



## SMF5 your personal responsibilities

Audit leaders working in an **authorised firm** (as defined by the Financial Services Markets Act) need to be aware of their **personal** regulatory accountability.

The chief audit executive is a Senior Management Function 5 (SMF5) role. Aspiring members and those thinking of a first move into financial services take note. We explain the key aspects of the SMF5 role as part of the Senior Managers Regime.

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## What is the Senior Managers Regime?

It is the approval process for senior managers performing key roles working within financial services (as defined in the FCA handbook and PRA rulebook). Approval must be gained ahead of starting the role. A senior manager must have a 'statement of responsibilities' that clearly says what they are responsible and accountable for. At least once a year organisations need to certify that senior managers are suitable to do their jobs.

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## Why and when did it come about?

In response to the 2008 banking crisis and significant conduct failings such as the manipulation of London Inter-bank Offered Rate (LIBOR), Parliament set up the **Parliamentary Commission for Banking Standards (PCBS)** to recommend how to improve standards in the banking sector.

The PCBS recommended a new accountability framework focused on senior management. It also recommended that firms take more responsibility for employees being fit and proper, and that there be better standards of conduct at all levels in banking firms.

Based on these recommendations, Parliament passed legislation in December 2013, leading to the **Financial Conduct Authority (FCA)** and **Prudential Regulation Authority (PRA)** applying the **Senior Management & Conduct Regime (SM&CR)** to the banking sector. Parliament made further changes to legislation in May 2016, requiring the extension of the regime to all Financial Services Markets Act **authorised firms**.

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## Purpose of Senior Managers Regime

The aim of the SM&CR is to reduce harm to consumers and strengthen market integrity by making individuals more accountable for their conduct and competence.

As part of this, the SM&CR aims to:

- encourage a culture of staff at all levels taking personal responsibility for their actions
- make sure firms and staff clearly understand and can demonstrate where responsibility lies

The Senior Managers Regime (SMR) is a component of the SM&CR and is relevant to persons performing senior roles in a firm. A senior management function is a function that requires the person performing it to 'be responsible for managing one or more aspects of the firm's affairs (so far as relating to regulated activities) and those aspects involve, or might involve, a risk of serious consequences for the relevant firm, or for business or other interests in the UK.' (Chapter 10C, FCA senior management regime for approved persons in relevant authorised persons)

One of these roles, known as Senior Management Function 5 (SMF5) is the role of the chief audit executive. The key aspects of the SMF5 role are now explained in detail.

## Senior Management Function 5 - role

Under SMR, firms must allocate prescribed responsibilities to one or more senior managers setting out their duties. This allocation forms part of the overall firm's management and governance map. The prescribed responsibilities are detailed in the [Senior Management Regime: Statement of Responsibilities](#).

Whilst the SMR will ensure that senior managers can be held accountable for any misconduct that falls within their areas of responsibilities, the conduct rules, introduced in March 2016, set out the basic standards for behaviour. These are high-level standards of behaviour that apply to almost everyone in the banking sector.

There are also some conduct rules that only apply to senior managers. These include reference to 'reasonable steps' to ensure that the business of the firm is controlled effectively; complies with the relevant requirements and standards and that any delegation of responsibilities is to an appropriate person and to oversee the discharge of the delegated responsibility effectively. Whilst there is no definitive explanation of what are 'reasonable steps', senior managers are expected to be able to provide the rationale for judgements and decisions, and evidence the actions they have taken, in relation to their areas of responsibility.

The specific requirements of the SMF5 role are not defined by the regulators. Some of the key considerations for the role of the chief audit executive are noted below but this should not be considered an exhaustive list:

1. The Institute of Internal Auditors (IIA) [International Professional Practice Framework \(IPPF\)](#) sets out the principles and standards for internal auditors and the practice of internal audit.
2. Different audit committees may expect different assurances from internal audit. The remit of internal audit will be agreed and set out in the approved [internal audit charter](#).
3. The Chartered IIA's [financial services code \(Effective internal audit in the financial services sector\)](#) sets out key expectations for internal audit.
4. The Basel Committee on Banking Supervision's document '[The internal audit function in banks](#)' addressed supervisory expectations for the internal audit function in banking organisations.
5. There will be other specific topics that internal audit is expected to cover based on the expectations of their regulators or relevant legislation.

6. Where the SMF5 has roles and/or responsibilities that fall outside of internal auditing, safeguards must be in place to limit impairments to independence or objectivity (Standard 1112).
7. In some organisations the appointed SMF5 may have a reporting line into an individual holding the role of SMF7 – Group Entity Senior Manager (eg the chief internal auditor of the group parent legal entity). In such circumstances it is good practice for the SMF5 and SMF7 role holders to define how the relationship works between the two of them.

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## Authorisation

Individuals who fall under SMR will need to be pre-approved by regulators. Not getting approval before taking up the role may lead to enforcement action against the firm and/or the individual. Some of the key points are noted below; internal auditors should confirm the current requirements by reference to the [Bank of England/PRA](#) and [FCA](#) websites:

For dual-regulated firms, the PRA leads the assessment of applications for the approval of the PRA-designated senior management functions. The authorisation of an individual to carry on PRA-regulated activities will not be granted unless both the PRA and the FCA are satisfied that the applicant meets the required standards. Applications are made by the firm and countersigned by the individual; both verify that the information contained within the application is complete and accurate.

Firms are required to assess the fitness and propriety of certain employees who could pose a risk of significant harm to the firm or any of its customers; and annually thereafter.

All senior management functions must comply with and meet the fit and proper test for approved senior managers. Approved persons must inform their firm and the PRA of any matter that may impact their ongoing fitness and propriety.

If an individual approved to perform a senior management function acts in a manner inconsistent with conduct rules or standards expected of an approved person, or if an individual knowingly consorts in a breach of their firm expectations – action by the regulator may include a fine, a suspension of the approval, imposing restrictions or issuing of a public statement relating to the misconduct. If a person is no longer considered to be fit and proper to perform the function, approval may be withdrawn or the individual may be prohibited from holding approval status in the future.

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## Closing Thoughts

Good corporate governance sits at the heart of the internal audit profession. Audit leaders should be fully supportive of the requirements of the SMR. As the financial services industry continues to reform chief audit executives should use their role as senior managers to demonstrate the very highest standards of corporate and personal ethics.

*You are leaders and we expect you to exercise leadership over your business model and your culture.*

*Jonathan Davidson, Director, FCA*

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## Further reading

Bank of England: [Strengthening accountability](#)

Financial Conduct Authority: [Senior managers and certification regime](#)

[Model internal audit charter](#)

[Internal audit charter](#)

[1000 Purpose, authority and responsibility](#)

[1112 Chief audit executive roles beyond internal auditing](#)