

CLIENT MEMORANDUM

Extension of the Senior Managers and Certification Regime by the UK's FCA to Insurers

What do General Counsel of insurers need to know about their possible role?

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AUTHORS

Joseph D. Ferraro | Nicholas Bugler | Andrew Tromans | Henrietta de Salis

Summary

- The UK's FCA intends to extend the Senior Managers and Certification Regime (**SM&CR**) to (re)insurers.
- The role of a firm's General Counsel being personally responsible for the legal function is potentially within the scope of the SM&CR.
- The interaction of a firm's legal and compliance functions is likely to be impacted by the new regime.

On July 26, 2017, the Financial Conduct Authority (**FCA**) published a press release together with consultations which include its proposals to extend the SM&CR to practically all regulated firms. In essence, the FCA intends that the SM&CR will apply to all firms offering financial services in the UK, including firms authorised in the UK and incoming branches of non-UK-authorised financial services firms, and will replace the current Approved Persons Regime.

The SM&CR has applied to banks, building societies, credit unions and Prudential Regulation Authority (**PRA**)-designated investment firms since March 2016, and the FCA now intends to extend its application to (re)insurers, other investment firms, insurance intermediaries and asset managers, among others. The regime will have a particular significance to the

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senior managers of the firms whose responsibilities fall within the SM&CR (**Senior Managers**). Senior Managers will be expected to take personal responsibility for their actions. We discuss below the scope of the SM&CR and how it will apply to Senior Managers and other individuals within a financial services firm, with particular focus on the role of the legal function.

Scope of the SM&CR

There will be three parts to the SM&CR:

1. *Five conduct rules.* These conduct rules will apply to all financial services staff within the firm, requiring individuals to: act with integrity; act with due care, skill and diligence; be open and cooperative with the regulator; pay due regard to customer interests and treat customers fairly; and observe proper standards of market conduct.
2. *Responsibility of Senior Managers.* The responsibilities of the Senior Managers will be clearly set out and, in the event that something goes wrong that is within a certain Senior Manager's purview, that person will be held personally to account. As with the current Approved Persons Regime, all Senior Managers will be approved by the FCA and appear on the Financial Services Register.
3. *Certification regime.* In addition to the regime for Senior Managers, under the certification regime at least once per year firms will assess and confirm the fitness, skill and propriety of those individuals who are not Senior Managers but whose jobs significantly impact customers or firms.

To ensure that the regime is proportionate to all firms to which it will apply, a "core regime" of specific requirements will apply to most firms. In addition, for larger and more complex firms, an "enhanced regime" will apply with extra requirements; however, these extra requirements will apply to fewer than 1% of firms.

In respect of firms who have limited permissions and are currently subject to a limited application of the Approved Persons Regime, the SM&CR will also apply but on a more "streamlined" basis.

Particular requirements on insurers

Under the consultation paper that concerns the extension of the SM&CR to insurers, at paragraphs 3.14 to 3.16, the FCA has stated that it intends to create a specific "Lloyd's FCA Conduct Risk Oversight" function for those entities operating at Lloyd's only. This function will be in addition to the other functions required under the "core" and "enhanced" versions of the regime.

Further, the FCA is proposing that the SM&CR will also apply to Insurance Special Purpose Vehicles (**ISPVs**) and small run-off companies, but on the more limited basis. For ISPVs there will be only three mandatory roles, although even at this level the regime could be more intrusive than equivalent requirements which apply to similar entities in other

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jurisdictions. We note this in particular given the recent news that the new regulations that will create the legal framework for an ILS market in the UK are expected to be approved after Parliament has reconvened following the summer recess, and come into force by October 31, 2017¹.

Focus on individual responsibility

The FCA makes it very clear in its press release that the new regime is “*about individuals, not just institutions.*” Jonathan Davidson, Executive Director of Supervision – Retail and Authorisations at the FCA, has stated that the regime will “*ensure that individuals in financial services are held to high standards*” and that Senior Managers are “*accountable both for their own actions, and for the actions of staff in the business areas that they lead.*”

This clearly represents the shift in perspective of the regulator from the firm to the individuals that work within it and the Senior Managers in particular. In preparation for the introduction of these rules, firms will have to reconsider their governance structures to ensure that they are ready for the full impact of the SM&CR. In turn, Senior Managers will need to ensure that there are robust lines of reporting within their business areas, such that they can inform themselves of all actions taking place which fall within the scope of their regulatory responsibilities. Without this, Senior Managers will find themselves personally accountable for matters of which they are not aware and could be subject to penalties.

Personal responsibility of the General Counsel?

Under the rules for “Overall Responsibility” currently applied to banks, building societies, credit unions and PRA-designated investment firms under the SM&CR, the legal function is included as a business area for which a Senior Manager must have responsibility.

Market participants have raised queries regarding this requirement and whether it means that, for example, a firm's General Counsel (**GC**) falls within or outside of the SM&CR. The FCA published a consultation paper on this issue in September 2016 for which responses were to have been provided by January 2017. Despite the significant number of responses made in respect of this based on the unique position of in-house lawyers compared with other managers within a firm, it is clear from the current consultation that the FCA has not yet reached a firm conclusion on whether this requirement will continue to apply to banks, etc. nor whether it will be extended to apply to other financial services firms. The FCA's focus when considering this in relation to, for example, insurance groups may be different from its focus with respect to banks. Within insurance groups, the legal function has a role in “bet the firm” litigation and handling controversial or high-profile claims, sanctions and anti-bribery/corruption compliance, where insurers face a different risk profile when compared to other financial institutions.

¹ In respect of which please see our update on the UK ILS regime, available [here](#).

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In any case, the consultation papers note that “*this policy is under review following industry feedback.*” This appears to leave open the possibility that the legal function *could* be covered by the SM&CR and, consequently, that GCs may be personally responsible as Senior Managers for the oversight of that function. For example, one of the prescribed Senior Management responsibility functions within the draft FCA rules is to ensure that the firm is “*informed of its legal and regulatory obligations,*” a role that naturally falls on a firm’s GC.

If GCs are brought within the regime and are held personally responsible for the legal function, they will naturally wish to consider how their role and responsibilities fit within the firm’s overall governance structure. Beyond this more practical consideration, a further concern arises when including the legal function within the SM&CR: the potential for conflict between a GC’s obligations to cooperate with the FCA and that GC’s obligations to keep legally privileged materials confidential on behalf of the firm. Will GCs be deemed uncooperative and punished where they do not provide information to the FCA on the grounds of legal privilege? In addition, oversight by the FCA adds a double layer of regulation for many in-house legal roles (since most in-house lawyers are also regulated by the Solicitors Regulation Authority).

Another more practical consideration is the manner in which the legal function within a firm will interact with the compliance function (if they are currently operated separately). Where the GC has personal responsibility for the oversight of the legal function as a Senior Manager, but a nominated compliance officer does not, this could create further conflict and the potential for confusion as to who is responsible for certain matters that span the legal and compliance space.

Even if the legal function is *not* brought within the scope of the expanded SM&CR for now, the role of the GC is likely to be changing. Due to the more stringent personal liability that will be faced by Senior Managers, we expect that GCs will increasingly be asked to provide legal advice to support business decision making. As such, GCs are increasingly likely to take a fundamental role in decision making processes as part of the wider management team. Whether over time this will be influential in bringing them further within the remit of the FCA so they are regulated as Senior Managers will remain to be seen.

Next steps

Responses to the FCA’s consultation on the extended application of the SM&CR are due by November 3, 2017. The Willkie team intends to provide input and we would be happy to consider and reflect any comments that clients and friends may wish to make on the proposals.

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If you have any questions regarding this memorandum, please contact Joseph D. Ferraro (+44 20 3580 4707, jferraro@willkie.com), Nicholas Bugler (+44 20 3580 4704, nbugler@willkie.com), Andrew Tromans (+44 20 3580 4715, atromans@willkie.com), Henrietta de Salis (+44 20 3580 4710, hdesalis@willkie.com), or the Willkie attorney with whom you regularly work.

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