

# SMF INTERVIEWS AT THE PRA AND FCA

## A PRACTICAL GUIDE FOR AUTHORISED FIRMS

### 1. Introduction

#### SMCR framework

- 1.1 The Senior Managers and Certification Regime (SMCR) established under the Financial Services and Markets Act 2000 as amended (FSMA) seeks to ensure that only relevant individuals that work for FSMA-authorized firms who are considered fit and proper by the FCA and PRA are appointed to carry out certain functions, known as senior management functions (SMFs), within such firms.
- 1.2 The SMCR has replaced the previous Approved Persons Regime (APR) and applies to all FSMA-authorized firms, namely since:
- (i) the inception of the SMCR in March 2016, UK banks (including UK branches of foreign banks), building societies, credit unions and PRA-designated investment firms;
  - (ii) December 2018, UK insurers and reinsurers (including UK branches of foreign insurance firms);
  - (iii) December 2019, FCA solo-regulated firms (including UK branches of relevant foreign firms), which include investment firms (including stockbrokers, securities and futures firms, asset managers and financial advisers), insurance intermediaries, mortgage lenders and administrators, consumer credit firms and claims management companies; and
  - (iv) December 2020, benchmark administrators.

Appointed representatives (ARs) remain subject to the APR. Payment service providers (which are not banks or building societies) and E-money issuers (which are not full credit institutions, credit unions or municipal banks) are not subject to the SMCR (or APR) given they are not authorized under FSMA (instead subject to the authorisation and registration regimes under the Payment Services Regulations 2017 and the Electronic Money Regulations 2011 respectively). As at the date of this publication, HM Treasury is consulting on extending the SMCR to financial market infrastructure firms (such as central clearing houses and central securities depositories).

- 1.3 FCA solo-regulated firms are categorised under the SMCR as “Enhanced”, “Core” or “Limited Scope” depending on their size and complexity (the vast majority are Core firms, the FCA estimates that approximately 350 are Enhanced firms and Limited Scope firms are those that were subject to a limited application of the APR) and are subject to a slightly different application of the SMCR depending on their category:

- (i) like banking and insurance firms, all FCA solo-regulated firms are required to have SMFs (Enhanced firms have the greatest number, akin to banking and insurance firms, and Limited Scope firms the smallest number) and statements of responsibilities (which set out the SMF role and its responsibilities) for each SMF;
- (ii) also like banking and insurance firms (with the exception of EEA branches) Enhanced and Core firms (also except EEA branches) are required to allocate “prescribed responsibilities” across their SMF population (prescribed responsibilities do not apply to FCA solo-regulated Limited Scope firms);
- (iii) each SMF is subject to regulatory pre-approval, the statutory duty of responsibility (to take reasonable steps to prevent regulatory contravention in their area of responsibility) and the FCA’s Conduct Rules (banking and insurance firms are subject to the same requirements with the addition of the PRA’s Conduct Rules and, for banking firm SMFs, the criminal offence of mis-management of a bank);
- (iv) FCA solo-regulated Enhanced firms, like banking and insurance firms, are also required to produce responsibilities maps (which set out the firm’s governance structure and the allocation of senior management responsibility across all business areas of the firm) and implement adequate SMF handover procedures.

1.4 Benchmark administrators are categorised as Core firms with the option to opt up to the Enhanced firm regime, or apply to be a Limited scope firm if they meet certain criteria. Such firms are only, however, expected to allocate four SMFs (Chief Executive, Executive Director, Chair and Partner (if the latter applies to the firm)) and a more limited number of prescribed responsibilities to them. The FCA’s Conduct Rules generally apply to them as other Core firms (with a more limited application to: (i) a firm which only administers certain commodity benchmarks (as set out under the UK Benchmarks Regulation, Annex II); or (ii) to individuals within a firm who only administer these benchmarks).

1.5 Claims management companies (CMCs) (which became subject to FCA regulation in April 2019) are categorised as Limited Scope firms and subject to the SMCR as it applies to other Limited Scope firms, with the exception of the number of required SMFs (only the Limited Scope and Compliance Oversight Functions). Where a CMC is authorised to carry out other regulated activities in addition to claims management activity and these activities place the firm in a different SMCR category (i.e. Core, Enhanced, banking or insurance firm), it will be subject to the SMCR as it applies to that category.

1.6 Finally, it is important to note that the regulators’ Financial Services (FS) Register now holds information on a greater number of individuals working in financial services firms (with the exception of benchmark administrators to which the new information requirements do not apply). Prior to November 2020, as well as information on regulated firms, the Register held information on approved persons (including the SMFs they hold and any regulatory sanctions and prohibitions made public). The same information is now held on individuals holding certification functions, executive and non-executive directors not holding an SMF, sole traders and certain ARs (known as “Directory Persons”). Information on Directory Persons within: (i) banking and insurance firms has been published since November 2020; and (ii) FCA solo-regulated firms, sole traders and ARs since March 2021 (since December 2020 where relevant firms had already provided the required information).

While this development does not have a direct impact on SMFs (given information on approved persons has always been, and will continue to be, held on the Register), SMFs should take into account that individuals they manage, are responsible for and potentially delegate to, may now be subject to the same information disclosure requirements.

## **Responsible regulators**

- 1.7 Banking and insurance firms are dual-regulated by the PRA and FCA (Dual-regulated firms) and, as a result, responsibility for approving and regulating approved persons is divided between the PRA and FCA. The PRA leads the assessment of applications for approval for PRA-designated SMFs, although it requires the FCA's consent before approving an application for an individual to perform any such function. If the FCA refuses to provide its consent for the approval, the PRA is obliged to refuse the application. The FCA is responsible for applications for approval for FCA-designated SMFs. The PRA may express a view on an application for an FCA-designated SMF where it considers that approval (or rejection) of such an application would have a material adverse effect on the advancement of both its primary objectives, namely to (i) promote the safety and soundness of the firms it regulates; and (ii) in respect of insurance firms, to ensure policyholders are adequately protected, and its secondary objective to facilitate effective competition in relevant markets as far as reasonably possible when pursuing its primary objectives.
- 1.8 FCA solo-regulated firms are authorised and regulated solely by the FCA and, as a result, the FCA is responsible for approving and regulating SMFs at such firms.

## **The introduction and development of SMF interviews**

- 1.9 Broadly speaking, the test for determining a candidate's fitness and propriety is threefold. It aims to assess:
- (i) honesty, integrity and reputation;
  - (ii) competence and capability; and
  - (iii) financial soundness.
- 1.10 Historically, the primary concern of the predecessor to the PRA and FCA, the FSA, was to verify the honesty, integrity and reputation of candidates, and it tended to regard the competence and capability of key management figures as largely a matter for the firm concerned. However, over a number of years following the financial crisis of 2007-2009, the FSA began to focus more on competence and capability, and this resulted in a far more intrusive, hands-on approach to corporate governance. A key part of this change in priorities was the introduction of an in-depth interview into the process, to assess the competence and capability of some candidates seeking approval to carry out Significant Influence Functions (SIFs) (as they were then called) at authorised firms (SIF interview).
- 1.11 The PRA and FCA have continued this approach since their inception and since the implementation of the SMCR in 2016. SIF, and now, under the SMCR, SMF, interviews have continued to be more common and more rigorous. In addition, the introduction under the SMCR of SMF statements of responsibilities, prescribed responsibilities and firmwide responsibilities maps has meant that SMF approval applications are subject to greater scrutiny and interviews go into more granular detail on the particular SMF role and its responsibilities than was previously the case before the regime's commencement.

## Purpose of this briefing paper

1.12 The purpose of this briefing paper is to give prospective candidates for SMF positions at authorised firms some guidance on what to expect and how best to prepare for these interviews. Candidates for positions at Dual-regulated firms should bear in mind that the PRA and FCA may both be involved in their approval (as set out at sections 1.4 above and 3 below) and read this briefing paper with that in mind.

## 2. When will an SMF interview be required?

2.1 The decision by the appropriate regulator as to whether to interview an SMF candidate under the SMCR is fundamentally risk-based and will depend to some extent on the size, complexity and risk profile of the firm concerned. That said, the regulators indicated in the early stages of the SMCR that they intended to interview a higher percentage of candidates than under the APR and this has certainly been seen so far since the regime began. The PRA indicated in its SMCR Evaluation Report (December 2020), that the regulators interview around 5% of SMF candidates.

2.2 At Dual-regulated firms, we would generally expect: (i) the PRA to interview candidates applying for the PRA-designated functions of chairman, chief executive, senior independent director, chief financial officer, chief risk officer, chair of the firm's risk or audit committees and increasingly the chief operations officer; and (ii) the FCA to interview candidates applying for the FCA-designated functions of executive director, chief compliance officer, money laundering reporting officer (MLRO), and the CASS oversight function. This reflects the regulatory practice we have seen since the regime began but is, nonetheless, an indicative, rather than exhaustive, list of the SMF candidates who may be interviewed.

2.3 At FCA solo-regulated firms, the FCA has, so far in our experience, taken a similar approach to Enhanced firm SMF candidates. SMF candidates at Core firms are less frequently interviewed and we have yet to see any Limited Scope firm SMFs being called for interview, largely on the basis of these firms' lower risk profiles.

2.4 It should, however, be borne in mind that each regulator has discretion to interview any candidate applying for one of its designated functions within an authorised firm and may do so even where the relevant firm has a medium or low risk profile if, for example, the regulator has concerns about the candidate's fitness and propriety, or, where the firm is small but the regulator has concerns about it or its regulated activities. It is particularly likely that an interview will be arranged if a candidate has not previously been approved under the SMCR, or if they are seeking approval for a role of a type for which they have not previously been approved, and is becoming more common where the firm has very few SMF roles in total.

2.5 In certain circumstances, a separate meeting between the relevant regulator and appropriate representatives from the applicant firm may also be required. For example, the chairman of the firm's nomination committee could be invited for a meeting to discuss the due diligence process the firm has undertaken in relation to a candidate in more detail.

### 3. SMF interviews: form and content

#### Process

- 3.1 The SMF interview is potentially a two stage process. The first interview is an unrecorded, but minuted, interview with the candidate, followed, if necessary, by a second, recorded interview. Each interview will take place at the offices of the relevant regulator in London and can be expected to last for approximately 90 minutes.
- 3.2 In relation to Dual-regulated firms, where both the PRA and FCA wish to interview a candidate, they will generally seek to coordinate a single joint interview with the applicant, although each regulator reserves the right to conduct separate interviews.
- 3.3 One of the merits of the potential two stage interview process is that, where the relevant regulator has serious concerns about the suitability of a candidate, it can express those concerns after the first interview and invite the candidate to a second interview, as well as providing the candidate with an opportunity to withdraw from the process without being formally rejected.
- 3.4 Since COVID-19 began, while the overall process has not changed, the regulators have, of course, conducted interviews via video and/or audio channels. While it remains to be seen to what extent this approach continues beyond the pandemic, it is likely the regulators will want to resume face to face interviews whenever possible in order to ensure these are as effective as possible. That said, they are likely to retain some flexibility where the candidate is based overseas, or within the UK but a significant distance from the regulators' offices.

#### Who should attend?

- 3.5 As a general rule, both regulators prefer to interview candidates unaccompanied. At the second interview stage, should this be required, candidates are advised that they may be accompanied by a lawyer. In this context, the candidate's lawyer is invited in the capacity of independent observer rather than as an adviser and would not be expected to take an active role in the interview itself. While not standard practice, we have seen cases where, if a candidate wishes to be accompanied by a lawyer at the first interview stage, the FCA has indicated that it would not object, but it would require advance notice and would then also have its own legal representation present.

#### Who will conduct the interview?

- 3.6 In composing the interview panel, the relevant regulator will draw on a pool of advisers, senior advisers and external technical specialists as required. The exact composition of the panel will vary according to the candidate, the firm and the nature of the prospective role. The PRA and FCA work to ensure that SMF interviews are conducted by suitably experienced interviewers and that interview panels have the correct balance of individuals and avoid any actual or perceived conflicts of interest. The PRA has sought to strengthen the composition of its interview panels and the FCA has made clear that a typical panel will include representatives from its relevant authorisations and supervision teams, a senior adviser and possibly a technical specialist.

3.7 Feedback from candidates would indicate that the regulators are making increasing progress on these aspects. Candidates increasingly report that interviewers have greater professional experience of the financial services sector, are well-prepared and well-informed, and both thoughtful and probing in their interview questions.

#### What will be discussed?

3.8 The relevant regulator will aim to explore a range of issues in SMF interviews, including but not limited to:

- (i) the general responsibilities of SMFs;
- (ii) the candidate's understanding of the SMF role that he or she has been asked to perform and, consequently, his or her responsibilities;
- (iii) the knowledge, skills and experience that the candidate will bring to the role;
- (iv) the candidate's view of the main risks facing the relevant firm and the role that he or she will play in managing them; and
- (v) the regulator's expectations of the candidate in performing the SMF role.

3.9 The relevant regulator aims to focus on the following key competencies for SMR roles:

- (i) **Market knowledge:** whether the candidate has awareness and understanding of the wider business, economic and market environment in which the relevant firm operates.
- (ii) **Business strategy and business model:** whether the candidate has a level of awareness and understanding of the firm's business strategy and business model appropriate to his or her proposed role.
- (iii) **Risk management and control:** the candidate should be able to identify, assess, monitor, control and mitigate risks to the firm. An awareness and understanding of the main risks facing the firm and the role that the candidate will play in mitigating them is very important.
- (iv) **Financial analysis and control:** whether the candidate has the ability to interpret the firm's financial information, to identify key issues based on this information and to put in place appropriate controls and measures.
- (v) **Governance, oversight and controls:** the candidate should be able to assess the effectiveness of the firm's arrangements to deliver effective governance, oversight and controls in its business and, if necessary, to oversee changes in these areas.
- (vi) **Regulatory framework and requirements:** the candidate needs to have awareness and understanding of the regulatory framework in which the firm operates and the regulatory requirements and expectations relevant to the SMF role which the candidate is seeking to carry out.

3.10 The PRA and FCA have adopted the FSA's stated policy that it would not seek to apply a "one size fits all" approach to its assessment of candidates and that it would not assess the competence of each candidate against all of the criteria listed above. Some of these criteria are likely to be far more relevant than others for certain SMF candidates.

- 3.11 The firm will, however, be expected to have considered all of these criteria in the context of the overall governance of the firm when the firm assesses the candidate as suitable for the relevant SMF role. For example, if a candidate for a director position lacks knowledge of a particular area of the firm's business then it will generally be expected that there will be appropriate knowledge of that area among other members of the board (and that the candidate will improve his or her knowledge of that area).
- 3.12 The regulators are keenly focused on the effectiveness of firms' due diligence of candidates and expect firms to be able to demonstrate that they have a robust recruitment process in place which includes acquiring regulatory references and qualification certificates, and carrying out criminal record, credit and directorship checks. Firms should notify the relevant regulator if a former employer, which is an authorised firm, is unwilling to provide a regulatory reference. A non-exhaustive list of supporting materials that should be provided with each application is available on the PRA's and FCA's websites. We can provide further guidance on the due diligence expected to be undertaken by the firm on the candidate on request.

#### 4. Which topics should be prioritised?

- 4.1 Clearly, the questions that will be put to candidates in SMF interviews will depend to a large extent upon the facts of each application. However, it is possible to draw some general conclusions about which of the criteria listed above the relevant regulator will prioritise when assessing candidates for each of the various SMF positions.
- 4.2 The regulators made clear in the early stages of the SMCR that the increased precision of the SMF roles, the requirements on firms to produce statements of responsibilities for each SMF, allocate prescribed responsibilities across the SMF population, and produce firmwide responsibilities maps, as well as the legal requirement on firms to undertake greater due diligence on candidates' fitness and propriety, would mean SMF approval applications would be subject to greater scrutiny than prior to the regime's commencement. This has increasingly been seen in practice since the regime came into force and particularly in relation to executive SMF positions.
- 4.3 As was the case prior to the SMCR coming into force, such candidates for executive director positions can expect to undergo the most intensive interview experience. The relevant regulator will seek to assess such candidates against most, if not all, of the criteria listed above, and such candidates will be expected to have a detailed knowledge of the business of the firm, the markets in which it operates and the key risks arising from the firm's business model.
- 4.4 Candidates for non-executive director (NED) SMF positions under the SMCR can also expect to face searching questions, in particular concerning the scope and responsibilities of their prospective role, their understanding of the regulatory framework, and, importantly, their ability and willingness to challenge and hold to account executives. The PRA expects to see a culture within firms which promotes discussion, debate, and challenge, with chairpersons taking a pivotal role in facilitating that culture. It may ask candidates for NED SMF positions to describe how they intend to contribute to that facilitation, and how they will discharge their responsibilities as a committee chair.
- 4.5 The PRA has stated that constructive challenge of the decisions and performance of the executives by all NEDs (whether or not holding SMF positions) improves the overall exercise of good judgement by the board and is

very much part of the collective responsibility the regulator expects boards to have for the governance of all aspects of the firm's business. Of particular importance is scrutiny by NEDs of the firm's strategy, including the viability and sustainability of the firm's business model and the appropriateness of the firm's risk appetite and management framework.

- 4.6 The PRA has previously acknowledged that, following the financial crisis and prior to the implementation of the SMCR, some NED SIF interviews over-emphasised the need for detailed technical knowledge, indicating that it does not regard this as an absolute prerequisite for all NED candidates. It has made clear, however, that all boards should include a sufficient number and quality of NEDs who, between them, understand the firm's business with sufficient depth to provide effective challenge to the executives. More specifically, NEDs, collectively, need to have sufficient current and relevant knowledge and experience, including market knowledge and sector experience, to understand the key activities and risks involved in the firm's business model, and provide effective challenge across all major business lines of the firm. Firms should be prepared to explain to the relevant regulator the particular skills and experiences that they envisage a new NED will bring to the board so that the individual can be assessed in that context.
- 4.7 The FCA has made clear more recently, in its SMCR Stocktake Report (August 2019), that the regime does not seek to redefine the NED role, nor does the FCA expect NEDs to act more like executive directors. Instead, it sees NEDs' oversight role and ability to challenge the executive management as key to safeguarding the interests of firms' stakeholders.
- 4.8 The PRA and FCA also consider that a structured induction and training plan for new NEDs, which takes account of their skills, experiences and any gaps therein, could be key to them quickly understanding the nature and risks of the business and becoming effective contributors to the board. Candidates should be able to demonstrate that such a plan is in place.

## 5. The tenor of the interview

- 5.1 As we received before the SMCR came into force, since its commencement we have continued to receive varied reports from candidates on their SMF interview experiences. Some have indicated their interviews have run smoothly and others have had more challenging interview experiences, with a depth of questioning that they had not fully expected. Candidates for both executive and NED SMF positions who have not had prior experience of key aspects of the firm's business have reported particularly challenging, and at times stressful, experiences.
- 5.2 While, of course, the nature and depth of questioning will depend on the nature of the particular role for which the candidate is being interviewed and the approach of the individuals conducting the interview, the interview process has certainly become more detailed, precise and in-depth since the commencement of the SMCR and the introduction of statements of responsibilities, prescribed responsibilities and firms' responsibilities maps.
- 5.3 Furthermore, in the early stages of the SMCR, the PRA indicated that candidates could expect more direct involvement from the regulators' supervision teams (which have been expected to lead on the more complex cases) with support from their authorisations teams and, as mentioned under "When will an SMF interview be required?" above, that the regulators intended to interview a higher percentage of candidates overall, than



under the APR. As also mentioned under the same section above, we have certainly seen an increase in the proportion of prospective SMF candidates being called for interview within particular firms and certain candidates being interviewed as a matter of course (broadly, those set out under the same section above). Candidates have also reported that interview panels have included PRA and FCA supervision personnel.

- 5.4 Particularly in light of these developments but also as a matter of good practice, candidates should ensure they spend an appropriate amount of time and care preparing for their interviews, so they are in the best position possible to respond effectively to the regulators’ interview questioning. While it remains to be seen to what extent interviews continue to take place through video and/or audio channels, candidates should also practice through such channels to ensure they are conveying the right and appropriate messages, and the “right tone” when doing so.
- 5.5 Section 6 below contains some key “dos and don’ts” for candidates applying for director SMF positions to bear in mind in relation to SMF interviews. We have indicated those points that are likely to be of relevance both to executive directors and NEDs with the code “E/NED”, those points that are likely to be of most relevance to executives with “E” and those points that are likely to be of most relevance to non-executives with “NED”. We should stress, however, that the degree of importance that each of the listed points will have in relation to any particular candidate will depend on the nature of his or her proposed role. Where we have stated that a point is relevant both to executive directors and NEDs, the range and depth of questions that candidates for executive directorships may be asked on the point are, as noted above, likely to be significantly greater than are likely to be experienced by candidates for NED positions.
- 5.6 Section 7 below contains specific guidance on the additional issues that the FCA can be expected to cover in SMF interviews relating to the compliance oversight and MLRO functions.

**6. Dos and don’ts**

<p><b>Dos</b></p> <p>✓ <b>Business model, strategy and plan of the firm (E/NED)</b></p> <p>Ensure that you have studied and are familiar with the existing or proposed business model, strategy, and plan of the firm, including:</p> <ul style="list-style-type: none"><li>• the types of business that the firm carries on and/or will be carrying on;</li><li>• the geographical locations of the firm’s branches and customers; and</li><li>• any major developments in terms of growth, new products or markets, or regulatory change.</li></ul> <p>✓ <b>Risks (E/NED)</b></p> <p>Ensure that you are aware of the firm’s existing or proposed risk appetite statement and its risk management and control framework, including how the risk appetite is used by the board to monitor the key risks to the business and to inform key business decisions.</p> <p>Ensure that you understand and can articulate the principal actual and prospective risks to the firm’s business, including: strategic and operational risks; credit, interest rate, and liquidity risks; market and concentration risks; and conduct risk, including retail conduct risk if applicable.</p> <p>Ensure that you are familiar with the proposed or existing recovery and resolution planning in place for the business.</p>
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Consider and be prepared to discuss the business' main challenges, how you understand these are being, or proposed to be, addressed by the board, and your view of the business' overall outlook.

Candidates should be aware of the PRA's supervisory statement updated in July 2018 on corporate governance and board responsibilities (SS5/16) and, in particular, its expectations on a firm's risk appetite, its risk management and control framework, and the board's active oversight of actual and prospective risks.

The regulators continue to focus heavily on conduct risk and expect all firms to have conduct risk frameworks in place to reduce, and ideally eliminate, harm to consumers and market integrity. Wholesale firms are subject to the FCA's Conduct Risk Programme, begun in 2015, which requires firm to have procedures in place to identify and manage conduct risk; sufficient senior management oversight of conduct within the firm; and take account of the conduct implications of any strategic decisions they make. The regulatory requirement to treat retail customers fairly is well-established (FCA's Principle for Business 6 expects fair treatment, and due regard for the interests, of customers) but, more recently and particularly as a result of COVID-19, the FCA's key focus has been on "vulnerable customers" (those particularly susceptible to harm given their personal circumstances). The regulator expects firms to take particular care in relation to such customers and SMF candidates should familiarise themselves with its final guidance (FG21/1, February 2021).

See further "Regulatory expectations in relation to the firm's culture" below.

### ✓ **Appropriateness of the firm's business model, strategy and plan, and risk appetite (E)**

Be prepared to explain and justify the firm's existing or proposed business model, strategy and plan, and its stated or proposed risk appetite statement, in particular:

- the viability and sustainability of the business model;
- the clarity and appropriateness of the risk appetite statement and how it supports the business strategy; and
- the effectiveness and appropriateness of the firm's risk management and control framework and how it is aligned with the firm's risk appetite statement.

See also "Regulatory expectations in relation to the firm's culture" below.

### ✓ **Governance and ownership structure of the firm (E/NED)**

Ensure that you are familiar with the governance and ownership structure of the firm where that is settled, including:

- the composition of the board of directors and committees of the board;
- principal non-board executives and their reporting lines;
- the principal functions of the firm and who is to lead each of these; and
- the shareholding structure of the firm and the identity of key shareholders or, if the firm is a subsidiary, where the firm fits into the structure of the group of which it forms a part.

The PRA has made clear that it expects the board to take collective responsibility for the governance of the firm and its business, and that the individual accountability established by the SMCR is complementary and additional to that responsibility.

The regulator has also increasingly emphasised the importance, and its expectation, of board diversity to improve discussion and decision-making across the firm's operations and risk strategy; enhance effective challenge across all aspects of the firm's business; and reduce the risk of group think (where a group of individuals reach a decision without consideration of the alternatives or critical reasoning based on a desire not to upset the balance of the group), thereby maintaining the safety and soundness of the firm. The PRA's Dear CEO Letter of March 2020 to banking and insurance firms makes clear that it continues to expect firms to have a board diversity policy in place and requires firms to engage "a broad set of qualities and competencies when recruiting to the management/governing body". Candidates for SMFs that sit on the board may be asked how they will contribute to, and help develop, the firm's board diversity policy and the regulatory outcomes the PRA is seeking to achieve.

The FCA, as UK listing authority, is also consulting on requirements for listed companies to disclose annually on a "comply or explain" basis their progress against certain proposed board diversity targets (including that at least 40% of the board should comprise women and at least one board member should be from a non-white ethnic minority background) and to include in

their corporate governance statement how their diversity policies apply to key board committees. Candidates may also be asked about these aspects.

See also “Regulatory expectations in relation to the firm’s culture” below.

### ✓ Regulatory regime applying to the firm (E/NED)

Ensure that you are familiar with the principal elements of the regulatory regime, and the regulators’ requirements and expectations, applying to the firm, including:

- the activities that the FCA and the PRA regulates, and the regulators’ requirements and expectations in relation to those activities;
- the UK corporate governance requirements;
- the FCA’s approach to supervision publication (April 2019);
- for candidates for SMF positions within Dual-regulated firms:
  - how the PRA regulates regulatory capital and liquidity requirements;
  - where relevant to the firm, the functions of an ICAAP/ICA and an ILAA and how, in broad terms, these are prepared; and
  - the PRA’s approach to banking supervision and approach to insurance supervision publications (both October 2018).

As at the date of this publication, the UK’s overall regulatory framework is being reviewed and consulted on by HM Treasury. The intention is that the framework will build on the structure originally set up under FSMA 2000 with clear allocation of responsibilities between Parliament, government and the regulators; enhanced transparency requirements applying to the regulators; and more systemic early-stage consultation between government and regulators in the policy-making process. The FCA is also consulting on a new Consumer Duty applicable to retail financial services which would comprise a new “Consumer” Principle for Business; requirements to take all reasonable steps to avoid foreseeable consumer harm and enable them to pursue their financial objectives; and a requirement to act in good faith. SMF candidates should familiarise themselves with these proposals and the impact they may have on the regulation of the firm they are seeking to join.

### ✓ Regulatory expectations in relation to the firm’s culture (E/NED)

The regulators have become increasingly focused on firms’ culture and its central role in achieving good customer outcomes, reducing the risk of regulatory misconduct, maintaining wider market integrity and continuing to build public trust in the financial services industry following the financial crisis.

They have made it clear that firms should have, and be able to demonstrate, a culture that encompasses risk awareness and management, accountability and responsibility, ethical behaviours and values, and diversity and openness. It should be “owned”, developed and led from the “top down” and embedded across the firm’s business.

The SMCR is at the centre of this culture, enhancing individual accountability and raising conduct standards at all levels. The regulators see SMF individuals (Senior Managers) as having a crucial role in contributing to the firm’s culture, by demonstrating that they are fully responsible and accountable for clearly defined business activities.

The regulators expect firms, as part of their culture, to demonstrate the processes they put in place to identify and manage risks to the firm, its customers and wider market integrity. They see Senior Managers having a central role in this, expecting them to demonstrate full responsibility and accountability for such risks in their respective business areas.

The regulators are also increasingly focusing on diversity and inclusion and expect this to form part of the firm’s culture, with the FCA stating in 2020 that healthy cultures are “purposeful, diverse and inclusive”. In relation to the diversity of senior management specifically, as well as the regulators’ focus on board diversity (as discussed under “Governance and ownership of the firm” above), the FCA expects a diversity of skills and experience across the senior management population as a whole, and one which supports collective suitability and reduces the risks caused by a lack of diversity, including group think.

The regulators’ joint discussion paper published in July 2021 (DP21/2) makes clear that the FCA will consider diversity as part of individual SMF applications and may withhold approval if it does not consider the appointment will contribute to the reduction of the risks caused by a lack of diversity. It also indicates in the paper that it is considering collecting “diversity data” on individual SMF candidates, although it has yet to provide further information on this and specifically on whether such data

would focus on the candidate's previous skills and experience, or whether it would extend to their values, gender and/or ethnicity.

The FCA is also increasingly focusing on non-financial conduct as part of an SMFs' fitness and propriety for the roles they hold and taking steps to sanction misconduct in this area (for example, sexual harassment or discrimination). It has made clear that it considers a healthy culture within a firm is one which does not tolerate such behaviour.

As a final point, the regulators' expectation of a "purposeful" culture references the increasing view, particularly following COVID-19, that companies' corporate purpose should reflect the interests of all stakeholders, not simply shareholders, including their employees, customers and other third parties with whom they do business and interact, and should contribute, within the remit of their business activities, to wider society.

Do ensure you are aware, and can demonstrate your understanding, of the regulators' expectations in relation to the firm's culture, particularly in relation to diversity and non-financial misconduct. Be prepared to discuss the existing, or proposed, culture, values and behaviour of the firm, how you understand this has been developed and embedded across the firm, and how you would contribute to it through your SMF role, both generally and specifically in relation to the identification and management of risks in the business area for which you would be responsible.

### ✓ **The nature and scope of your SMF role (E/NED)**

It is of course critical that you can articulate to the interviewers precisely the nature and scope of the role for which you are applying, including, in particular, in the case of an executive director role, the extent of your functional/divisional responsibilities and reporting lines and, in the case of a NED position, the scope of any additional specific oversight responsibilities you will assume.

In preparation for this, ensure that you understand the role's prescribed responsibilities under the SMCR, the role's statement of responsibilities, and the regulatory Conduct Rules applying to the SMF. In addition and importantly, ensure that you understand the statutory duty of responsibility applying to SMFs and the regulators' guidance on "reasonable steps" to discharge this duty (see next section for publication references). For candidates applying for SMF roles within Dual-regulated and FCA solo-regulated Enhanced firms, it would also be useful to have sight of the firm's responsibilities map (which sets out the allocation of senior management responsibility across all business areas, and which such firms are required to produce and maintain).

### ✓ **Regulatory regime applying to the SMF role (E/NED)**

Ensure that you understand the duties of the relevant SMF for which you are seeking approval under the relevant PRA and FCA rules, as well as how that function fits, and works with, other relevant SMFs.

Ensure you are aware of, and understand, the framework of the SMCR, its intention and purpose to strengthen individual accountability, and how it applies to the firm as a whole and forms part of the regulators' expectations in relation to the firm's culture (see "Regulatory expectations in relation to the firm's culture" above).

It would also be helpful to be aware of the key regulatory developments in relation to the SMCR since its inception in March 2016, including the FCA's supervisory review, stocktake report and SMCR guidance (September 2016, August 2019 and September 2020); the PRA's SMCR evaluation report (December 2020); the regulators' application of the conduct standards to "notified/non-approved" NEDs (those that do not require approval) (May 2017); the FCA and PRA guidance on the duty of responsibility (May 2017 and July 2018 respectively) and the FCA's discussion paper, consultation paper and policy statement on the status of firms' legal function under the SMCR (September 2016, January 2019 and July 2019 respectively) (all publication references below).

It would be sensible to review key publications on this subject in advance of the interview, in particular:

#### **All firms:**

- FCA supervisory review feedback FS 16/6 and stocktake report focusing on banks (September 2016 and August 2019); FCA SMCR guidance for FCA solo-regulated firms (September 2020); and PRA SMCR evaluation report focusing on banking and insurance firms (December 2020). Although not all of these reports and guidance are directly applicable to all firms, it is worth SMF candidates for any firm being aware of their content;

- FCA NED guidance in its Code of Conduct sourcebook (COCON) and PRA supervisory statement 5/16 on “Corporate Governance and Board Responsibilities” (updated July 2018) (while PRA’s guidance is directly applicable to Dual-regulated firms, it is worth SMF candidates for FCA solo-regulated firms being aware of it);
- FCA Business Plan 2021–22 (in particular, FCA’s priorities on firms’ culture, and on diversity and inclusion (chapters 3 and 5));
- PRA and FCA policy statements 12/17 and 17/8 respectively on the application of the regulators’ Conduct Rules to notified/non-approved NEDs (both May 2017);
- FCA discussion paper 16/4, consultation paper 19/4 and policy statement 19/20 on the status of firms’ legal function under the SMCR (September 2016, January 2019 and July 2019 respectively);
- FCA guidance FG 19/2 on statements of responsibilities and responsibilities maps (March 2019) (while this guidance is primarily for FCA solo-regulated firms the FCA has indicated that Dual-regulated firms may also find it useful); and
- FCA’s approach to supervision publication (April 2019) (pages 11 – 12).

#### **Dual-regulated banking firms:**

- PRA supervisory statement 28/15 (updated June 2021);
- FCA and PRA guidance on the SMF duty of responsibility in FCA policy statement 17/9 and PRA supervisory statement 28/15 (May 2017 and July 2018);
- for candidates applying for approval as a banking firm’s chair of the remuneration committee, the regulators’ rules on remuneration discussed in PRA and FCA joint policy statement (PRA PS12/15 / FCA PS15/16) (June 2015), PRA policy statement 7/17 and supervisory statement 2/17 (April 2017 and updated July 2021 respectively), and FCA policy statement 17/10 (May 2017); as well as PRA and FCA policy statements 20/26 and 20/16 respectively on changes to the remuneration rules in light of the transposition of the EU Capital Requirements Directive (both December 2020);
- PRA approach to banking supervision publication (October 2018) (pages 13 – 16).

#### **Dual-regulated insurance firms:**

- PRA supervisory statement 35/15 (updated June 2021);
- PRA and FCA policy statements 15/18 and 18/15 (both July 2018) and FCA Guide for insurers on the extension of the SMCR to insurers (updated February 2019);
- FCA guidance on the SMF duty of responsibility in FCA policy statement 18/16 (July 2018);
- For candidates applying for approval as an insurance firm’s chair of the remuneration committee, PRA supervisory statement 10/16 (updated July 2018);
- PRA approach to insurance supervision publication (October 2018) (pages 14 – 17).

#### **FCA solo-regulated firms:**

- FCA policy statement 18/14 (July 2018) and FCA Guide for FCA solo-regulated firms on the extension of the SMCR to FCA solo-regulated firms (updated July 2019);
- FCA guidance on the SMF duty of responsibility in FCA policy statement 18/6 (July 2018);
- FCA policy statement 20/12 on SMCR implementation date extension (October 2020).

#### **Benchmark administrators:**

- FCA policy statement 20/5 on the extension of the SMCR to benchmark administrators (June 2020).
  - **Claims management companies:** FCA policy statement 19/9 on the extension of the SMCR to claims management companies (March 2019);
  - FCA policy statement 20/12 on SMCR implementation date extension (October 2020).
- All FCA and PRA publications can be found at [www.fca.org.uk](http://www.fca.org.uk) and [www.bankofengland.co.uk/pr](http://www.bankofengland.co.uk/pr) respectively.

### ✓ **Your regulatory understanding and experience (E/NED)**

Where you do not have prior experience of working in businesses of the types to be carried on by the firm, be prepared to explain what steps you have taken to ensure that you understand the regulatory regime within which such businesses operate. While this is particularly the case if, in the context of an application for an SMF at a bank, you do not have prior experience of working in a deposit-taking institution, all candidates who do not have prior experience of the firm's business should be prepared – as referred to above under "The tenor of the interview", a number of candidates in this situation have reported particularly probing questions from the regulators.

### ✓ **Regulatory priorities and concerns for the relevant industry sector (E/NED)**

Ensure that you are aware of the current policy priorities and concerns in regulating the industry sector in which businesses of the type carried on by the firm operate. These are documented in various publications available from the FCA website ([www.fca.org.uk](http://www.fca.org.uk)), including the FCA's business plan 2021-22, PRA website ([www.bankofengland.co.uk/pr](http://www.bankofengland.co.uk/pr)a), including the PRA's business plan 2021-22 (May 2021) and from the Bank of England's Financial Stability Reports, which are available from the Bank's website ([www.bankofengland.co.uk](http://www.bankofengland.co.uk)).

As well as diversity and consumer protection (as discussed above), of particular note currently is the regulators focus' on climate change and sustainability more broadly, and on operational resilience and cyber security. They expect responsibility for climate change to be allocated to a specific SMF and responsibility for operational resilience and cyber security is typically allocated to the chief operations officer.

Depending on the nature of the firm's business, candidates should familiarise themselves with the key regulatory publications in these areas, which include PRA supervisory statement 3/19 (April 2019) and feedback (July 2020) on climate-related financial risk management requirements for banks and insurers and their implementation progress; FCA consultation paper 21/17 on climate-related disclosure requirements for asset managers and asset owners (June 2021); and the regulators' joint policy on operational resilience and PRA supervisory statement 2/21 on outsourcing requirements (both March 2021).

### ✓ **Regulatory priorities and concerns for the firm (E/NED)**

Ensure you have read and are familiar with the regulator's latest supervisory risk assessment letter to the firm, and any other topics which are the subject of supervisory concern or attention. The regulators' annual supervisory priorities' letters to banking, insurance and asset management firms (usually at the start or very end of the year) are also sensible to review. Currently, candidates can anticipate one or more questions on COVID-19's potential impact on the firm's growth and financial stability.

### ✓ **Board decision-making (E/NED)**

Think carefully in advance of the interview about how you envisage the board taking decisions and how you intend to contribute to that process effectively. Take account of the PRA's expectations in relation to the board's collective responsibility (as set out at "Governance and ownership structure of the firm" above).

### ✓ **Qualifications in the general sense (E/NED)**

Decide in advance of the interview how, in general terms, you will articulate your suitability for the role, in terms of your qualifications, experience and leadership qualities.

Candidates will be expected to have given thought to their own needs in terms of training and development, particularly those candidates applying for roles for which they have relatively little obviously relevant experience.

NEDs should consider how their skills and experience will complement those of the executives and other board members, and in particular, contribute to the development of the firm's strategy, culture and risk management framework.

### ✓ **Motivation (E/NED)**

Be prepared to explain your motivations for applying to carry out the relevant SMF, including (where relevant) the due diligence you undertook in relation to the firm and the position before you accepted the role, and your capacity to perform the role in view of other commitments you may have.

### ✓ **Time commitments (NED)**

Be prepared to demonstrate that you have given due consideration to, and are able to meet, the level of time commitment that will be required for the role. In particular, be prepared to give an account of your other roles and professional activities, including other non-executive directorships, and to demonstrate that these will not interfere with your ability to perform your duties effectively. This is a particular point included in the PRA's supervisory statement on corporate governance (SS12/16, updated July 2018).

### ✓ **Leadership qualities (E/NED)**

Be prepared to explain why you believe that you have sufficient leadership qualities to take on the relevant SMF, both by reference to your past experience and your personal qualities. This will be particularly important in respect of an application for the role of an executive director, chairman of the board or chair of a key board committee (e.g. the audit committee). The regulator expects candidates for these roles to be:

- highly authoritative;
- in the case of a NED, capable of challenging the executive effectively; and
- in the case of a chief executive or chair of the board, capable of marshalling the diverse skills and contributions of other board or committee members.

### ✓ **Holding executives to account (NED)**

Both the FCA and PRA have made it clear that a fundamental role for all NEDs, whether or not they are subject to approval, is the effective challenge of the performance and decisions of the executives and holding them to account on the areas and matters for which they are responsible, while also supporting their leadership of the business.

Be prepared to explain in detail:

- how you will effectively and constructively hold executives to account on:
  - the performance and decisions of individual executives;
  - the firm's proposed or existing business strategy;
  - the viability and sustainability of the firm's proposed or existing business model;
  - the effectiveness of the firm's proposed or existing risk management framework; and
  - the firm's culture, values, and behaviour and how these elements are being developed and instilled across the business;
- how you will ensure that you understand the risks to which the firm is exposed as its business develops and the quantitative and qualitative aspects of those risks;
- how you will go about ensuring you are given adequate information to make judgements and questioning and clarifying financial information and other data which executives may present to you by, for example:
  - questioning the assumptions on which that information or other data is based;
  - understanding the processes that have been applied to prepare the information or other data; and
  - understanding the uncertainties that may be embedded in the information or other data; and
- what steps you will take if you find yourself in fundamental disagreement with the chief executive (or another executive director) on a course of action.

## Don'ts

### ✘ Difficult questioning (E/NED)

To some candidates, the regulator's questioning may sound a little brusque at times. Do not respond aggressively, however inappropriate you feel the line of questioning to be. That said, we have received increasing reports from candidates since the commencement of the SMCR that the regulators' interview approach and style has been less aggressive than prior to the regime's commencement.

### ✘ Ill-informed interviewers (E/NED)

If you find that the interviewers are not as familiar as you would like with the proposed strategy of the firm, do not patronise them, however irritating it may be that they have not done their homework.

### ✘ Your experience (E/NED)

The interviewers may ask you questions about the quality and/or quantity of your experience, even where your experience in the sectors in which the firm will operate is very considerable. Do not be offended, as even where your experience is self-evident the regulator may nevertheless wish to go through the process of testing it. In addition, do not take the view that significant past experience is a substitute for reviewing relevant regulatory background materials (on which see above) and revising your knowledge of the regulatory system to which the relevant firm is subject.

### ✘ Your authority (E/NED)

If your role will involve senior executive responsibilities, or chairing the board or a committee of the board, you may be asked whether you feel you have the authority to carry out this role effectively. Again, this line of questioning should not be regarded as offensive, however inappropriate you feel it to be: it is among the points that the PRA and FCA tend to test as a matter of routine in these cases.

### ✘ Disagreements (E/NED)

The interviewers may disagree with or challenge some of the remarks that you make in the interview. Do not be offended by this and remember that they might be doing this simply to see how well you stand your ground and can make a case that you are right.

## 7. Candidates for compliance oversight and MLRO positions

7.1 Both the compliance oversight and MLRO positions are FCA-designated SMFs. Candidates for these positions need to be able to demonstrate to the FCA that they:

- (i) have a sound and proactive grasp of the regulatory issues facing the firm's business;
- (ii) can discuss those issues openly with the regulator and that they are used to fostering an environment in which problems are disclosed to and discussed with the regulator where that is appropriate;
- (iii) are aware of regulatory priorities for the sector in which the firm operates; and
- (iv) have sufficient force of personality and experience of dealing with senior executives not to be dominated by executives to the detriment of compliance and good risk analysis.

7.2 While it will be important to demonstrate a good grasp of the applicable rules, these candidates also need to be able to demonstrate, at a general level, a capacity to move beyond the minutiae of day-to-day compliance to engage with strategic issues facing the firm and to address such questions as:



- (i) Has the firm's risk appetite been agreed and stated? Is it being used to monitor and control key risks and inform key business decisions?
- (ii) What compliance risks are inherent in the firm's business plan? How can these be mitigated?
- (iii) What management and compliance resources will be required to ensure that these mitigating actions are as successful as possible? Are those resources available?
- (iv) Has the candidate discussed the firm's business plan with the firm's executives (or prospective executives) from a regulatory/compliance perspective? (The candidate should, of course, have done so).

7.3 In relation to the MLRO position, candidates would be well advised to attend the interview equipped with one or two generic examples of situations in which they would expect a report to the FCA and/or the National Crime Agency to be made in a business environment similar to that of the relevant firm (without, of course, disclosing details of names, dates or other features sufficient to identify any past cases). It is also sensible for such candidates to have thought in advance about what steps they are going to take to ensure that:

- (i) the need to make such reports is well understood and acted upon in the business of the firm; and
- (ii) so far as possible, staff speak to the MLRO accordingly as soon as the "reasonable suspicion" test has been satisfied concerning a particular person or transaction, if not before that threshold is reached.

## 8. After the interview

8.1 Having reviewed the content of the information provided both by the firm and the candidate, after the interview(s) the PRA or FCA (or both, as relevant) will make a decision on whether to grant approval to the candidate. If the relevant regulator proposes to refuse the application it will begin by discussing its concerns with the firm and the individual concerned, thereby providing an opportunity to modify or withdraw the application.

8.2 If an applicant is not minded to modify or withdraw its application at this stage then there are two levels to the appeal process. The process can be initiated by referring the matter to the PRA's relevant decision making committee or the FCA's Regulatory Decisions Committee (RDC), as appropriate, for consideration. If the relevant committee does not decide in favour of the applicant, the matter can be escalated to the Upper Tribunal, which is an independent tribunal that, amongst other things, hears appeals against PRA and FCA approval decisions.

8.3 A detailed examination of the appeals process is beyond the scope of this briefing paper, and it is to be hoped that by following the guidance outlined above candidates will not reach a point where they have to consider whether to engage with that process. However, we can provide information and guidance on the appeals process on request.

If you would like to discuss the issues raised in this briefing paper, or any other financial regulatory matter, please do contact one of us or your usual Slaughter and May contact:

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