



## Front of mind Joanne Davis

### Compliance, culture and evolving regulatory expectations – SM&CR

**O**n 31 March 2021, Mark Steward, executive director of Enforcement and Market Oversight at the FCA delivered a keynote speech on compliance, culture and evolving regulatory expectations to an audience at NYU Law School's on compliance, culture, and ESG. Mr Steward spoke about the role of the UK's Senior Manager and Certification Regime ("SM&CR") and the FCA's Five Conduct Questions programme ("5CQs") – the annual self-assessment exercise for wholesale firms.

The FCA's expectations around culture have developed from the initial focus on "tone from the top" to "tone from within", and firms must work to embed a compliance culture which ensures all employees are accountable and engaged.

The SM&CR will impose personal liability on senior managers, so that it is in their own interest to avoid liability and thus enforcement. Mr Steward referred to this as a "virtuous circle."

The FCA is considering expanding the 5CQs to include a sixth question, focusing on diversity and inclusion ("D&I").

The SM&CR has applied since March 2016 and to all FCA-regulated firms since December 2019. Mr Steward explained that the SM&CR has led to significant changes in the way firms allocate responsibilities, align those responsibilities to relevant controls and ensure oversight as to how these controls operate.

It has pushed firms to closely assess their control systems and functions for possible vulnerabilities that could lead to failure. It is in such vulnerable areas where firms must focus their efforts and build reasonable steps for senior managers in order to prevent non-compliance.

Covid-19 and remote working present examples of where firms will need to continue to ensure that their controls

are robust and that senior managers stay on top of possible vulnerabilities, so that they are able to take all reasonable steps to avoid failure. The FCA has highlighted at various points during the pandemic that it expects firms' control environments to adapt appropriately to the current circumstances; for example, the latest Market Watch publication specifically focuses on recording telephone conversations and electronic communications when alternative working arrangements are in place, including increased homeworking.

It's clear from the latest report from the FCA's Cyber Coordination Groups that firms are also very alive to the challenges posed by remote working – not least the expansion of firms' security perimeters, ability to monitor activities, and the strain placed on traditional systems and controls when these are transitioned to remote working.

The Five Conduct Questions aim to help firms pinpoint areas for, and implement, effective change as well as allowing the FCA to monitor their progress. The 5CQ require self-reflective answers to the following:

1. What proactive steps do you take as a firm to identify the conduct risks inherent within your business?
2. How do you encourage the individuals who work in front, middle, back office, control and support functions to feel and be responsible for managing the conduct of their business?
3. What support (broadly defined) does the firm put in place to enable those who work for it to improve the conduct of their business or function?
4. How does the Board and ExCo (or appropriate senior management) gain oversight of the conduct of business within their organisation and,

equally importantly, how does the Board or ExCo consider the conduct implications of the strategic decisions that they make?

5. Has the firm assessed whether there are any other activities that it undertakes that could undermine strategies put in place to improve conduct?

Mr Steward noted that the FCA is considering the addition of a sixth conduct question for all firms: "Is your management team diverse enough to provide adequate challenge and do you create the right environment in which people of all backgrounds can speak up?"

Mr Steward reflects that the 5CQ assessment has been developing from a top-down approach (senior management delivering "the tone from the top"), through a stage of "tone from above" (an example being set by one's immediate line manager), to now focus on the "tone from within". This requires individuals to consider their own "mindset, preferences, beliefs, habits and pre-dispositions" rather than just being aware of "how the CEO or line manager might respond in a situation".

Additionally, Mr Steward explained that the SM&CR and 5CQ push firms to adopt a different approach because these regimes require firms and individuals to consider how behaviour, or non-compliance, might lead to failure. In particular, the statutory duty of responsibility that is placed on senior managers requires them to consider failure as a result of non-compliance meaning that they then take steps to avoid or prevent such failure.

#### In summary

It is for firms, and all of their people, to consider both their own and collective actions in order to effect real cultural change, either as a result of the threat of enforcement or cultural awareness and stewardship.

However, human nature will still lead some people to act in a non-compliant manner, however inexplicable that might look from the perspective of those in control functions, or the regulator. ■

For more information, please contact:

Jo.Davis@auxillias.com  
Daksha.Mistry@auxillias.com

Or visit the company website at  
[www.auxillias.com](http://www.auxillias.com)