

1 June 2023

Prudential Regulation Authority
20 Moorgate London EC2R 6DA, United Kingdom

Financial Conduct Authority
12 Endeavour Square London E20 1JN, United Kingdom



Japanese Bankers Association

JBA comments on the Discussion Paper: “Review of the Senior Managers and Certification Regime (SM&CR)”

Dear Sirs/Madams:

The Japanese Bankers Association¹ (JBA) appreciates the opportunity to provide our comments on the Prudential Regulation Authority (PRA) and Financial Conduct Authority’s (FCA) discussion paper: “Review of the Senior Managers and Certification Regime (SM&CR)” (hereafter the “DP”) on 30 March 2023.

The JBA member banks, as non-UK financial institutions, have operations in the UK. We hope our comments will contribute to the policy debate going forward. In addition to the responses that we have made to specific questions; we would like to provide general comments as follows.

General comment

The JBA agrees with the objectives of the SM&CR, which seeks to promote safety and soundness, reduce harm to consumers and strengthen market functioning by requiring that financial services professionals are individually accountable to their employers and regulators.

On the other hand, as we have stated in comment letters on the SM&CR's consultation paper², we believe that the subsidiaries/branches of globally active non-UK financial institutions are adequately governed by local management and that the SM&CR has room for further improvement from this perspective. In particular we expect the SM&CR to become a better regulation by reviewing the balance between collective decision-making considering the existing governance structures of non-UK financial institutions and adopting of more appropriate proportionality based on size and a more efficient Senior Management Functions (SMF) approval process.

Please refer to the following sections for specific comments.

¹ The Japanese Bankers Association is the leading trade association for banks, bank holding companies and bankers associations in Japan. As of June 1, 2023, JBA has 114 Full Members (banks), 3 Bank Holding Company Members (bank holding companies), 76 Associate Members (banks & bank holding companies), 51 Special Members (regionally-based bankers associations) and one Sub-Associate Member for a total of 245 members.

² <https://www.zenginkyo.or.jp/fileadmin/res/abstract/opinion/opinion261041.pdf> and <https://www.zenginkyo.or.jp/fileadmin/res/abstract/opinion/opinion270535.pdf>

Specific comments

Q4: Please provide any suggestions that can help ensure that appropriately qualified individuals are not deterred from taking up relevant Senior Manager roles.

(Our response)

Senior executives, non-executives and business line heads in international financial institutions often perform both UK roles and global roles. The SM&CR should take these cases into account, as the procedures by the SM&CR may be unduly burdensome compared to the share of the UK activities in their global roles.

Global roles do not necessarily need to be performed within the UK but can bring a great deal of insight and enhanced international competitiveness into UK business activity. In line with the core principles of the SM&CR, these individuals may have the most appropriate expertise, competence and experience to also run the related UK businesses and best meet the “fit and proper” test. However, bringing these individuals within the scope of the SM&CR has proven to be unduly burdensome. It has meant that individuals spend a large amount of administrative and compliance time maintaining their obligations with respect to the SM&CR which is disproportionate to the amount of power that they exercise with respect to the UK activity in their global role.

Additionally, individuals in global roles are already heavily scrutinised under the home country’s legislation. An additional, documentation heavy UK regime is burdensome. As a result, either individuals refuse to take on the global role with respect to the UK, or they only take on the global role after sufficient education and training from local legal and compliance representatives, which involves a great deal of human and capital resource as well as time. To ease these burdens, consideration should be given to applying substitute compliance.

The SM&CR should include a mechanism whereby a global role can be created that includes coverage of UK roles but does not have to become an SMF. As an alternative, it could be supported by the local board/executive function in order to achieve good governance.

A regime whereby a global role could be created, supported by collective decision making at the UK level, would be more palatable. It can avoid the need for individuals to deal with heavy certification, documentation and compliance burdens but still achieve accountability and transparent decision making through principles.

Q6: To what extent do the specific accountabilities of individual directors established by the Senior Managers Regime work in ways that complement the collective responsibility of the board of directors or decision making committees? Are there ways this could be improved?

(Our response)

There should be better balance under the SM&CR between clarifying areas of individual accountability capturing the core SMF and areas where collective decision making is more appropriate.

There have been concerns that while boards are set up to promote collective decision making, the SM&CR acts against this by promoting individual responsibility. Collective decision making allows for the consideration of a more diverse range of opinions, which in certain areas of high risk and sensitivity may be more appropriate (e.g., human capital resource management, ESG). Therefore, it should be considered to focus on collective responsibility much more or to adopt simpler (less document heavy) approaches to assignment of responsibilities more generally.

It may be argued that there could be tension created by putting in place a hybrid structure of individual and collective decision making because this could get particularly complicated in international governance structures. We would like to request the PRA/FCA to clarify the scope of the SMF role and provide guidelines. This is especially the case where SMF roles sit with international individuals and where decisions are made functionally at a global level. Clear guidelines of how global senior executives should exercise their role in respect of the UK regulated firms could be useful. Alternatively, the SM&CR could set out specific provisions for decisions formally made by the board or equivalent to fall entirely outside individual accountability.

Q9: To what extent do you agree or disagree that the scope of the SM&CR is appropriate?

(Our response)

We disagree with the expanding scope of the SM&CR.

Since the regime was introduced, changes have been made to the number of SMFs, the roles that require approval by the regulator, and the list of prescribed responsibilities. For instance, a Chief Operations Function was added to the list of Senior Management roles in 2017 and firms were required to allocate responsibility for identifying and managing climate-related financial risk to a Senior Manager in 2019.

While it is understood that the regime should be able to evolve in order to meet the regulatory needs of the time, there is a concern that using the regime to address every new issue of concern will cause it to become overburdensome.

Also, the scope of the SM&CR should be more proportionate. Especially for smaller firms, the current scope of the SM&CR is relatively broad and the administrative burden is quite heavy.

Please see also response to Question 11.

Q10: Are there actions the regulators could take in respect of the SM&CR that would help enhance competition or international competitiveness?

(Our response)

For the UK to enhance its international competitiveness as a significant global financial centre, it should provide further clarity on the application of the SM&CR to staff based at global headquarters and their role

when implementing global strategy in the UK branch/subsidiary.

It is understood that the SM&CR has been successful in enhancing the culture of the UK financial services sector as well creating a high standard for governance and accountability for senior roles. However, the regime's distinction between developing global strategies versus local implementation, that requires the allocation to an SMF, may lead to decision making being localised in the UK. Furthermore, the regime's distinction between developing strategy, which can be done by global staff who do not hold an SMF role, versus local implementation of that strategy, which must be done by a locally approved SMF, is difficult to separate in practice for most firms who operate global business and global control functions. A consequence is that the SMF regime may lead to decision making being overly localised in the UK, as SMFs attempt to demonstrate their independent decision-making, which could result in UK subsidiaries/branches being viewed as less strategically important entities outside the UK, and therefore the UK subsidiaries/branches attracting less investment and support from the Group.

Firms may also be encouraged to put in place purely administrative reporting lines and structures of governance from the UK as a cure for compliance with the SM&CR while ensuring a globally coordinated approach. However, these additional compliance and administrative structures are not necessary if consideration could be given to solutions which allow UK subsidiaries/branches to rely on group level individuals who are responsible for elements of the UK business but who do not have to become SMFs and/or be based in the UK. For example, there may be individuals based outside the UK who are better placed to run global business lines which include UK business activity. In such instances, in line with the SM&CR, the individual has limited authority for delivering the UK strategy and risk appetite unless they become an SMF. If the SM&CR framework could allow for "gaps" in the individual allocation of responsibility for the UK entity, such that some of the responsibilities are not covered by the UK SMCR regime but are captured by a different governance structure, individuals outside of the UK may have a greater appetite for taking on global roles that also cover the UK.

To ensure accountability at the UK level, we would like to suggest that the decision making and final implementation of the strategy by the non-SMF non-UK individual should be allowed if collective decision making at the board or equivalent level provide support for it.

We strongly believe that a greater allowance for collective decision making in combination with the ability to create global roles with better placed individuals with the appropriate expertise that can be held outside of the SM&CR will boost international activity within the UK but still maintain safety and soundness with robust accountability structures and appropriate expertise.

Q11: To what extent do you agree or disagree that the SM&CR is applied proportionately to firms and individuals?
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(Our response)

We agree that the SM&CR is sufficiently proportionate to reflect the type of entity (e.g. UK banks, UK branches of foreign banks, etc). On the other hand, separate and clear categories for UK branches of foreign banks should be introduced in order to allow firms to apply proportionality more appropriately.

For smaller firms, as stated in the response to Question 9, the current scope of the SM&CR is relatively broad and the administrative burden is quite heavy. The UK PRA's categories for supervisory purposes (category 1 to 5), where a firm's size, complexity and business type are reflected adequately, could be set as clear categories for UK branches of foreign banks in the SM&CR. More sufficient proportionality could enhance the effectiveness of the SM&CR as well.

Q12: How could the process for SMF approvals be further improved?

(Our response)

(i) More efficient and simplified approaches

A large number of staff need to be certified by firms and the annual certification renewal process is highly time consuming.

The interval for renewal of certification should be extended from the current annual interval. Certification should also be renewed only when a certified person changes role.

In addition, a more simplified application process could be applied to the SMFs other than the Management Body SMFs (CEO, etc) given the difference of involvement level in the firm's decision-making and/or risk between the Management Body SMFs and the other SMFs. A more simplified application process for the SMFs other than the Management Body SMFs could make the whole of regulatory approval process more effective and efficient while maintaining the components of the SM&CR.

(ii) 12-week rule

It is understood that the PRA/FCA hope to address some of the delays in the SMF approvals process. However, allowing the 12-week rule for longer and greater flexibility for interim positions with greater authority in the meantime would be desirable.

There are several practical issues with the SMF approval process. For senior roles, it can be long and arduous and often creates accountability gaps in the interim.

Where senior individuals are being replaced, time needs to be factored into the finding of an appropriately skilled replacement. For UK executive and non-executive positions, this can be especially challenging and time consuming. A further delay is then caused by the need to undertake the criminal records check and procure the regulatory references. All this must take place even before the SMF application can be submitted.

Although decisions on Senior Management applications are supposed to be made within three months of being

submitted, the process can be stopped whenever the regulators ask a question or decide to arrange a meeting. These means that it is many months between agreeing to hire a senior manager and the senior manager being appointed. The 12-week rule is not sufficient to cover this. It is often the case that the 12-week rule has lapsed much before the related senior manager is appointed. This creates short periods of non-compliance from a regulatory perspective for firms.

Additionally, managing decision making and governance in the meantime can be difficult as new boards and committees are unable to make timely decisions due to a lack of appropriate composition and approvals to perform official functions. It also creates risks for the individuals themselves with uncertainties around SMF approvals creating job vulnerability.

Currently, the PRA/FCA have a great deal of freedom as to the length of time and steps that it takes considering an SMF application. Even where the 12-week grace period ends, the PRA/FCA can either approve or provide a reasoned decision not to approve. In the latter case, the grace period may or may not get extended subject to what is decided by the approver at the time. Effectively, there does not seem to be a genuine time limit or followable procedure on how the PRA/FCA should respond as well as how long the PRA/FCA can take to provide a final response on SMF applications. This makes it very difficult for firms to make succession plans, contingency plans and generally manage changes in governance structures as there is no consistency as to the application process.

In order to cover the governance risks and gaps that the inconsistency and inefficiency that the SMF application process creates, the PRA/FCA should develop and publish a consistent approval process and establish transparent procedures. In addition, within the approval process, there should be more communication from the PRA/FCA to the firms, and this process should proceed in a mutually satisfactory manner.

Q14: To what extent do you agree or disagree that the 12-week rule sufficiently helps firms to manage changes in SMFs?
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(Our response)

Please see response to Question 12.

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We thank the PRA and the FCA for the opportunity to comment on the DP and hope our comments will contribute to further consideration.

Yours faithfully,

Japanese Bankers Association