12-week rule', and is intended to provide sufficient flexibility to deal with short-term, unexpected absences.

During the evaluation, we received feedback from some firms that there could be greater clarity in terms of the application of the 12-week rule and the timetable in respect of time-limited and permanent approvals. In December the PRA and FCA began consulting on clarifying regulatory

27 See paras 2.36–2.39 of Supervisory Statement 28/15.
28 Supervisory Statement 5/16, Corporate Governance : Board Responsibilities, July 2018, https://www.bankofengland.co.uk/prudential-regulation/publication/2016/corporate-governance-board-responsibilities-ss

expectations in cases where a senior manager takes leave for longer than 12 weeks (long-term leave); and interested stakeholders are encourage to respond directly to the Consultation Paper.[29]

Theme 3: Ensuring the SM&CR is flexible enough for different business models

The SM&CR covers all PRA-regulated firms, and therefore needs to be sufficiently adaptable, across banks and insurers, to apply to large international firms and smaller domestic institutions as well as a range of foreign branches operating in the UK, and to those in both the mutual and non-mutual sectors.[30] Supervisory Statements note that in assessing whether a senior manager has taken reasonable steps, the PRA may take account of the size, scale, and complexity of the firm, and whether any delegation in functions has been appropriately arranged, managed, and monitored. A majority of firms surveyed felt that the SM&CR was proportionate (the data in Chart 7 reflects this), but the fraction expressing a contrary view was higher among Category 3 and 4 firms.

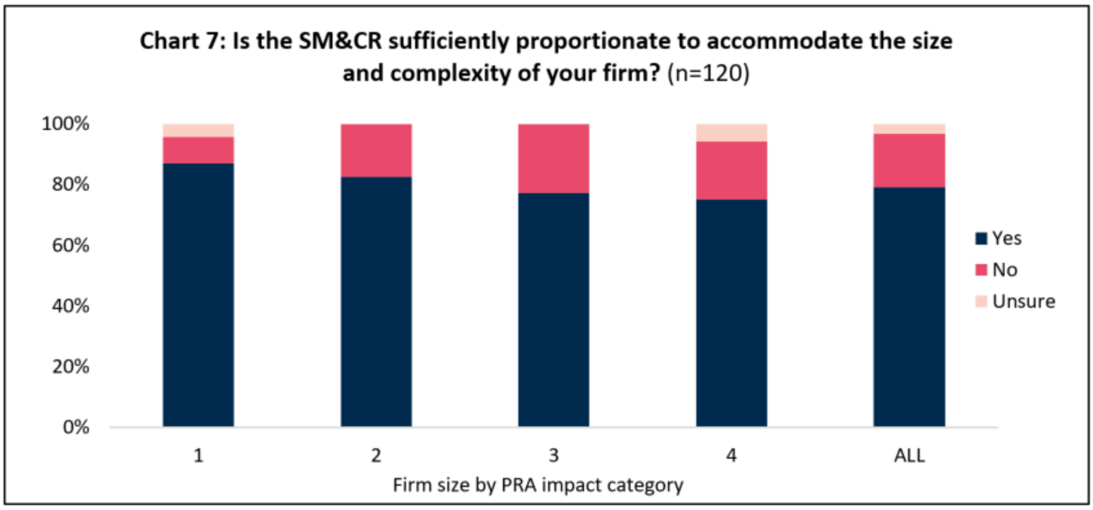

Chart 7 shows the percentage of firm Governance functions that consider the SM&CR to be sufficiently proportionate to accommodate the size and complexity of their firm, broken down by firm size, which is indicated by PRA impact category.

Recommendations	
7	**Allocation of responsibilities:** **Seek further views on:** • the usage of the Head of Key Business Area (SMF6) designation at insurers to see why this is used less than at banks; • the way in which the designation of certain individuals as Key Function Holders works alongside the SM&CR; • the case for further guidance in allocating Prescribed Responsibilities; and • an option for smaller firms to submit SM&CR documentation less frequently.

29 The chapter 'Clarifying our expectations for temporary, long-term absences' is contained in the FCA's Quarterly Consultation No. 30 (CP20/23): https://www.fca.org.uk/publications/consultation-papers/cp20-23-quarterly-consultation-paper-no-30.

30 There are several ways in which proportionality has been built into the system; for example, a streamlined approach for small institutions. Such firms have to assign a reduced set of senior manager Prescribed Responsibilities, while credit unions need have one senior manager only.

8	**Time-limited and conditional approvals** Explore options for making time-limited and conditional approvals more readily used in the appointment of senior managers.
9	**New senior manager expectations** **New senior manager expectations**: The PRA should consider adding an inventory of guidance and expectations in respect of senior manager responsibility for new and emerging risks to the individual accountability section of the Bank of England website. Looking ahead, supervisors should seek to work with the existing set of senior manager policy expectations wherever possible, to limit their growth

Explore options to ensure the correct individuals are in scope of the regime

Firms can assign the designation Head of Key Business Area (SMF6) to individuals that oversee significant business lines (which will vary from firm to firm). The usage of the SMF6 role does, however, vary between sectors; 94 out of a total of 104 SMF6 holders work for deposit takers or designated investment firms. The quantitative thresholds for deciding whether an individual should be an SMF6 are similar between banks and insurers. In both cases, the business line must account for gross total assets (or technical provisions for an insurer) of £10 billion or more, or for more than 20% of the firm's gross revenue. This divergence in outcomes could be examined to determine if it is a material issue for insurers.

In the insurance sector, the concept of a Key Function Holder (KFH) overlaps with the definition of a senior manager, although many do not perform SMF roles. KFHs, like senior managers, submit Statements of Responsibilities (SoRs) to the PRA and FCA. Given the number of KFHs, it would be useful to have further feedback on firms' experience of having senior individuals that are designated as KFHs operating alongside the SM&CR.

Under the SMR, a number of Prescribed Responsibilities must be assigned to one or more senior managers in addition to their essential responsibilities (see Box 1). During the evaluation, there were some suggestions that the regulators might provide further guidance on the allocation of the Prescribed Responsibilities. In addition, the PRA were asked whether in certain circumstances PRA Prescribed Responsibilities could be assigned to a FCA senior manager role. At present, the relevant Supervisory Statements set out a number of expectations in relation to the allocation of Prescribed Responsibilities. Since the evaluation received a limited number of observations on this, further feedback would be useful in determining the importance of these issues for firms.

SoRs and Management Responsibilities Maps (MRMs) are not to be regarded simply as regulatory returns, but as part of a firm's documentation of internal corporate governance. As such, the PRA expects SoRs and MRMs to be used by firms to aid the clarification, documentation, embedding, and the review of their internal governance arrangements.[31] However, given the administrative task involved, there is a case for examining the frequency of reporting for smaller firms, as long as the regulators receive prompt notice of major changes.

In addition, regulated firms often operate in the context of group structures, where decision-making at a legal-entity level occurs alongside group-wide management processes. In some cases, non-executive directors of a UK regulated firm may hold a senior executive position elsewhere in the group, and have a direct influence over the regulated firm exceeding that usually associated with a

31 See para 2.46C in SS28/15 and para 2.60 in SS35/15.

notified non-executive director (i.e. one that does not hold a SMF role). Moreover, by definition, senior executives do not meet the objective independence criteria required of notified NEDs. In these situations, the relevant group executive may be assigned the designation Group Entity Senior Manager (SMF7) to reflect this additional influence. The SMF7 responsibility is particularly important where the UK operations of an international group are highly integrated with the rest of the group. The relevant Supervisory Statements provide guidance on the use of the SMF7 designation.[32] Given the extent to which regulated firms may operate within complex groups with multiple UK entities and/or matrix management, the PRA would welcome feedback on the application of this Senior Management Function.

Usability of time-limited and conditional approvals

Firms must obtain PRA and/or FCA approval prior to appointing an individual to a new senior manager role. Approvals are usually made on a permanent basis, but the regulators have the option of making these on a conditional or time-limited basis. The Parliamentary Commission on Banking Standards specifically recommended that such discretionary powers should be part of the new accountability regime, including in cases where it was judged necessary for an applicant to acquire a certain skill to carry out the job well. Since 2016, however, very few approvals have been made on this basis. There were, for example, only 24 time-limited approvals across banks and insurers in the first 4.5 years of the SM&CR, and no conditional approvals.[33]

These two potentially flexible tools are therefore underused. There is merit in exploring how they might be applied more widely. One factor that appears to discourage the willingness of applicants to take on time-limited and conditional roles is the requirement that such approvals are published in the form of a decision notice (unless publication is judged unfair to the firm or the candidate, or prejudicial to the PRA’s objectives). As this approach is set out in FSMA, any amendment of this specific requirement would need to be discussed with HM Treasury.

SMF responsibilities and expectations

In addition to the responsibilities set out in the PRA Rulebook, the PRA has issued Supervisory Statements or letters calling on firms to assign responsibility for particular risks to one or more senior managers. This has been used to address the need for senior oversight of new and evolving risks, such as those arising from benchmark transition, climate change, and crypto assets.

A number of firms have said they find such statements helpful in understanding the PRA’s expectations, but it was also noted that such communications are not located together on the Bank of England’s website. It would be useful, for ease of reference, if an inventory of these additional responsibilities was included in the individual accountability section of the website.

Looking ahead, in the light of the number of expectations that have been set recently, the PRA should seek to work with the existing set of senior manager expectations wherever possible, to limit their growth.

Conclusions

It is welcome that the industry and regulators view the SM&CR as performing an instrumental role in supporting better prudential and conduct outcomes, in line with International Monetary Fund

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32 See paras 2.12-2.16 in SS28/18; and paras 2.5-2.9 in SS35/18.
33 Parliamentary Commission on Banking Standards, 2013, page 136: https://www.parliament.uk/documents/banking-commission/Banking-final-report-volume-i.pdf.

expectations (see Box 2). The evidence to date does not suggest the need for major changes to the approach taken. At the same time, stakeholders have pointed to some areas which could benefit from amendment. The PRA welcomes comments on the findings of the evaluation and its recommendations. This will inform the case for reviewing rules, expectations, or communication relating to the SM&CR, and for engaging further with other UK authorities on these points.

As stakeholders gain additional experience of the SM&CR, the PRA will welcome any further feedback about its practical application.

Annex 1: 2020 SM&CR Firm Survey Results

In early 2020, a voluntary survey was sent to a cross section of 140 PRA-regulated firms, including UK and globally headquartered banks and insurers (impact categories 1 to 4), to understand better their experience and implementation of the SM&CR. The survey comprised two parts: one with questions for the senior manager responsible for overseeing the implementation of the regime (Part A), and another with questions for the function responsible for implementing the regime within the firm (Part B). We received 120 responses out of 140 firms invited to participate.

Culture and Behaviour

Based on the survey responses, the SM&CR is widely considered to have had a positive impact on culture and behaviour, with 94% of SMFs who responded to Part A of the survey, and 96% of governance functions responding to part B, considering the SM&CR to have brought about positive meaningful changes to behaviour in industry. The survey showed that 83% of senior managers considered the regime to have brought positive change in their working practices and those of their immediate colleagues; whereas 14% of SMFs did not consider there to have been a change, although very few firms expanded on this point

When asked to highlight changes in behaviour that have stemmed from the introduction of the SM&CR, many firms said that it had resulted in clearer articulation of authority and had improved focus on accountability and responsibility. Ninety-four percent of firms found that, at least occasionally, the SM&CR has helped hold individuals to account (see Chart 8 below).

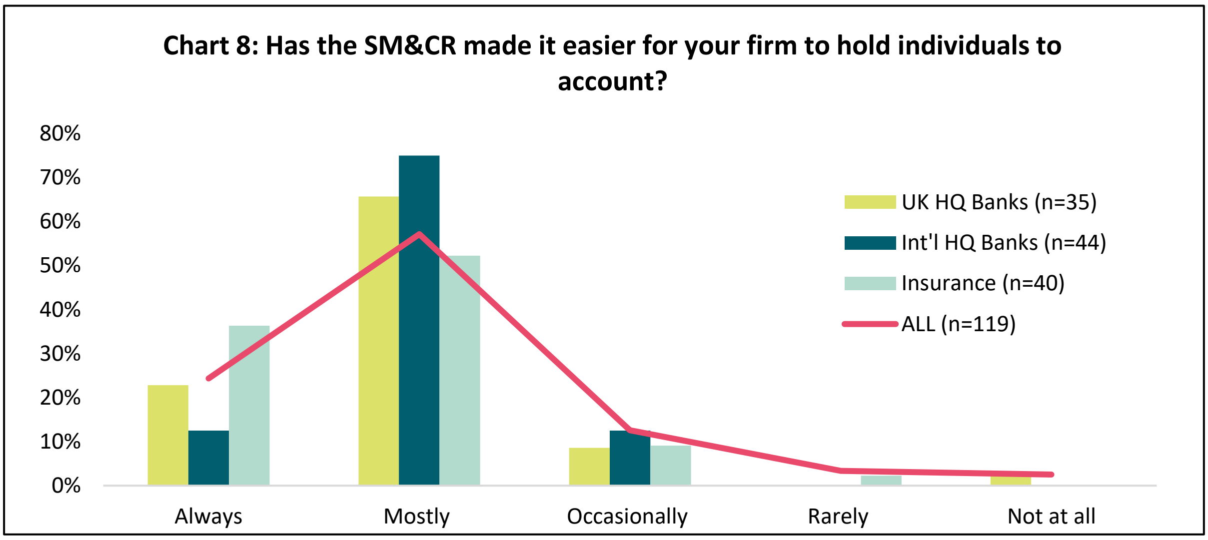

Chart 8 shows whether firm Governance functions consider the SM&CR to have made it easier for firms to hold individuals to account, broken down by UK headquartered banks, internationally headquartered banks and insurers.

As shown in Chart 9, half the firms surveyed reported an increase in risk aversion (smaller firms were slightly more likely to report this). However, many consider the SM&CR to have enhanced decision-making by increasing the focus on responsibilities. Some firms noted that the increased risk aversion stems in part from the lack of clarity on expectations around documentation.

Chart 9 shows whether firm Governance functions consider risk aversion in industry to have increased or decreased as a result of the SM&CR being introduced, broken down by firm size which is indicated by PRA impact category.

Ninety-three percent of firms felt that decisions were being made at the appropriate level of seniority, with the remaining few reporting there was a tendency to escalate decisions above the appropriate level.

Prescribed Responsibilities

Some firms did not consider certain Prescribed Responsibilities to map easily to a specific individual (eg capital funding and liquidity), including some of the newer responsibilities such as LIBOR. It was, however, recognised that there is challenge in making the regime sufficiently flexible while promoting consistent application.

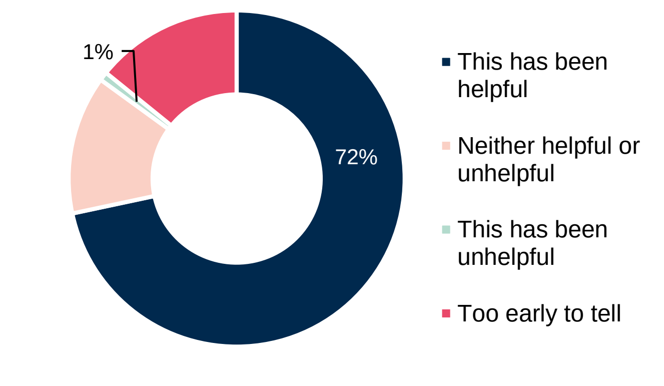

Chart 10 shows the percentage of firm Governance functions that consider the requirements and guidance for clarifying responsibilities in their firm to be helpful or unhelpful.

As shown in Chart 10, a majority of firms found it helpful for the PRA to introduce requirements and guidance for new and evolving risks, noting that it brought increased clarity, particularly in relation to the regulator's expectations. However, some firms noted that they would benefit from the regulator applying this in a more consistent way, supported by a central repository of new requirements for their reference.

The majority of firms report linking Statements of Responsibility to objectives for SMFs and variable remuneration decisions, albeit indirectly through the remuneration scorecards (Chart 11, details these findings).

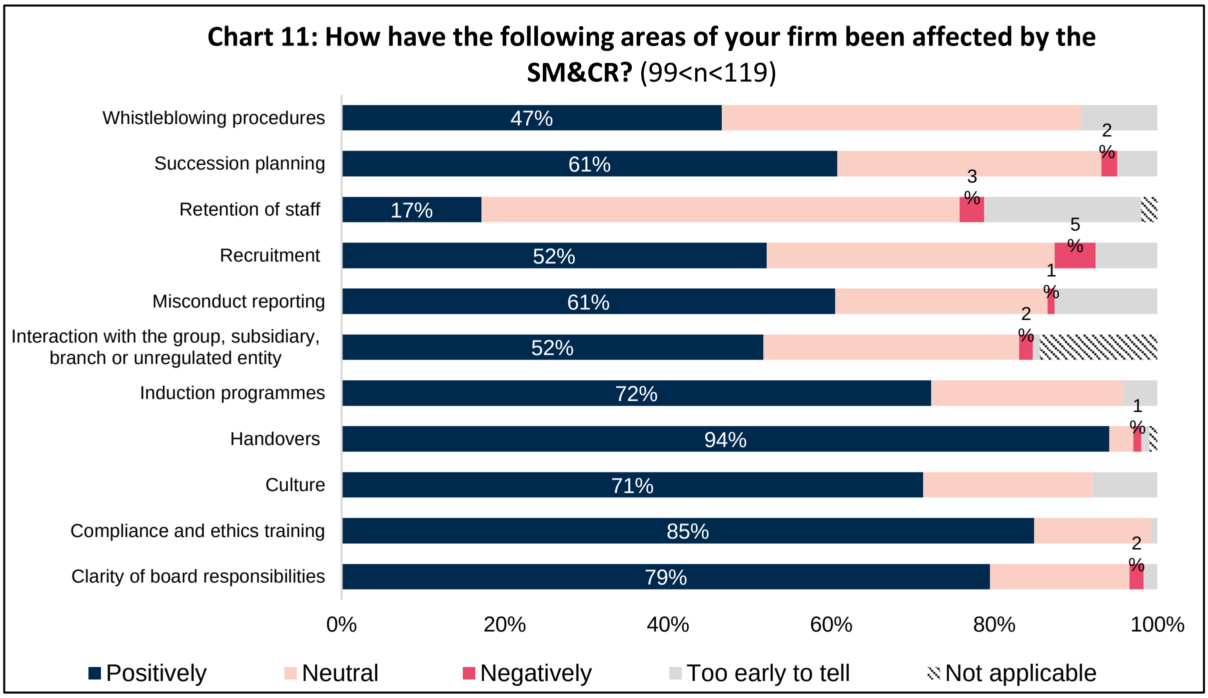

Chart 11 shows how a number of areas, including: whistleblowing procedures; succession planning; retention of staff; recruitment; misconduct reporting; interaction with group, subsidiary, branch or regulated entity; induction programmes; handover; culture; compliance and ethics training; and, clarity of board responsibilities; have been affected by the SM&CR in firms, on a scale from positively to negatively.

Implementation in Firms

The survey showed that 83% of firms said the SM&CR has changed their working practices for the better; and 97% of firms report integrating the regime in their business-as-usual practices in ways beyond simple regulatory compliance to some degree (see Chart 3).

Proportionality

Overall, 79% of firms consider the SM&CR to be sufficiently proportionate to accommodate their size and complexity. There are still some smaller firms and/or insurers that disagree (see Chart 7 above). Most of those that questioned the proportionality of the regime considered it to have resulted in increased risk aversion, or thought that it is too early to form a view on this point. Where firms consider the regime to be proportionate overall, there were still questions as to the administrative burdens that arise from specific features of the regime. Some firms have suggested that it would be helpful for the PRA to consider moving to periodic updates of required documentation opposed to the continuous updates expected currently.

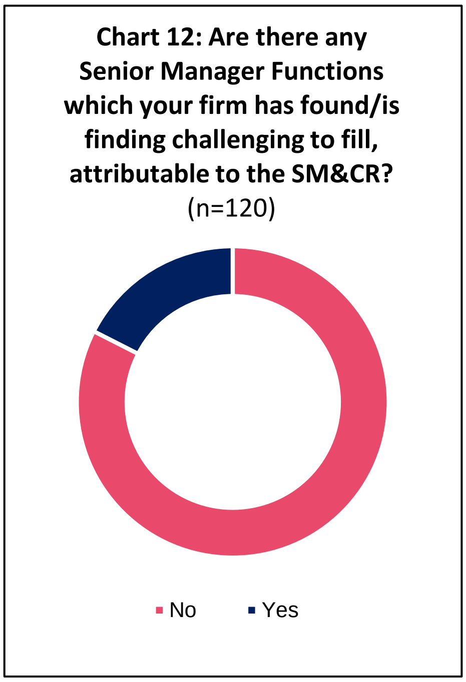

Chart 12 shows the proportion of firms that have found Senior Manager Functions difficult or challenging to fill in their firm due to the SM&CR.

Recruitment practices

As Chart 12 shows, 83% of firms said that they did not find it difficult to fill roles as a consequence of the SM&CR. A few, however, noted it was challenging to recruit for the Head of Operations Function (SMF24) given the broad scope of responsibilities essential to the role; a similar point was made in relation to the Chief Risk Officer Function (SMF4).

A few firms consider the pool of candidates had shrunk for non-executive director roles since the introduction of the SM&CR, due to the increased regulatory exposure, especially when compared to industries which are not subject to an accountability regime.

On the other hand, others observed it was the high demand within the industry for particular skills, rather than the SM&CR itself, that could make it difficult to find candidates to fill SMF roles.

Fitness and propriety

The majority of firms reported that the fitness and propriety process had supported higher professional standards. As shown in Chart 13, the majority of firms reported that the fitness and propriety process had supported higher professional standards. Additionally, in their qualitative responses, 45% referred to the positive impact of this element of the SM&CR, noting how it had strengthened internal processes (eg during recruitment, handover, and performance appraisals) and encouraged consistency. Some firms noted issues relating to the appointment of senior managers on an interim basis, including the length of time it takes to approve SMFs, with delays sometimes stemming from the regulators.

Chart 13: Have the tools for assessing the Fitness and Propriety of senior individuals – eg the approval process for Senior Managers, Certification, regulatory references – supported higher professional standards in your firm? (n=119)

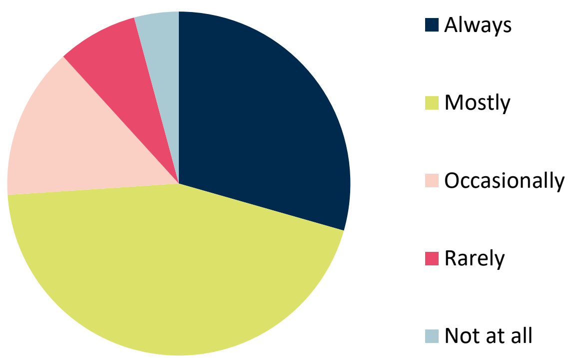

Chart 13 shows, on a scale of always to not at all, the proportion of firm Governance functions that consider the tools for assessing Fitness and Propriety of senior individuals (for instance, including the approvals process for the Senior Managers, Certification, regulatory references) to have supported higher professional standards in their firm.

Some firms reported issues relating to the appointment of senior managers on an interim basis, including the length of time it takes to approve SMFs, with delays sometimes stemming from the regulators.

Regulatory references

Regulatory references were commonly viewed as a helpful tool for improving conduct, but they were also seen as one of the most operationally difficult parts of the approval process. Nonetheless, 85% of firms either considered regulatory references they received to be either mostly or always of sufficient quality to inform their assessment of an individual’s fitness and propriety.

There are some reported issues around consistency in completing references, particularly when obtaining references for individuals previously outside of the regime, and with receiving references in the six-week time frame (with consequences for the approval process).

Certification Regime

The Certification Regime was considered an effective mechanism for promoting improved behaviour and conduct among staff by 86% of firms either mostly or always. Insurers' views on effectiveness were lower, but it was noted that the regime needed more time to bed down to form a view (see Chart 14). Both banks and insurers suggested that implementation could be improved with more guidance to encourage consistency, particularly for individuals based outside of the UK.

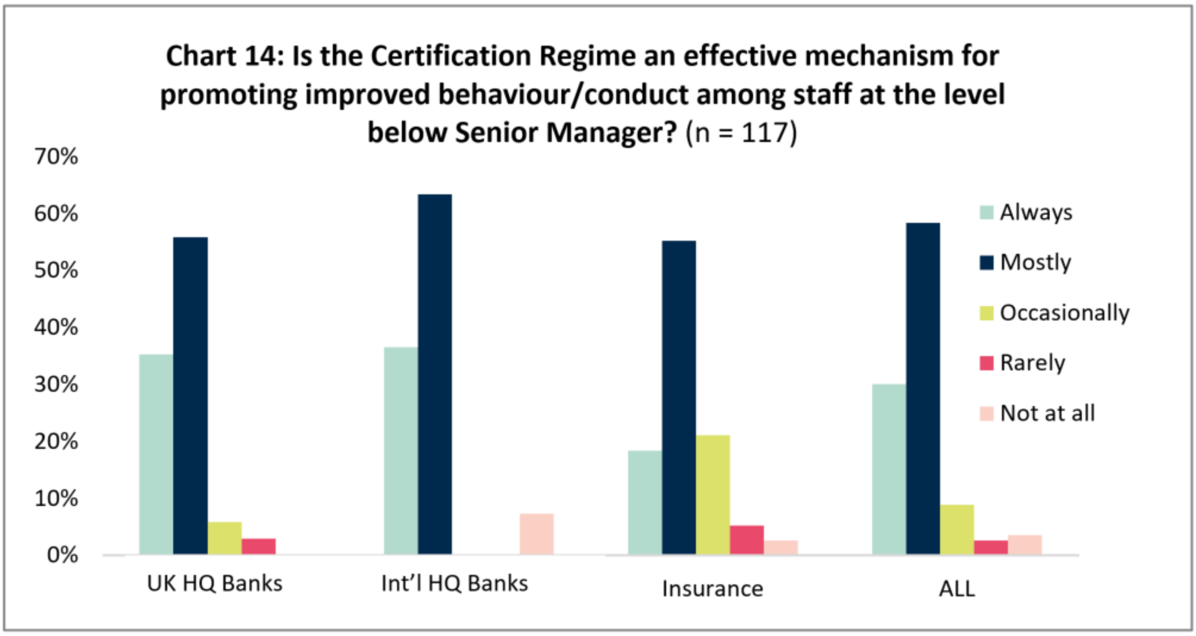

Chart 14 shows whether firm Governance functions consider the Certification Regime to be an effective mechanism for promoting improved behaviour/conduct among staff at the level below Senior Manager, broken down by UK headquartered banks, internationally headquartered banks and insurers.

Conduct rules

Individual conduct rules apply to all employees, and 95% of firms reported they had integrated the conduct rules into their HR and recruitment practices at least most of the time (see Chart 15). Firms note the integration into employee handbooks, codes of conduct, company values, and employee appraisal processes.

There were some requests for further guidance on the threshold of conduct breach reporting and the level of materiality required, including the suggestion that the regulator could benchmark practices to enable more consistency.

Enhancing the SM&CR

The majority of firms did not make suggestions for further enhancements to the regime – some were cautious, believing that the SM&CR needed more time to bed down. However, there were some calls for further guidance in a number of areas to improve its implementation across industry, including on sharing general good practice, reasonable steps, regulatory references, thresholds for conduct rule reporting, and how to apply the different parts of the regime to those outside of the UK.

Chart 15: Are the conduct rules integrated into wider processes within your firm (eg HR processes and recruitment practices) (n=118)

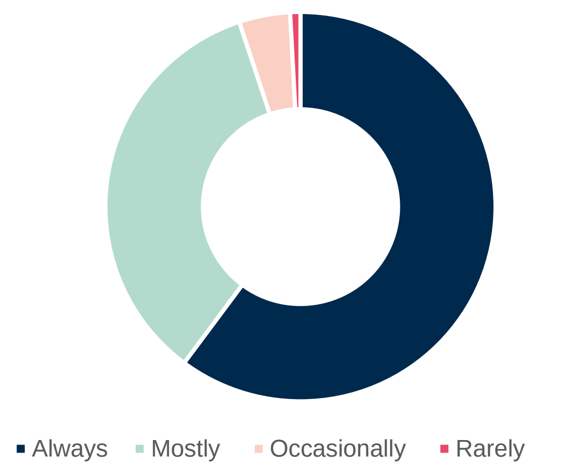

Chart 15 shows the proportion of firm Governance functions that consider the conduct rules to be integrated into wider processes within their firm (eg HR processes and recruitment practices).

Annex 2: Evaluation criteria used

In conducting the evaluation of the SM&CR, the PRA applied the following evaluation criteria.

Evaluation Criteria	Research Questions	High level metrics
Effective on-boarding (recruitment process): pre-approval, approval, fitness and propriety (F&P).	For different elements of SM&CR: is on-boarding, including pre-approval for SMRs, effective and used in the correct circumstances? Has firm fitness and propriety testing and on-boarding been implemented effectively and consistently?	Firms able to attract and retain high quality senior individuals for SMF (and CR) roles.
		F&P and on-boarding effectively and consistently implemented, including through use of regulatory references.
		Coverage of SMR and CR consistent with expectations (fewer SMFs than under the previous regime). Scope sufficient for supervisory needs.
Implementation in PRA and use by supervision	Is the SM&CR integrated into PRA supervisory approach and used to advance wider supervisory outcomes? Are the elements of the regime efficient and mutually supporting?	Effectively made operational by PRA – including interaction with FCA.
		All elements of the regime used as part of general supervisory toolkit to advance both governance and wider outcomes.
		SM&CR effective across different business models. No gaps in allocation of responsibility.
		Supervision clear who in firms is responsible for particular issues.
Implementation and use in firms	Have firms put in place adequate systems and controls to embed all elements of the SM&CR? Do firms use elements of the SM&CR for their own assurance/governance processes other than compliance? Is the burden proportionate to the observed benefits?	Responsibilities clearly allocated among SMFs (including between group entities), resulting in 'greater clarity about who is accountable for what in firms'.
		'Use test': used by firms for own purposes (ie goes beyond compliance exercise).
		Effective implementation of the SM&CR including regulatory reference framework.
Ability of firms and regulator to hold individuals to account	Is it easier for firms and regulators to hold individuals to account?	PRA using the regime to hold individuals to account.
		Firms using the SMR to hold individuals to account and clarify responsibility.
		Individuals with poor conduct records are identified by firms.
Impact of the SM&CR on governance outcomes	Do individuals take greater responsibility for their actions? Does the SM&CR support wider good corporate governance outcomes?	Clear allocation of responsibilities in firms and link between seniority and accountability strengthened.
		SMR supporting good governance practice in firms. (eg decision-making, complementary functioning of collective and individual accountability).