

A joint response to the PRA and FCA's joint consultation on the  
*Approach to non-executive directors in banking and Solvency II firms & Application of the  
presumption of responsibility to Senior Managers in banking firms*

April 2015

The British Bankers' Association (*BBA*) and the Association for Financial Markets in Europe (*AFME*) welcome the opportunity to respond on behalf of their members to the FCA consultation paper CP15/15 and PRA consultation paper CP7/15 on their *Approach to non-executive directors in banking and Solvency II firms & Application of the presumption of responsibility to Senior Managers in banking firms*<sup>1</sup>.

The BBA is the leading association for banks active in the UK. It represents over 170 banking members, which are headquartered in 50 countries and have operations in 180 countries worldwide. As well as banks headquartered in the UK, BBA members include third country banks which operate in the UK either as branches or subsidiaries, or often as a combination of both.

AFME represents a broad array of European and global participants in the wholesale financial markets, and its members comprise all pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association through GFMA (Global Financial Markets Association) to communicate the industry standpoint on issues affecting the international, European and UK capital markets.

Our members welcome the revised approach to the inclusion of non-executive directors (NEDs) in the Senior Managers Regime, in particular the narrowing down of the Regime to exclude standard NEDs (as defined in the consultation paper) and the greater clarity about the PRA and FCA's expectations of those NEDs that remain in-scope as Senior Managers (in-scope NEDs) because they act as Chairman, chair a key board committee or act as Senior Independent Director (SID) in relation to a relevant authorised person.

Our response focusses on those aspects of the consultation paper which apply to our members as relevant authorised persons. With the exception of Question 3, we have not considered questions that are relevant only to insurance companies.

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<sup>1</sup> <http://www.fca.org.uk/static/documents/consultation-papers/cp15-05.pdf>

## FCA CP15/5 PRA CP7/15 - response to consultation questions

**Q1 [PRA]:** Do you agree with the content of Part 1<sup>2</sup> of the PRA's draft Supervisory Statement (in Appendix 2) regarding the responsibilities and accountability of NEDs in scope of the Senior Managers Regime?

We support the confirmation of the PRA's approach which will exclude Standard NEDs from the scope of the Senior Managers Regime but have some concerns that are outlined below.

Whilst welcoming this approach we think it important that both regulators and the industry recognise that it may result in consequences on board dynamics and board structures which the industry is not yet in a position to fully understand. We would welcome continued dialogue with the regulators to ensure any unintended consequences are identified and can be appropriately managed and would encourage the PRA and FCA to monitor the impact of the new regime on board room composition and structure.

Further, the industry raised issues in relation to the recruitment of suitable candidates for NED positions in the joint response to the July Consultation Paper. The difference in potential regulatory liability of in-scope NEDs and standard NEDs may make taking on the role of an in-scope NED less appealing, potentially making it more difficult for firms to attract suitable candidates for these roles.

We welcome the PRA's helpful clarification that the responsibilities of in-scope NEDs are confined to such NEDs' performance of their non-executive responsibilities, recognising that they are neither required nor expected to assume executive responsibilities for the management of a firm's business.

The draft PRA supervisory statement at Appendix 2 in our view succinctly captures the responsibilities of an in-scope NED at paragraph 2.7 and we are pleased to see it is broadly aligned with the UK Corporate Governance Code<sup>3</sup>.

We consider that, with a view to aligning further the activities of in-scope NEDs with the Code the following refinement could be made to the introduction and fourth bullet of paragraph 2 to read:

"These activities include:

- *Requesting management to provide* access to all appropriate relevant management information and, if necessary, external information so as to *enable all members of the board/committee to apprise themselves of matters under discussion in order for the board/committee to discharge its duties*; ~~ensure that all NEDs are appropriately apprised of all matters under discussion; and~~

We note that the fifth bullet in paragraph 2.7 provides that the activities for which an in-scope NED is responsible include ensuring that the Board and/or the committees which they chair provide "independent oversight of executive decisions". It is important that in-scope NEDs

<sup>2</sup> We assume the question is referring to Part 2?

<sup>3</sup> <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf>

are assured that the PRA does not intend to extend the accountability of a chair beyond the management of the Board or the relevant committee in accordance with its terms of reference, which should require them to ensure the committee devotes its time and attention to the right matters, that it meets with sufficient frequency and fosters an open, inclusive discussion. Such activities support the members of the Board or the committee in performing their roles and are expected to result in independent oversight of executive decisions. However the wording of this bullet as drafted may suggest greater expectations of the role of a chair.

It is essential that the responsibility of a chair is not extended beyond responsibility for the structures and processes of the board and/or committees that they chair such that, for example, they are potentially accountable for the consequences of issues considered and decisions taken by that board or committee even where they have properly performed their role as chair.

In the absence of confirmation the potential difference in regulatory liability between a chair and a member of a board or committee is likely to make it extremely challenging for firms to attract suitable high calibre individuals to take on chairmanship roles.

We would appreciate confirmation from the PRA that it does not intend to extend the accountability of a chair as noted above and suggest that the wording of the introduction and the fifth bullet be amended such that this provision reads:

These activities include .....

*'facilitating the provision of appropriate support to assist the board and/or committee in provide~~ing~~ independent oversight of executive~~s~~ decisions.'*

We note that the amendment to the introduction would result in some consequent amendments to the language of the first three bullets.

We also make the following points on the guidance:

- a. the same bullet point in paragraph 2.7 of the PRA draft supervisory statement refers "independent" oversight of executive decisions. We request confirmation from the regulators that "independent" in this context refers to the state of mind and position of the committee, as opposed to an independent process to be run in parallel with the relevant process being run by executive management;
- b. the guidance should recognise that Chairs of committees will be discharging their responsibilities in accordance with the authority delegated to them by the board. As such, we suggest amending the first paragraph of paragraph 2.7 of the PRA draft supervisory statement to read:

The potential accountability of NEDs in scope of the PRA's SMR under the Presumption of Responsibility is restricted to those activities for which they are responsible, in accordance with the powers delegated to them by the Board; and

We have assumed that the prescribed responsibilities (“PRs”) set out in the final rules published in PS3/15 (which are not subject to consultation) replace those set out in Annex 1 to Appendix 2 of PRA CP7/15 and therefore have not commented on the PRs as set out in that Annex 1 (though we note the amendments made to the PRs as they were set out in Annex 1).

In relation to the PRs set out in PS3/15:

- a. Please clarify the wording of PR18. Given the amendments that have been made to the other PRs required to be allocated to in-scope NEDs, we would expect this to read:

responsibility for ~~developing and~~ overseeing the development of the firm’s remuneration policies and practices ~~procedures~~ in accordance with SYSC 19A (Remuneration Code) of the *PRA Handbook*

rather than the current language which could be seen as more of an executive responsibility

- b. We would also welcome clarity around the reasons for, and anticipated effect of, the change to the proposed wording of PR19 in PS3/15 from:

independence, integrity and effectiveness of...policies and procedures on whistleblowing”  
to

independence, integrity autonomy and effectiveness of...policies and procedures on whistleblowing”;

- c. We note that PR21 (allocation of SID responsibilities) has been removed from PS 3/15. Please could you confirm that firms that are not required to appoint a SID under existing legislation or the UK Corporate Governance Code and will not be obliged to appoint a SID as a result of the implementation of the Senior Managers Regime?

We agree with the PRA’s proposals that firms should ensure that standard NEDs observe Conduct Rules 1 - 3 and SM4 only, and that in-scope NEDs should be required to observe the Conduct Rules, including those applicable to Senior Managers. The implication of this is that a breach of the Conduct Rules by a NED, whether or not a Senior Manager, would be directly enforceable against the individual NED but that the presumption of responsibility will not apply in such circumstances to a standard NED (in any event) or to an in-scope NED where there has not been a breach by the firm for which the individual has presumed responsibility.

We would appreciate confirmation from the PRA that our interpretation of how the Senior Manager Conduct Rules will apply to NEDs is correct.

We note that the criminal offence applies to all Senior Managers, including in-scope NEDs (but, if we correctly understand CP FCA15/10, PRA9/15, clause 2.3, not to Senior Managers of incoming branches).

The criminal offence applies where it can be shown that the Senior Manager was involved with a decision which:

*'causes the failure of the group institution'*<sup>4</sup> with the result that the failed institution either:

- a) enters insolvency,
- b) is subject to a stabilisation option pursuant to Part 1 of the Banking Act 2009,
- c) or for the purposes of the Financial Services Compensation Scheme is unable, or likely to be unable, to satisfy claims against it.

It would be helpful were the PRA to provide examples of circumstances in which an in-scope NED could be reasonably held liable for a criminal offence. Such elaboration is important as we believe that the potential for criminal prosecution, even if remote, will remain a deterrent to the taking up by suitably-qualified, risk-averse individuals of in-scope NED roles.

We note that paragraph 2.9 of the draft supervisory statement anticipates responsibilities not captured in PRA/FCA rules being added to the Statements of Responsibilities of in-scope NEDs in some circumstances. This is quite vague and seems to run contrary to the concise approach required for other senior managers. Could the PRA clarify its intentions?

Further guidance on what firms are expected to do in the event of performance issues with standard NEDs would be helpful, recognising that the firm will be expected to enforce the relevant Conduct Rules. We understand that the PRA would be able to sanction a standard NED by imposing a prohibition order in extreme cases. Paragraph 2.23 of the consultation paper is confusing and it would be helpful if the PRA could spell out the forms of enforcement process it believes it can take against a standard NED.

**Q2 [FCA]:** Do you agree with the guidance in Appendix 3 concerning the role and responsibilities of NEDs within the FCA SMR?

Yes, this is helpfully aligned with the PRA's draft supervisory statement. We welcome both regulators' recognition that NEDs will have regulatory responsibilities which are more limited in scope than those applicable to executive directors and the guidance setting out the types of activities for which the regulators expect in-scope NEDs to be responsible. The difference in potential regulatory liability may give rise to unintended consequences on board dynamics and we would welcome on-going dialogue with the PRA and FCA on this issue.

Whilst we assume the FCA's intention is to address this guidance only to in-scope NEDs approved by the FCA as Chair of the Nominations Committee, some of it (in particular the guidance on the general role of a NED) does appear to be directed in a more general way. The heading to 1 Annex 1G certainly suggests a wider potential application of this guidance than we would anticipate and further clarity around the intentions behind that apparent widening would be welcomed. In particular we would appreciate confirmation that the

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<sup>4</sup> S.36 Financial Services(Banking Reform ) act 2013

presumption of responsibility applies to such a chair only in respect of this responsibilities as a chair and not to the performance of the general role of a NED.

It would also be helpful if the wording of paragraph 3 and the provisions of the PRA's draft supervisory statement relating to the responsibilities of the chair of a committee were more closely aligned. The comments made above in our response to Question 1 in relation to the PRA's draft supervisory statement are also relevant to paragraph 3 of the FCA's Annex G to Appendix 3 and in addition sub-paragraph 5 (reporting to the main board on the committee's activities) should be considered carefully. If sub-paragraph (5) is to remain, it should perhaps be limited to 'material' or 'significant' activities.

Would the FCA clarify that the requirements relating to the required levels of care and skill are not intended to require higher standards than company law requirements and that the description of the role of a standard NED does not impose more onerous obligations than existing legal and regulatory obligations.

**Q3 [PRA]:** Do you agree with the PRA's proposed scope for the SIMR as far as NEDs are concerned? In particular, please consider the:

- decision to align the scope of the SIMR and the SMR
- inclusion of NEDs within the Group Entity Senior Insurance Manager function
- proposed proportionate application of the regime

While, as stated above, we do not speak for the insurance industry, we support the PRA's decision to align the scope of the SIMR and SMR. This accords with our view that regulatory processes should be agnostic towards the type of regulated activities that a firm undertakes. Individuals charged with the responsibility of overseeing a firm's safety and soundness should be held to the same high standards of behaviour and individual accountability regardless of whether they are a Senior Manager in an insurance firm or a relevant authorised person.

This alignment will also support the PRA's own operating processes in relation to the approval of potential Senior Managers under both the SIMR and the SMRs, ensuring that the costs of administering the two regimes will be lessened. In this instance we do believe that a one-size-fits-all approach is appropriate!

We recognise that not requiring NEDs in incoming third country Solvency II branches to be generally pre-approved is a proportionate approach, which we support. We imagine that in only rare cases will the nature of the branch's activities require that such a NED be pre-approved. It would be helpful if, once the SIMR has bedded down, the PRA were publicly to disclose the circumstances in which it has required such pre-approval, in order that other firms can benefit and learn from this information and thus ensure that their own governance principles are aligned with PRA expectations.

**Q4 [PRA]:** Do you agree with the PRA's proposals for the:

- allocation of core responsibilities to NEDs within the SIMR
- application of the Conduct Standards to NEDs within the SIMR

- requirement for firms to ensure that NEDs outside the scope of the SIMR observe the Conduct Standards 1-3, 7 and 8?

We have chosen not to respond to this question, believing others are better placed to do so.

**Q5** [FCA]: Do you agree with the FCA's proposed approach to NEDs under the APR for Solvency II firms?

We have chosen not to respond to this question, believing others are better placed to do so.

**Q6** [FCA]: Do you agree with the FCA's approach to NEDs in incoming EEA Solvency II branches?

We have chosen not to respond to this question, believing others are better placed to do so.

**Q7** [FCA]: Do you agree with the FCA's approach to NEDs in incoming non-EEA Solvency II branches?

We have chosen not to respond to this question, believing others are better placed to do so.

**Q8** [PRA]: Do you agree with the proposed notification requirement for standard NEDs in relevant authorised persons, including the draft form set out in Appendix 5?

We agree with the proposed notification requirement and would welcome clarification and/or further guidance of the following matters;

- a. the stage of the appointment process the PRA expect to receive the Notification Forms and the time period in which the PRA will share any concerns with the firm;
- b. the Notification Form requires a number of other documents to be submitted with it. We would welcome further guidance on;
  - what the PRA would expect firms to adopt as key criteria in assessing whether the appointee has the personal characteristics, level of competence, knowledge and experience and qualifications to perform the role effectively;
  - how the PRA will use these documents when being notified of unauthorised NED; and
  - to what extent will the PRAs' approach on these points differs from its current approach under the approved persons regime; and
- c. The process for notification of standard NEDs at the time of commencement of the Senior Managers Regime is not clear. Will the grandfathering form be updated to accommodate standard NEDs?

Finally, as standard NEDs will not be subject to pre-approval by the regulators, we are concerned to avoid undue delays where a standard NED is subsequently appointed as Chairman, SID or Chairman of a key Committee. Whilst we note there are measures for temporary cover, it would be useful to have confirmation on whether informal succession

planning discussions will continue with the regulators to assist in streamlining the appointment process.

**Q9 [PRA]:** Do you agree with the clarifications and expectations set out in Part 2<sup>5</sup> of the Supervisory Statement in Appendix 2 regarding the PRA's proposed application of the presumption of responsibility?

The clarifications are helpful. In particular, we welcome the confirmation in paragraph 3.14 that where a firm has reached a bilateral settlement with the PRA in relation to a regulatory breach by the firm, this does not bind the individual or the PRA in considering whether or not there has been a regulatory contravention by the firm for the purposes of the presumption of responsibility.

We note that paragraph 3.8 states that the PRA does not see the presumption of responsibility as being a basis for action only in significant cases or as a last resort and that it will consider each case on its merits.

It is essential that a proportionate approach is taken to regulatory enforcement proceedings brought against Senior Managers on the basis of the presumption of responsibility. We have previously commented on the risk that the new regime will adversely impact collective decision-making and discourage risk-averse individuals from taking-up or retaining Senior Manager roles, particularly if the presumption of responsibility is not proportionately applied. Confirmation from the PRA that it intends to invoke the new regime only in instances of serious or material regulatory breaches by firms would be instrumental in mitigating this risk.

On a similar note, paragraph 3.17 states that the PRA in determining whether a senior manager is responsible for managing any of a firm's activities, Statements of Responsibilities and Responsibility Maps should be relevant evidence but that the PRA may look behind these if it considers it appropriate. Could the PRA clarify the circumstances in which it would look behind these documents and confirm that they would be limited to situations in which a firm had failed to ensure that these documents accurately reflected the actual allocation of responsibilities among its Senior Managers?

We welcome too the statement at paragraph 3.20 that the PRA does not intend to apply standards "retrospectively" or with the benefit of hindsight but note that the FCA does not appear to have included an equivalent statement in its own proposed guidance on the presumption of responsibility. Can we anticipate that the FCA will adopt the same approach?

We would expect regulators not to adopt a tick-box exercise in relation to the very large number of proposed steps set out in paragraph 3.21, recognising that there may be justifiable reasons for not undertaking one of those steps in a particular situation.

We note from paragraph 3.19 that the individual will normally be expected to submit evidence and make representations to the PRA about the reasonable steps they have taken before the PRA will issue an initial Decision Notice. We assume that all such evidence and

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<sup>5</sup> We assume this question is referring to part 3



representations will be treated in confidence by the regulator and not provided to third parties without the individual's prior consent.

**Responsible Executives**

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