

10/15

Financial Services Authority

Effective corporate governance

Significant influence controlled
functions and the Walker Review

September 2010

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This Policy Statement reports on the main issues arising from Consultation Paper 10/3 *Effective corporate governance (Significant influence controlled functions and the Walker Review)* and publishes final rules.

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Copies of this Consultation Paper are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

List of acronyms used in this Policy Statement

Actuarial Function Holder	(AFH)
Advisory, Conciliation and Arbitration Service	(ACAS)
Appointed representatives	(ARs)
Banking Consolidation Directive	(BCD)
Building Societies Regulatory Guide	(BSOG)
Chief risk officer	(CRO)
Conduct of Business sourcebook	(COBS)
Consultation Paper	(CP)
Controlled function	(CF)
Cost-benefit analysis	(CBA)
Criminal Records Bureau	(CRB)
Equality Impact Assessment	(EIA)
European Economic Area	(EEA)
Financial Reporting Council	(FRC)
Financial Services and Markets Act 2000	(FSMA)
Frequently Asked Questions	(FAQs)
Limited Liability Partnerships	(LLP)
Markets in Financial Instruments Directive	(MiFID)
Non-executive directors	(NEDs)
Policy Statement	(PS)
Retail Distribution Review	(RDR)

Senior Independent Directors	(SIDs)
Senior Management Arrangements, Systems and Controls sourcebook	(SYSC)
Significant Influence Function	(SIF)
Supervision Manual	(SUP)
Support Level Agreement	(SLA)
Treating Customers Fairly	(TCF)

1 Overview

Introduction

- 1.1 In January 2010, we published Consultation Paper (CP) CP10/3: *Effective corporate governance (Significant influence controlled functions and the Walker Review)*. The CP advanced a range of proposals designed to improve both the quality of governance within firms and the intensity of our supervisory regime. It also contained proposals to implement, where appropriate, the recommendations made by Sir David Walker in his review of corporate governance in banks and other financial institutions.¹
- 1.2 CP10/3 proposed:
 - a new framework of classification of controlled functions;
 - other changes to the approved person regime, including the scope and definition of certain, already existing controlled functions;
 - some guidance detailing our expectations of the role played by non-executive directors (NEDs) and a proposal to delete current guidance that discusses the limits of a NED's liability; and
 - guidance on risk governance and our plans to support the implementation of recommendations in relation to this area made by Sir David Walker in his review.
- 1.3 We also provided information on our approved person and Significant Influence Function (SIF) interview process, to detail the way we assess the fitness and propriety of individuals applying to perform SIF controlled functions.
- 1.4 This Policy Statement (PS) sets out a summary of the responses we received to CP10/3 and includes the final Handbook text that will implement our proposals.

1 http://webarchive.nationalarchives.gov.uk/20100407010852/www.hm-treasury.gov.uk/walker_review_information.htm

Developments since CP10/3

- 1.5 The role of good governance in financial services firms continues to be high on the international and domestic agenda. Since we issued our CP in January, the Basel Committee on Banking Supervision issued a set of principles in March 2010 for consultation.² These principles are for enhancing sound corporate governance practices within banking organisations. In June, the European Commission published its Green paper on Corporate Governance.³ Domestically, the Financial Reporting Council has now published a new (May 2010) edition of the UK Corporate Governance Code and in July 2010, published The UK Stewardship Code. More widely, Hector Sants's speech on 17 June 2010⁴ to the Chartered Institute of Securities and Investments conference drew attention to the importance of a firm's culture in developing good regulatory outcomes and the role that governance plays in this.

Responses and our final policy approach

- 1.6 The consultation period closed on 28 April 2010. We received 74 responses from trade associations, professional bodies, regulated firms of various sizes and individuals from the accountancy and legal professions and the Financial Services Consumer Panel. We are grateful to all those who took the time to submit their views. A list of all non-confidential respondents is attached at Annex 3.

Consultation feedback on our new framework of significant influence controlled functions

- 1.7 We set out in Chapter 2 a summary of the responses we received to our proposals in CP10/3. Respondents raised detailed questions and requests for greater clarity, especially in respect of three key areas relating to: Parent entity SIFs (CF00); concern about the potential increased liability of non-executive directors (NEDs) resulting from our proposal to delete guidance in SYSC; and the establishment by firms of risk committees and appointment of a chief risk officer. We also clarify the number of individuals within a firm that may hold the new systems and control functions (CFs 13-15) and the position for outsourcing of these functions. We explain our decision to provide guidance to ring-fence the individual holding the internal audit (CF15) controlled function, to reinforce their independence; and clarify the application of the new SIF controlled functions for appointed representatives.

Approving and supervising Significant Influence Functions

- 1.8 Although our CP did not contain any consultative proposals amending the way that we approve and supervise individuals holding or seeking to hold approved person status, respondents welcomed our explanation in the CP of the approved

2 Principles for enhancing corporate governance – consultative document (www.bis.org/publ/bcbs168.htm).

3 Corporate governance in financial institutions and remuneration policies, European Commission, COM(2010)284/3.

4 Do regulators have a role to play in judging culture and ethics? (www.fsa.gov.uk/pages/Library/Communication/Speeches/2010/0617_hs.shtml)

person application and SIF interview processes. This section of our CP elicited many comments from respondents, which are covered in Chapter 3 of this Policy Statement.

The Walker Review and other proposals

- 1.9 Chapter 4 details the progress that has been made in those other areas that we covered in our CP, including Sir David Walker's review (though his recommendations regarding the establishment of risk committees and a chief risk officer, are both covered in Chapter 2), as well as other changes – for example, to reflect the publication by the Financial Reporting Council of the *UK Corporate Governance Code*.
- 1.10 Given respondents' general support for our proposals, we intend to proceed largely on the basis outlined in the CP, but clarifying and responding to issues raised where this is consistent with the scope of our consultation.
- 1.11 The new rules will become effective from 1 May 2011.

Equality Impact Assessment

- 1.12 As a public authority, we are subject to the equality duties that apply to public bodies. This requires us to conduct impact assessments of our activities and policies on equality and diversity issues. We have published the corresponding equality impact assessment (in Annex 2) for the implementation of the rules and guidance that are set out in this Policy Statement.

Who should read this Policy Statement?

- 1.13 This paper will be of particular interest to: regulated firms, the parents of regulated firms and those applying for authorisation; individuals who hold significant influence functions and individuals who exert significant influence over regulated firms; and those involved in recruiting SIFs and in overseeing, developing and administering processes for complying with our approved persons regime.

Structure of this paper

1.14 The rest of this PS is set out as follows:

- Chapter 2 summarises the feedback we received to the questions in CP10/3 and our responses to the issues raised.
- Chapter 3 responds to comments received about our approved person and SIF interview process.
- Chapter 4 provides an update on progress in implementing the recommendations from Sir David Walker where we have a role, and other issues that were highlighted in Chapters 1 and 6 of CP10/3.
- Annex 1 provides a cost-benefit analysis and compatibility statement.
- Annex 2 provides an equality impact assessment.
- Annex 3 provides a list of the non-confidential responses to our consultation.
- Annex 4 provides a summary table of the new controlled functions.
- Annex 5 provides information on implementation.
- Appendix 1 contains the final Handbook text.

Consumers

This PS details the extension in scope of the approved person regime and so will be of interest to both consumers and consumer bodies.

2 Consultation feedback and responses

- 2.1 This chapter sets out details of the responses we received to our proposals. For convenience, the table detailing the current and proposed new controlled functions that appeared in CP10/3, appears at Annex 4.
- 2.2 Many respondents took the opportunity not only to provide answers to the 15 questions in the CP, but also to preface their responses with their general observations on our overall proposed approach to facilitating improved and effective corporate governance.
- 2.3 The vast majority of respondents support – or at least recognise and accept the reasoning behind – our intention to establish a more intensive approved-person regime and a more robust approach to supervision in the interests of improving the quality and effectiveness of firms’ corporate governance structures.
- 2.4 Firms are supportive, in principle, of our ensuring consistent application of our SIF controlled function proposals across all firms, regardless of their corporate status. However, due to the complexity and diversity of corporate governance models and the challenge in measuring their effectiveness, firms suggest that we must be mindful of the fact that not all of the proposed new controlled function (CF) roles are relevant to all firms. Firms asked us to apply proportionality when considering SIF applications, based on the risk posed to consumers and the sector as a whole, so that we do not adopt a ‘one size fits all’ policy.
- 2.5 A number of respondents have observed that implementing the proposals set out in the CP will create pressures for their own resources. They urge us to establish clear service standards to allow firms to progress appropriately and in a timely manner with their hiring decisions.

Our service standards

Our service standards are underpinned by our statutory obligation under section 61.3 of FSMA, to determine applications within three months. We publish our service level agreements on our website in our Performance Account, including setting out the length of time the application process is expected to take in practice – this will relate directly to the complexity of the application under consideration. For approved person

applications that involve a SIF interview, inevitably these will take longer than seven days to process and so fall within the 15% of applications that are outside the Support Level Agreement (SLA) (but still within the three-month statutory obligation).

CP10/3 described (paragraph 4.7) the type of information we require to process an application and emphasised the desirability of firms submitting applications in good time and in good order (see 4.11 to 4.13 of CP10/3). If, however, information is missing from the application, or the information provided gives us cause for concern, processing time will almost always be longer. In each case, we will notify the firm of any extension to the processing times.

Our Handbook Notice 102 (23 July 2010) announced that we have amended the Supervision Manual (SUP) to remove the only reference we make in it to non-statutory service standards for supervision processes. In particular, we clarify the time necessary for us to assess approved person applications. We will ensure that applications for approved person status are processed promptly, while ensuring that we deliver greater focus on the quality of governance in firms, our more restrictive risk appetite and, where appropriate, our intensive assessment of individuals seeking to carry out SIF roles.

Classifying significant influence controlled functions

We asked:

Q1: Do you agree with our proposal to separately identify certain key roles that are performed within the CF1 (director), CF2 (NED) or CF28 (Systems & controls) controlled functions?

- 2.6 Over 80% of respondents support our proposal to create the more granular, role-specific controlled functions – both for Governance and Systems and Control roles – and agree with the rationale behind this. A minority of respondents, however, believe that the existing rules and principles within our Handbook – by which firms and CF2s are already bound (including APER, FIT, SYSC and PRIN⁵) – are adequate and that our aim can best be achieved through supervision.
- 2.7 Of those that are not in favour of our proposals, there is concern that the changes will increase the administrative burden and costs both on firms (such as credit unions) – although these are not quantified – and on our own resources. Our focus on individuals' experience and qualifications could increase the conformity and homogeneity of those at the top of the UK financial services industry, with the risk that levels of challenge and alternative points of view are reduced. There is also a view that requiring separate approval for particular roles on the governing body could undermine its unitary nature, which is fundamental to UK corporate governance structures.

5 Senior Management Arrangements, Systems & Controls sourcebook (SYSC), Statements of Principle and Code of Practice for Approved Persons (APER), The Fit and Proper test for Approved Persons (FIT) and Principles for Business (PRIN).

- 2.8 All respondents, whether or not in favour of our proposals, have requested greater clarity and detail about the roles and responsibilities specific to each of the new significant influence controlled functions and how the approvals process for these roles will operate. Respondents asked us to allow firms to tailor arrangements to their particular circumstances, by presenting the guidance as a menu of potential responsibilities, with the understanding that they may not apply in every case.
- 2.9 We argued in our CP that our proposal to split the CF28 function into three new, distinct functions (finance, risk and internal audit – CFs 13, 14 and 15 respectively) will give us a greater understanding of the governance structure within larger firms. It was suggested that we should already have a good understanding of a firm’s governance structure and, as a possible alternative to our proposal, changes in governance structures could become subject to an explicit notification obligation under SUP 15.
- 2.10 Respondents’ specific queries on our proposals fall into the following areas:
- Whether or not firms are obliged to appoint individuals to the new roles (CF00, CF2a-e, CFs 13-15).
 - How the CF2a-e roles interrelate to the CF2 NED role and whether they apply only to a NED holding the chairmanship of a committee.
 - Whether firms will be able to appoint Senior Independent Directors (SIDs) under transitional arrangements or whether this CF will be subject to separate approval.
 - That we should clarify whether we expect there to be only one individual approved for each of the CF 13, 14 and 15 roles.
 - How our proposals (including for CF00) impact on complex, shareholder-owned organisations, such as multinational banks and insurers, and on other forms of entity (i.e. Limited Liability Partnerships, partnerships and mutuals) and unusual group structures.
 - Whether the new CFs may be held by executive directors rather than by NEDs, whether, e.g. in smaller firms, a single person may hold more than one CF role and that the proposed granularity of roles should not preclude executive directors from performing the roles of chairperson of the risk/audit/remuneration committees where that is deemed appropriate in the circumstances of the firm.
 - Where a committee operates on behalf of a group of regulated firms, will the chairman be required to hold a CF for each regulated firm within the group or just the (regulated) parent entity itself?

Internal audit function

- 2.11 In welcoming the internal audit function (CF15), respondents emphasised the importance that internal audit plays in ensuring the effective governance of organisations and the need to ensure the organisational independence of internal audit to achieve this objective. To this end, we have been asked to prohibit the person responsible for internal audit from also being responsible for another governing function. We have been asked also to emphasise and include in our rules the key role of the modern, internal audit function: that of reporting on the effectiveness of the systems of internal control.

Our response: In developing our proposals, we have been careful not to adopt a 'one size fits all' approach. The nature, scale and complexity of firms vary considerably and each firm will want to have in place effective governance structures commensurate with these criteria. It is important both for us and for firms that we have the opportunity to assess individuals seeking to be appointed to these roles at the gateway. We believe it is preferable for all parties to be certain that the individual appointed to a SIF role is approved for the specific role before they take it up. It would be far more disruptive to all parties if an individual, once appointed to a SIF role, were subsequently found to lack the necessary skills.

We do not agree that requiring separate approval for particular roles on the governing body could undermine the unitary nature of the board, although it should be noted that, while not typical in the UK, company law does not exclude a two-tier (or dual) governance structure, if a firm deems such a structure to be the most suitable for its needs. The key issue is the comparative effectiveness of the governing body, regardless of whether it is unitary or two-tier.

Regarding the more granular regime allowing us to develop a greater understanding of larger firms' governance structures, supervisors do already have a detailed knowledge of the individual firms for which they are responsible. Our proposals will, however, enable us to take a broader view across firms of their respective governance structures, including tracking and assessing those individuals who move between roles within firms, including where the new role requires a different set of skills and competencies from the individual's previous one – for example, the skills and competencies required of a marketing director are very different to those of a chief risk officer. We will also acquire more consistent data from which to produce more detailed management information to better inform our future policy development.

Administrative burdens

We note the concerns that have been expressed regarding the potential administrative burdens, particularly on smaller firms, in complying with the new arrangements and introducing, where they do not already exist, new CFs. It is important to stress that the decision about whether or not a firm should create these roles will depend in some cases on the firm's nature, scale and complexity – for example, a credit union will not require a SID (CF2b). As such, we envisage that firms needing to appoint any or all of the proposed new roles, will do so proportionately, taking account of their specific circumstances and in consultation with their supervisor.

Multiple holders of the systems and control functions (CFs 13-15)

Our rules do not prevent several individuals holding the CF28 controlled function and we do not expect the division of this CF into the three, new functions (finance, risk and internal audit) to lead to a reduction in current numbers authorised to fulfil the CF28 function. If someone is currently a CF28, we expect them to move to one of the new functions (CFs 13-15).

We would expect at least the most senior person filling the CFs13, 14 and 15 positions to be approved for these roles, to avoid a situation where multiple people perform the function and it is unclear who takes responsibility if something goes wrong. However, depending on the particular circumstances of the firm, it may be that more than one person is exercising a significant influence and so should also be appointed to a particular role. There may, for example, be instances where more than one role may fall within a particular controlled function, such as where the risk function covers both market risk and operational risk.

Applicability of the new CFs

Our proposals will apply to all types of firm – corporate entities, partnerships and mutuals – to the extent that it is appropriate to their respective governance structures and nature, scale and complexity. The impact of the proposed ‘Parent entity’ SIF controlled function (CF00) is discussed in our response to Questions 6 and 7.

The FAQs on ‘Parent entity’ SIFs (see Questions 6 and 7) cover those instances where a committee operates on behalf of a group of regulated firms.

Some NEDs, especially those who are newly appointed to a governing body, will not be required to chair a committee and so will carry out only the typical duties of a NED (the CF2 role), as already described in our Handbook (e.g. SUP 10.6.8 R). Only those individuals appointed by their firms to chair the governing body itself or some of its committees or to assume the role of SID, will be required to be approved as CFs 2a-e. As noted in CP10/3, any individual already holding these posts, including that of the SID, will be covered by the transitional notification arrangements.

While we would not preclude executive directors from performing the roles of chairperson of the risk/audit/remuneration committees, where that is deemed appropriate in the circumstances of the firm, we would expect this to be in exceptional circumstances only and for these functions typically to be filled by a NED.

Internal audit function (CF15)

We agree that this function is a key element in ensuring the effective governance of a firm and, to facilitate this, it is helpful to ensure that the person performing it is independent in the organisation from the functions on which they give assurance. To this end, we are adding further guidance to SUP 10 to make it clear that we expect the person responsible for CF15 not to be responsible for another governing function. This is consistent with the provisions in SYSC 3 and 6 to the effect that, where a firm has to have a designated internal audit unit, it is separate and independent from the firm’s other functions and activities.

Many firms already have in place a wholly independent internal audit structure that allows for the individual(s) holding the internal audit role not to be responsible for other functions. However, we regulate some 14,500 small firms, many of which may have no alternative, due to their scale, to have individuals responsible for both the internal

audit and other roles. So we intend, for reasons of proportionality, to limit the scope of the application of the new guidance in SUP to those firms we assess to have an impact score of 'low to medium' or higher (those firms that are uncertain of their impact score are advised to contact our supervisors). Further details are provided in the cost-benefit analysis in Annex 1.

We asked:

Q2: Are there any other key roles we should be identifying?

2.12 Nearly all respondents to this question consider our proposals to be sufficient to capture within the approved person regime all the key roles in firms that exert significant influence at either the governance or systems and controls level. They also consider that any further additions are likely to increase the administrative burden on firms.

2.13 We have, however, received suggestions to create the following roles as controlled functions:

- Chairman of the Nominations Committee.
- An anti-fraud/anti-money laundering function.
- Operational processes and IT systems.
- Limited Liability Partnerships (LLP) members – to resolve any potential confusion created by members of a 'body corporate' being regarded as CF4s (partners).
- To create another sub-function of CF2 – a CF2f – to capture 'with-profits' committee members as provided for in SUP10.6.8R(2). These individuals are not board members of a firm and as such are not actual NEDs of the firm. However, it is argued that their separate inclusion within the framework with a specific CF for them would support our aims and provide greater clarity on their exact role within a firm.
- To create a new, formal NED role accountable for 'oversight, assurance and ethics', with a significant time commitment (two to three days a week). The 'oversight assurance and ethics' NED would be tasked with helping to resolve time commitment issues for other NEDs, who could rely on the new NED to filter out what is and what is not important for them to consider, especially in the context of the speed and complexity with which events in the financial services sector materialise.
- To create CF00 a-e (as proposed for CF2), as a means of identifying whether an approved person's responsibilities apply to parent, the subsidiary or both.
- To re-expand the CF30 definition, to make compliance with the requirements of the Retail Distribution Review (RDR) easier to track for firms, the FSA and consumers.

Our response: We welcome the suggestions that have been put forward by respondents for possible new roles to be brought within the scope of the SIF controlled function regime, some of which (e.g. Chairman of the Nominations Committee) we think merit consideration. Our position, however, is not to propose any further, new SIF controlled functions for the present. It is important to allow sufficient time for the changes that were announced in CP10/3 to become established. If we were to proceed with any proposal to introduce further roles to the regime, we would undertake a consultation exercise to ascertain the views of interested parties.

Of the suggestions that have been made by respondents, we are of the view that many are already captured within the existing SIF regime. For example, the anti-fraud/anti-money laundering function is already captured within the existing CF11 (money laundering reporting), as described in our Handbook at SUP 10.7.13 R and SYSC 3.2.6I R. Regarding preventing and, where it occurs, identifying fraud (and financial crime generally), this is already sufficiently captured in our existing rules, e.g. SYSC 6.3 and responsibility for 'Operational Processes and IT systems' is sufficiently well captured in our rules for managing operational risk (SYSC 7). We believe therefore that there is no need to create new controlled functions for these roles.

We see no need to create a controlled function for members of a Limited Liability Partnership, having received no indication from firms generally that there is a lack of clarity surrounding the CF4 role. SUP 10.6.21 R states: 'If a firm is a Limited Liability Partnership, the partner function extends to the firm as if the firm were a partnership and a member of the firm were a partner'.

We have noted the suggestion to create a new controlled function, responsible for 'oversight, assurance and ethics' and will look at this further in the context of work we are doing on culture in firms.

We cover the relationship between the 'Parent entity' SIF (CF00) and the granular CF 2 (a-e) later in this PS (see response to Questions 6 and 7).

We have no current plans to re-expand CF30. However, as set out in our PS on the Mortgage Market Review (PS10/9), we are extending the regime by creating a new controlled function, CF31 (home finance business), so that it will apply to those individuals advising on, arranging or entering into home finance business.

We asked:

Q3: Do you agree that we should separately approve all candidates for a systems and controls function, even if they have, or are seeking, approval to perform a governing function?

2.14 Over three-quarters of respondents to this question agree that we should approve all candidates separately for a systems and controls function, even for those individuals that have, or are seeking approval to perform a governing function. It was suggested that the approvals process for such individuals is run on a unified basis, to ensure that the candidate's overall suitability can be assessed quickly to avoid any delays in appointing approved persons to their new roles.

- 2.15 Those not in favour of our proposal argued that, where the candidate is applying to perform a governing function or is already approved for a governing function, it is not clear what value we will be delivering by separately approving all candidates for the systems and control function, especially for positions such as finance director, where the governing function and the systems and control function are not easily separable.
- 2.16 It has also been noted that some firms that are part of larger groups might not have individuals carrying out one or more of the new systems and controls functions within a CF28 approval. We have been asked to clarify whether such firms are required to appoint individuals to these roles or whether they can rely on functions being carried out within the parent company.
- 2.17 Regarding the specific competencies required of the internal audit function (CF15), it has been noted that it is important to recognise explicitly that these competencies are related to knowledge and technical skills, as well as to behavioural traits, such as objectivity and the skills to provide rigorous challenge.

Our response: We welcome the significant level of support that we have received to this proposal and confirm that it is our intention to assess, where necessary, an individual's overall suitability to fulfil both a governing and systems and control function as a single process.

The finance director is an important position, requiring specific skills and competencies, which (along with the internal audit and risk functions) the generic CF28 role fails to capture adequately. The finance director would normally be approved either as a CF1 or CF28 depending on whether the individual concerned was a director on the governing body. The creation of an explicit finance (and internal audit and risk) function remedies this. Even where an individual has already been approved for a governing function, this may not necessarily mean that they have the requisite skill, experience, competencies and capabilities to hold a CF13 – for example, especially where they may be moving from an unrelated role, such as a CF1 marketing director.

CP10/3 (Chapter 2) explained our reasons for introducing a more granular structure to capture the specific key roles within firms' governance structures. It is important that firms have the correct people, with the right skills, to fill these positions (and who are accountable for them) and we would expect firms to ensure that the most senior individuals carrying out these roles are approved by us to carry them out.

Our cost-benefit analysis in CP10/3 recognises that there will be costs incurred both by firms and by us in implementing the more granular regime for CFs 13-15. However, the regime allows us to hold individuals accountable for carrying out their responsibilities. To the extent that our fit and proper assessment is effective in screening out 'unsuitable' candidates and yield better or more suitable candidates, this could assist prudent and sensible management.

Where firms do not have individuals carrying out one or more of the new systems and controls controlled functions, they should consult their supervisors, who will advise on whether or not such roles are necessary to facilitate good governance and the effective running of the firm. The appointment of individuals to CFs 13-15 is not mandatory and will depend on each firm's nature, scale and complexity.

Internal audit function (CF15): competencies

We acknowledge the role of today's internal audit function as a key line of defence for the firm. We are amending SUP 10.8.3 R to include a requirement that the internal audit function reports on the effectiveness of the firm's systems of internal control.

Outsourcing

- 2.18 We have been asked to clarify whether it is permissible to outsource certain controlled functions to a third-party service provider and whether the creation of CFs 13-15 to replace CF28 will mean that individuals filling these roles have to be employees of the organisation, which may be unrealistic for small firms.

Our response: We confirm that our proposals do not prevent a firm from outsourcing the work involved relating to certain control functions to a suitable third-party service provider. We would expect such an arrangement to comply with the outsourcing provisions in Chapter 8 of our Senior Management Arrangements, Systems and Controls sourcebook (SYSC) (or, for insurers, managing agents and the Society of Lloyd's, SYSC 3.2.4 and 13.9), in particular, that the outsourcing does not result in the delegation of senior management responsibility. In line with this, CFs 13-15 can only be allocated to a person or persons at a firm. A third-party service provider may be used to help a firm fulfil a particular task or activity but cannot be in a position of significant influence – that can only be a person at a firm or in its parent. For example, if a firm's internal audit function has been outsourced, the person carrying out the internal audit function (CF15) would normally be the person responsible for that function to the governing body or in larger firms to the audit committee.

We asked:

Q4: Do you agree that we should automatically grant the new controlled functions to individuals already performing the relevant role within their existing approvals?

- 2.19 There is near unanimity among respondents to this question in support of our proposed transitional arrangements for those individuals already performing the new CFs within the scope of their existing approval as a governing function or CF28. They also agreed that requiring all current holders of new CF roles to go through the approvals process would be excessively burdensome.
- 2.20 However, there is concern that our proposal to provide automatic approval for the new CFs to individuals already performing the relevant role will mean that individuals may be able to continue performing crucial approved person functions without having the necessary competence. There is also concern that, as these individuals would be subject to 'normal' ongoing supervision requirements after being granted the new CF status, it would be a firm's supervisor that would effectively determine the suitability of the individuals performing these new roles, without the involvement of qualified senior individuals. As such, the risk is that this will not deliver a consistent approach across the industry.

- 2.21 We have been asked to consider establishing a rolling programme of approvals for individuals already performing the relevant roles within their existing approvals (if necessary, following the provisional granting of such functions under the new rules). As a minimum, we should retain the discretion to require existing incumbents to undergo the new approval process in cases where they have specific concerns about a firm's governance.

Our response: It remains the responsibility of the firm to undertake its own due diligence checks to be certain that any individual(s) assigned to controlled functions have the necessary competencies and capabilities to carry them out effectively.

Once an individual has been approved to carry out a controlled function, it is incumbent both on the firm and the individual to ensure that they continue to possess the competence and capabilities to fulfil the role with 'due skill' (APER Statement of Principle 2). Our regular ARROW supervisory visits to firms will seek to ensure that this is the case, supported by our new SIF regime that assesses and approves those individuals seeking to move between SIF roles.

We have been asked to require existing incumbents of SIF roles to undergo the new approval process in cases where they have specific concerns about a firm's governance. This is something that we would not rule out, once the notification procedure under the transitional arrangements for telling us which of a firm's current approved persons are performing any of the new roles has elapsed and where we have doubts about whether the individual who is moving from their current to a new SIF role continues to meet the requirements in FIT and APER. However, for the current transitional arrangements for these changes, the benefits of such an approach – where there are no other underlying causes for concern – do not justify the costs, except in instances described in Question 3.

Applying the new SIF functions to Appointed Representatives

CP10/3 did not explicitly address the question of the application of our proposed new CFs to appointed representatives (ARs). Currently, only limited controlled functions apply to ARs – the governing functions and the customer function. This is because ARs are generally smaller, less complex businesses and because regulatory responsibility ultimately rests with the authorised principal.

Our draft rules would apply the new SIF CFs to ARs, because the new CFs are classed as governing functions. However, our Handbook does not distinguish between controlled functions performed by an AR, while our Register does. This, we believe, may cause confusion and operational difficulties for firms. We propose, therefore, that the new SIFs should **not** apply to ARs when they are introduced in 2011 and we have given effect to this through an amendment to SUP 10.

We asked:

Q5: Do you agree that a phased approach of between three and 12 months is sufficient for the notification process and that the Remuneration Code provides an appropriate basis for this phasing?

2.22 We received over 50 responses to this question, the overwhelming majority of which agrees that a phased implementation of between three and 12 months is sufficient for the notification process. A few others asked us to consider allowing firms, regardless of size, at least six months (not three) or between six and 18 months for transition, although no substantive evidence was provided in support of this argument.

Our response: We are satisfied that the transitional period for firms is sufficient.

Significant influence functions – other proposals

Parent entity SIFs (CF00)

We asked:

Q6: Do you agree that we should extend the proposed CF00 (parent entity SIF) regime to apply irrespective of the corporate status of the UK subsidiary?

Q7: Do you agree that we should extend the proposed CF00 (parent entity SIF) regime to apply to regulated firms whose parent entity is also FSA-authorised?

2.23 We received 45 substantive responses to Question 6, of which nearly all agree that the corporate status of the UK-regulated firm is irrelevant when considering whether the persons exercising influence over the entity should be approved. A lesser proportion, but still well over half, agrees with our proposal (Question 7) to extend the proposed CF00 regime to regulated firms whose parent entity is also FSA-authorised. Both questions on the proposed parent entity SIF have, however, prompted considerable comment, in particular seeking clarification for the CF00's detailed implementation and applicability.

2.24 Those not in favour of the proposed 'Parent entity' SIF controlled function do not believe it is necessary or that sufficient explanation has been given that the CF00 regime should extend to regulated firms whose parent entity or holding entity is also FSA-authorised. Some considered the proposal to be too wide-ranging and may place too great a responsibility on the senior management of global firms for their UK subsidiaries. We have been asked therefore, regarding CF00 and for the purpose of clarity, to explain what is meant by exercising 'significant influence', to clarify the boundaries of CF00 responsibilities, particularly in the overseas context.

- 2.25 One respondent asserted that applying the new CF00 and CF2a-e functions is likely to be inconsistent and will be particularly challenging where regulated firms are part of group structures, including groups with an unregulated public holding company. The regulated subsidiary company or companies may not have these specific roles and there is concern that the result will be inconsistent application of the proposals.
- 2.26 Further general guidance is requested on how individuals who hold CFs 00 and 2a-e in relation to a firm of which they are not directors are supposed to comply with APER 5-7, because, as they are not directors, there is no part of the firm's business for which they are actually responsible.
- 2.27 One respondent has observed that the new CF00 requirements appear to require each member of the group management committee for each of the regulated subsidiaries to be registered, adding to the complexity of the registration regime and creating an unnecessary complication. The individual should not need to be approved as a CF00 and a CF1, as this would be duplication.
- 2.28 We have been asked to provide guidance on those individuals within a group holding company who, by virtue of the global remit of their senior management role, or because they hold a specific governance role within the board of a group holding company, are required to be SIFs for a UK-regulated subsidiary. And we have been asked to explain how the CF00 regime will be enforced for international firms operating in the UK – in particular, to reflect flexibility for the different types of CF00 responsibilities.
- 2.29 More generally, we have been asked to clarify why we have proposed the removal of the exclusion for FSA-authorized firms when extending the 'Parent entity' SIF (CF00) role and whether the CF00 should be held at the parent or the subsidiary.
- 2.30 There is concern that the 'Parent entity' SIF regime creates an apparent overlap with the 'Controllers' regime. There is also concern about the issue of competing (and potentially conflicting) duties and responsibilities and where a CF00 may hold an approved person role for the parent firm, where that parent firm is regulated. Such persons will have two sets of regulatory duties (for the parent and subsidiary respectively), which may not always be entirely aligned. We have been asked how any conflict of duties and/or interests are to be managed and resolved – particularly regarding enforcement powers, such as which duties are to take precedence over others.

Our response: Our proposal to create the 'Parent entity' SIF (CF00) has prompted considerable comment, in particular regarding clarification about the CF00's detailed implementation and applicability. Many of these comments actually apply to the rules on 'Parent entity' SIFs that were made in our Policy Statement (PS09/14), published in July 2009. We propose to answer these points (paragraphs 2.23-2.30) by means of Frequently Asked Questions (FAQs), which will be inserted as guidance into the Handbook in APER and SUP 10.

We acknowledge that firms, especially complex ones with a matrix structure, will want to consider carefully how to apply the guidance that is contained within the FAQs and that some may still be uncertain as to their impact. Firms will have seven months from the publication

of this PS until our rules and guidance come into force (on 1 May 2011) to consider these issues. In the meantime, we invite such firms to contact us, should they need assistance in resolving which individuals should come within the CF00 regime and which should not. Our proposal to remove the exclusion for FSA-authorized firms when extending CF00, was explained in paragraph 3.6 of CP10/3.

Controllers and close links regime

Regarding the interaction between CF00 and the controllers and close links regime, FSMA requires individuals or corporate bodies wishing to acquire or increase control in a UK-authorized firm, to seek approval from the FSA. In most groups, where a person is performing CF00, it is unlikely that the person will also fall within the controller definition. The change in control process and approved persons process are distinct from one another. The suitability of an individual to become a controller will quite likely be different to the suitability of a person to perform a function under the approved person regime, in as far as skill, qualifications and training are concerned. For example, an individual's competence will be assessed in the latter, but may not necessarily be as relevant in the former. There are, however, some similarities – such as considering the reputation of the individual and their financial soundness.

This is a similar situation with our 'close links' regime, the primary focus of which is to ensure that firms are not used for the purposes of financial crime. So suitability of close links is assessed under COND (TC3), not FIT.

Conflicts of interest

Effective management of conflicts of interests is at the heart of maintaining fair, orderly and efficient financial markets. Individuals may find themselves with conflicting roles and responsibilities. For example, an individual may be an approved person for both the group holding company and a subsidiary, the respective interests of which are not necessarily aligned. As a result, the individual may find themselves in situations where they are conflicted in carrying out the responsibilities of both roles.

Firms and individuals acting in a dual capacity should be aware of and implement their regulatory duties to identify and manage conflicts of interest as provided for in SYSC 10 of the Handbook. In particular, when dealing with conflicts of interests arising out of the structure and business activities of other members of a group, we would draw their attention to the guidance in SYSC 10.1.9, SYSC 10.1.10R (2) and SYSC 10.1.11.

The changes set out in PS09/14 were designed to clarify that we are interested in the operational fact and nature of any influence that an individual exerts from the parent entity. So if there are conflicts in an individual's role, we consider that this would be a result of their governance arrangements and apportionment of responsibilities and not as a direct result of the approved person regime. There may be situations where a person is required to be approved as a parent SIF and separately approved for another role they carry out on behalf an authorised subsidiary firm. As with any approved person role, we expect a firm to have clear documentation of an individual's role and responsibilities. Firms should also have clear and appropriate apportionment and oversight of responsibilities (SYSC 2.1.1 R; 2.1.3 R and 4.4.3 R). Any frequently occurring irreconcilable conflict between an individual's dual roles would be likely to require modifications to a firm's governance structure.

We asked:

Q8: Do you agree that these transitional periods are sufficient?

- 2.31 There is a commonly held view among the 43 substantive comments received to this question that supports a longer transitional period for implementing the arrangements for CF00 for currently approved persons and for new approvals: a minimum six to nine (not three to six) month transition period for firms to identify those in a parent firm requiring approval to perform a SIF in a subsidiary; and 12 months for identifying such individuals in large and complex groups. However, as with the responses received to Question 5, no substantive evidence was provided in support of extending the transitional period.

Our response: We are satisfied that a transitional period for firms of three to six months is sufficient, even for large and complex groups, given the lead time from the publication of this Policy Statement and rules and guidance and their coming into force from 1 May 2011.

Extending controlled function 29 (CF29)

We asked:

Q9: Do you agree that it is appropriate for us to extend CF29 to UK branches of incoming EEA banks accepting retail deposits?

- 2.32 No respondents to this question oppose our proposal to extend CF29 to UK branches of European Economic Area (EEA) banks. Several did, however, make certain, general observations.
- 2.33 Respondents asked whether the existing scope of application of CF29 to branches of EEA banks is sufficiently clear and that further guidance would offer greater clarity on our expectations regarding branches of EEA banks, as well as the differences in the application of rules to branches and subsidiaries in general (whether EEA or non-EEA banks).
- 2.34 One respondent expressed concern that the extension of CF29 to UK branches of incoming EEA banks accepting retail deposits does not accord with the spirit of MiFID home/host split. There was also concern that the proposed extension could, in practice, set an unwelcome precedent and risk a ‘tit-for-tat’ approach in other areas of business. Another respondent said that it is not clear that the proposal is consistent with the functions of a host state regulator under the Banking Consolidation Directive (BCD).
- 2.35 We have been alerted to an apparent inconsistency between a reference in paragraph 3.16 of the CP to ‘an individual’, suggesting that one person should be approved as a CF29 and elsewhere in CP10/3 suggesting that a number of individuals could be authorised for CF29. The respondent is concerned that there will often be several UK-based senior managers and there could potentially be several individuals at the head office or within the parent company with some

responsibilities for the UK branch. We have been asked whether it would be more effective if the proposal was that the firm may select just one representative to assume the CF29 role (either the most senior manager in the UK or the overseas-based individual with line management for the UK branch).

Our response: On the basis of the responses received, we intend to implement our proposal to extend CF29 to UK branches of incoming EEA banks accepting retail deposits. As a general principle, the scope of any CF is defined by the activity rather than to the institution in which it is undertaken. The existing scope of the application of CF29 to branches of EEA banks is set out clearly in our Handbook (SYSC 10.1).

Consistency with MiFID and the Banking Consolidation Directive (BCD)

We believe that our proposals are consistent with our obligations under MiFID and the Banking Consolidation Directive. We already apply CF29 to UK branches in relation to designated investment business. The extension of CF29 to branches of incoming EEA firms accepting deposits is consistent with this approach, taking into account our regulation of retail banking conduct of business, which applies to EEA firms conducting business in the UK. We also recognise that whether the CF29 will apply to an individual in a branch of an incoming EEA firm accepting deposits will depend on the allocation of responsibilities. Given that our approach has not been contested, either in the past or in response to CP10/3, we do not believe our proposals give rise to a risk of adverse measures by other EEA member states.

Multiple holders of the significant management function (CF29)

We do not want to limit unnecessarily the application of CF29 to one person only – a firm may have as many CF29s as it requires, consistent with its internal structure. There may also be circumstances where firms must have more than one individual in a CF29 role – for example, if there is more than one person within the branch who meets the definition of head of a significant business unit. This may depend on the size and activities of the branch, and it is of course open to firms to structure themselves and allocate responsibilities in various ways. As such, we would expect the application of CF29 to be considered on a firm-by-firm basis. However, we would expect individuals holding a CF29 designation to be of sufficient seniority within the firm and the degree of influence exerted to be significant. If firms are unsure if certain individuals should be approved for CF29, we would expect close liaison with our supervisors.

Compromise agreements

We asked:

Q10: Do you agree that our proposed guidance on ‘compromise agreements’ is useful in clarifying the current position?

- 2.36 Of the 46 responses received to this question, only one was not in favour of our proposal to clarify our position in respect of ‘compromise agreements’, arguing that both parties to the compromise agreement need to have a formal safe harbour that protects their respective positions in dealing with the FSA.
- 2.37 However, a number of respondents in favour of our proposal have sought clarification on certain issues relating to this matter.
- 2.38 One respondent asserts that, as failure to complete correctly the approved person application form would constitute a rule breach and, with the incumbent enforcement powers available to the FSA, it is unhelpful to include reference to s.398 of FSMA (which states that ‘A person who, in purported compliance with any requirement imposed by or under this Act, knowingly or recklessly gives the Authority information which is false or misleading in a material particular is guilty of an offence’).
- 2.39 It is suggested that our guidance on ‘compromise agreements’ should be split between existing contracts and future ‘agreements’ that firms may wish to make, since the guidance outlined in CP10/3 seems to encourage firms to breach existing contracts entered into in good faith.
- 2.40 We have been asked to confirm that we will not take retrospective action in relation to ‘compromise agreements’ and to provide further clarification confirming that the guidance applies to all compromise agreements settled after an appropriate transitional period of ‘date certain’. This, it is suggested, will assist firms and individuals contemplating settlement to adapt their stance in pending and new cases accordingly, in full knowledge of their obligations on both sides.
- 2.41 We have been advised to include within our guidance the compromise agreements known as ‘Tribunal claims’, which are settled under legally binding Advisory, Conciliation and Arbitration Service (ACAS) contracts (COT3) between the parties to settle actual or potential complaints to the Employment Tribunal.
- 2.42 We have been asked to clarify whether our position on compromise agreements applies to disclosure to other firms, as well as to the FSA. It would generally be helpful if more information about potential candidates and their history were available to firms during the recruitment process, especially for individuals who have been the subject of qualified withdrawal.
- 2.43 It was suggested that the reference to rule SUP 10.13.7 R seems to be incorrect and that it should in fact refer to SUP 10.13.6 R.

Our response: With respect to the need for both parties to a compromise agreement to have a formal safe harbour that protects their respective positions in dealing with the FSA, the position is clearly set out in paragraph 3.22 of CP10/3, that ‘the requirements of our principles and rules override any duty of confidentiality entered into between a firm and its employee’. This reaffirms our existing position regarding the duty to disclose. We do not agree that it is unhelpful to include reference to s.398 of FSMA in our proposed guidance at SUP 10.13.7A G. This reference is included specifically to emphasise its consistency with our clearly stated position on the requirement for full disclosure to us of

all relevant information and the potential consequences to firms and individuals of failing to comply with the provisions of this section of FSMA.

Compromise and 'COT3' agreements

'COT3' agreements made through and registered with ACAS are a well-established device to enforce tribunal settlements. We agree that adding a reference to 'COT3' agreements will make our guidance more reflective of common practice in employment law, so we have included reference to such agreements in SUP 10.13.7A G.

Our position on whether compromise agreements apply to disclosure to other firms, as well as to the FSA, was set out in Policy Statement, PS09/14. We aimed to avoid prescription on the format and nature of the information that we expect to be provided in references. It is not a mandatory requirement for firms to request references (although we would expect this to form part of a firm's due diligence). However, where they are requested, SUP 10.13.12 R requires the firm receiving the request to disclose all relevant information. This applies regardless of when the agreement was entered into. To clarify this position, we propose amending SUP10.13.7AG to say that, not only does the rule about giving information to the FSA take precedence, so too, does the duty to give information to another firm. We also make it clear that s.398 of FSMA is relevant to both SUP 10.13.6 as well as to SUP 10.13.7.

Non-executive directors (NEDs)

We asked:

Q11: Do you agree with our proposed guidance on the time commitment required for chairmen and NEDs?

- 2.44 We received 55 responses to this question – nearly all agreed with our proposal to provide guidance for NEDs' and chairmen's time commitment to their role. The few respondents opposed to the guidance argued that it is almost universally accepted that the value of a NED should be judged by their contribution rather than by an arbitrary number of days. Also, it is the firms and each of their NEDs that are best placed to determine time commitment, so it is inappropriate for us to 'second guess' arrangements between two sophisticated parties.
- 2.45 Many of those in favour of our proposal have suggested what this guidance might usefully cover, including:
- An emphasis that NEDs' responsibilities are, essentially, a full-time commitment. For NEDs even to discharge their basic responsibilities – and to achieve quality of outcome – requires at least three days per month. As such, it is felt that our commitment to 'have regard' to the extent to which a NED is capable of devoting an adequate level of time to the firm is too vague.
 - The need for us to take into account differing business models in the UK and to avoid 30-36 days becoming the yardstick for all financial institutions. While this may be appropriate for certain entities, it may not be for others (e.g. small/ lower-risk firms).

- An explanation about our thinking in support of the suggested minimum time commitment.

Our response: We acknowledge that a NED's time commitment may vary, depending on the needs of the applicant firm and the candidate's actual responsibilities. However, as we made clear in CP10/3 (Chapter 4), we will consider the candidate's existing commitments when assessing their suitability for the role in question.

We consider issues relating to NEDs' responsibilities and liabilities in our response to Question 12, below.

The responsibilities and liabilities of NEDs

We asked:

Q12: Do you agree that we should delete the guidance in SYSC 2 and 4 on NEDs' responsibilities?

- 2.46 Our proposal to delete the guidance in SYSC 2.1.2G and 4.4.4G has prompted the only instance of significant opposition to the range of proposals that were set out in CP10/3, albeit that the number of respondents not in favour of this proposal represents only just over half of the 54 substantive replies that we received to this question.
- 2.47 Several respondents are concerned at the subjective nature of our intention to look closely at NEDs' performance, especially where it appears to us that they may have persistently made poor decisions or have failed to act in a timely and sufficient (i.e. in respect of the responsibilities of their role) way. We have been asked to make clear how we will judge whether executives have 'persistently made poor decisions'. What criteria or evidence will be used to assess executive decision making and what the criteria will be for judging NEDs' performance in this area?
- 2.48 Respondents argue that removing the guidance in SYSC 2 and SYSC 4 could be construed as signalling a change in our approach to NEDs, especially for their potential liability (including, possibly, even for actions that fall outside their statutory general duties), which is likely to create a disincentive to individuals to apply for such roles.
- 2.49 Rather than removing the guidance altogether, respondents strongly urge us to retain it and, where necessary, amend it to reflect the fact that, although in law the duties of directors do not distinguish between executive directors and NEDs, the approved person regime does in terms of CF1 and CF2 designations. It is therefore appropriate to provide guidance about the different expectations between CF1 and CF2 (including the implications for those NEDs in an unregulated holding company and who would perform the new 'Parent entity' SIF (CF00) controlled function) and to recognise that the obligation of a NED is to challenge, but not to execute.
- 2.50 We have been asked that any guidance that we do provide in relation to the scope of NEDs' obligations should complement and be consistent with the existing company law regime within which NEDs operate.

- 2.51 More generally, there is concern that increasing the NEDs' role (e.g. by requiring them to chair a number of committees) could lead to a NED being more involved in the operation/executive management of the firm, which could erode or be seen to erode their independence.
- 2.52 Many respondents are concerned at the extent to which our more intrusive vetting process and required time commitment may deter able candidates from taking up senior roles in regulated firms. Equally, it is advanced that, if we do not clarify our regulatory expectations of NEDs, the supply of quality individuals to fill these roles for all types of financial institution will be compromised.
- 2.53 We should assess the role of NEDs in 'Limited Activity'⁶ firms and the expectations of shareholders and how they might implement any action concerning the decisions and performance of firms, since it is not clear in the case of Interdealer Broker firms, where there exists no relationship with the public, how this could be assessed or work in practice.

Our response: We expect NEDs to take the initiative in challenging the governing body (and its committees) and in their interactions with the SID. We will identify poor decision-making by executives (and the persistency of such decisions) through our supervision process – with a focus on outcomes that increase the risks to our regulatory objectives. Where decisions are taken that could increase the risks to our regulatory objectives, we would expect to see that the board was advised on the issue by the board risk committee (where one exists), by the relevant senior manager or the through the SID on the basis of a pre-meeting with the NEDs. We would also expect the minutes of the board meeting at which the issue was discussed to show clear evidence of NEDs debating and challenging the issue. The outcome of these interactions should be that the executive directors and executives have a clear and fully debated mandate on which to act.

The responsibilities and liabilities of NEDs

We are satisfied that the Handbook (e.g. in APER Statements of Principle (APER 2.1) and FIT), as well as recent speeches by our chairman, chief executive and other senior executives (see our website) provide a sufficiently clear exposition of our expectations about NEDs' and other directors' roles and the crucial importance generally of effective governance mechanisms.

For clarification, the guidance in SYSC 2.1.2 G and in SYSC 4.4.4 G applied only to non-common platform firms; the guidance was intentionally not amended to make it applicable to common platform firms on the implementation of the Markets in Financial Instruments Directive (MiFID). As such, the guidance applied only to SYSC 2 firms (insurers and Lloyd's firms) and to firms covered by SYSC 4.4 (generally low-impact firms, e.g. professional firms and general insurance intermediaries).

NEDs' roles and responsibilities are limited to acting through the board. The position remains that, if they have adequately discharged their responsibilities, they will not be held liable for the failings of the firm or others within it. This is consistent with other parts of the Handbook, e.g. in APER 3.1.8 G, which states that 'The FSA will be of the opinion that an individual performing a significant influence function may have breached

⁶ A 'Limited Activity' firm is an entity as specified by Article 20(3) of the Capital Adequacy Directive (2006/49/EC), e.g. investment firms that deal on own account only for the purpose of fulfilling or executing a client order.

Statements of Principle 5 to 7 only if his conduct was below the standard which would be reasonable in all the circumstances’.

Our policy intention remains unchanged to that expressed in CP10/3 (paragraph 5.3): ‘To avoid any misinterpretation by firms of the existing guidance in SYSC 2 & 4 that we will not hold NEDs responsible for failing to challenge and to intervene. This is not the case’.

Given the limited application of this guidance, we felt that simply deleting it from the Handbook would be the more straightforward option. However, we note that many respondents have said that the guidance, albeit not directly relevant to NEDs in the types of firm specified above, is helpful in outlining generally the parameters of NEDs’ responsibilities and distinguishing between these and other roles. In view of these representations, we propose only a partial deletion of the Handbook guidance and to give it general applicability to all types of firm.

We are satisfied that our rules and guidance for NEDs are consistent with company law.

NEDs’ independence

We are not persuaded that increasing NEDs’ role could erode or be seen to erode their independence. It is unlikely and indeed would be inadvisable for an individual NED to chair more than one committee, and this would be picked up in the application process in terms of the individual’s capacity to devote sufficient time to fulfil these roles effectively. NEDs are not being asked to chair executive committees, but rather sub-committees of the governing body that reports to it. This is a legitimate duty of a NED. It makes board composition increasingly important to ensure that there is a competent group of people to determine strategy and then to populate the board sub-committees to monitor the implementation and the management of risk strategy.

Our supervisory approach towards NEDs

There is some anecdotal evidence to suggest that, due to our more intensive supervisory approach, a few individuals have been deterred from putting themselves forward as NEDs for banks and other financial institutions. We remain convinced, however, that the benefits of our more intensive vetting regime and our support generally of Sir David Walker’s recommendation about a NED’s time commitment outweigh the risk of reducing the pool of talent from which firms can draw NEDs.

‘Limited Activity’ firms

‘Limited Activity’ firms are as vulnerable potentially as other regulated firms to poor risk management, weak audit arrangements and a lack of robust challenge of the executive, especially in instances where there may be a dominant chief executive, or where power is concentrated within a small group of senior executives. We have also identified corporate governance frameworks (many of which are complex) within certain firms that are, in some cases, too informal, where board and committee meetings are infrequent and where there exists an inadequate reporting mechanism and poor quality management information to allow risks to be properly identified and assessed. Compliance functions within these firms have tended to be under-resourced and, so, have not been as effective as they should be. Our conclusion, therefore, is that ‘Limited Activity’ firms should be treated the same as any other regulated firm and captured fully within the SIF regime.

UK Corporate Governance Code

We asked:

Q13: Do you agree that we should amend our rules to reflect the introduction of the new Corporate Governance Code?

- 2.54 All who responded to this question agree that our rules should be amended to reflect the new UK Corporate Governance Code (the Code).
- 2.55 Respondents have made a general point that it is important that all the relevant codes, regulations and guidance should be consistent and that any duplication of requirements or the FSA implementing rules that differ even slightly from the Code may cause firms unnecessary confusion, uncertainty and increased cost.

Our response: The Financial Reporting Council (FRC) published a revised Combined Code – to be known in future as the UK Corporate Governance Code – on 28 May 2010. Our Handbook Notice 102 of 23 July 2010 included an Instrument amending our rules (in the Building Societies Regulatory Guide (BSOG) and other sections of our handbook) to refer to the updated Code, as well as a number of other consequential changes to our rules, including transitional provisions, to reflect the fact that the old version of the Code will continue to apply to accounting periods beginning before 29 June 2010. These changes came into force on 6 August 2010.

The Walker Review – effective risk management

We asked:

Q14: Do you agree with the content of our proposed guidance on board risk committees?

- 2.56 All but three of the 57 responses we received to this question agree that our proposed guidance will be helpful in reaffirming that it is a firm's governing body that is ultimately responsible for risk governance throughout the business and that it should be for each governing body to consider establishing a risk committee to provide focused support and advice on risk governance.
- 2.57 One respondent, while in favour of the proposal, is, still concerned that the proposed wording may be too permissive and may not fully reflect the intent of the recommendations made by Sir David Walker.
- 2.58 Those who are not in favour of our issuing guidance argue that it already exists and clearly says that firms themselves should consider the appropriateness of establishing a board risk committee. It is noted too that a requirement to establish a risk committee will add a regulatory burden for the smallest firms and we have been asked to consider an exemption based around fee bands, which might differentiate effectively between those firms where a separate approval is desirable or not.

- 2.59 Respondents, although in favour of our proposal, have asked us to provide greater clarity and information on a number of areas:
- Whether we intend to extend the scope of the guidance to create board risk committees beyond FTSE-listed banks and life insurers, since our reference in paragraph 6.25 of CP10/3 to ‘FTSE 100-listed bank and insurers’ appears to be out of line with Sir David’s recommendation (23) that ‘the board of a FTSE 100-listed bank or life insurance company should establish a board risk committee...’.
 - Whether it is necessary for all firms, regardless of nature, scale and complexity of firm (bearing in mind the issue of proportionality for ‘small’ firms in particular), to establish a risk committee and, if so, whether to appoint a NED as its chairman and a CF2d.
 - If a firm has no NEDs, but has a risk committee, how will we be expected to identify the committee’s chairman?
 - Even if a firm has an individual responsible for ‘risk’, whether that firm is still expected to establish a risk committee and appoint a chairman.
 - Whether the decision to have/not to have risk committee should be reviewed every 12 months as part of a business strategy review?
- 2.60 We have been asked to set out detailed guidance and standards about what effective risk management looks like and to define the ‘typical’ responsibilities of a risk committee, highlighting those that, for example, may be appropriate for a bank, but not an asset management firm. We are also encouraged to strengthen the guidance on the establishment of risk committees, to set out that any firm whose failure might have systemic consequences for the UK financial system generally should appoint a chief risk officer and risk committee (as proposed in SYSC 21.1.1 (3)).
- 2.61 Concern has been expressed that SYSC 21.1.1(G)(3) removes the element of ‘guidance’, which permits firms to adopt an approach that is appropriate to their business and dictates that they follow a particular approach. Additional advice is therefore sought to enable particularly international firms (recognising their differing governance structures) and smaller, but complex firms to apply our guidance flexibly.
- 2.62 Respondents argued that firms should have full discretion about whether to create risk committees or to continue with combined risk and audit committees. They said it is important to consider the role of the internal audit and the contribution it can make towards the effectiveness of risk committees.
- 2.63 Regarding the risk committee’s role, we have been asked to amend SYSC 21.1.5(1) and (2), to stipulate that the risk committee should be required to approve key risk policies, standards and guidance and that the FSA approves the terms of reference of such committees.
- 2.64 We are also asked to consider whether SYSC 21.1.5(2) (f) (to provide advice to the firm’s remuneration committee on risk weightings) might sit better with the chief risk officer rather than with the risk committee.

- 2.65 We have been asked to consider whether it would be advantageous to both firms and to the FSA, if we were to require a formal relationship between ourselves (an ‘appropriate individual’) and a firm’s chairman of its risk committee, with the chairman having a ‘formal personal obligation to the FSA under the terms of his/her approved person status, to report on risk management work and progress to the FSA on regular (at least quarterly) basis’.
- 2.66 One respondent has suggested that risk committees be comprised of a broader membership rather than NEDs only, since this may be more helpful to firms in bringing together a wider range and depth of expertise from across an organisation to develop the formal risk management framework and maintain buy-in to it. To achieve this, we are asked to consider replacing ‘predominantly non-executive’ in SYSC 21.1.5(3) with ‘include non-executive directors, senior executives and risk specialists’.
- 2.67 On the other hand, another respondent maintains that the risk committee should be chaired by a NED and that its composition should be independent. To facilitate this, we are asked to consider amending SYSC 21.1.5 (3) G to provide an explicit reference to the need to establish the independence of the chairman of the risk committee.

Our response: It is for each individual firm to determine, based on its nature, scale and complexity, as well as its attitude and exposure to risk, whether or not to establish a risk committee of the governing body. Where no risk committee has been established, we would expect the firm to keep this situation under regular review (e.g. as part of the firm’s business strategy review) and to create such a committee should circumstances change and/or, for relationship managed firms, on the advice of their supervisor. Moreover, even where no risk committee exists, the firm should consider appointing someone to be accountable for risk at the firm, with the governing body retaining responsibility for risk oversight.

There is no requirement on small firms to establish a board risk committee and, on the basis of proportionality (i.e. nature, scale and complexity), it is unlikely that credit unions, for example, would require one. There should, however, still be someone accountable for risk at the firm and the governing body will retain responsibility for risk oversight.

Responsibilities of the risk committee

The ‘typical’ responsibilities of a risk committee are already well defined in our Handbook at SYSC 21.1.5G. We are satisfied also that the Handbook outlines, to a sufficient degree, what our expectations are in terms of risk management. Firms requiring greater clarification may wish to explore the professional institutes (e.g. The Chartered Insurance Institute, The Association of Corporate Treasurers, etc.) providing training on risk management and support for their members.

Life and general insurers

Paragraphs 6.24 and 6.25 of CP10/3 set out our proposal to include guidance in SYSC 21.1.1G (3), 21.1.5 G & 21.1.6 G on the need for firms, in particular FTSE100-listed banks and insurers, to consider the value of establishing a risk committee. However, as one respondent to the CP noted, this proposal goes beyond the final scope of the recommendation (Rec. 23) made by Sir David Walker (in his review of corporate

governance in banks and other financial institutions) on risk governance, in which he identifies FTSE 100 life insurers rather than FTSE 100 insurers as needing to consider establishing a risk committee where one does not already exist.

We have considered this matter carefully. The establishment of a risk committee is not mandatory; the decision whether or not to establish such a committee is a matter for each individual firm, in consultation with their supervisor. We are aware that not all general insurers are of a similar nature, scale and complexity or have similar attitudes to risk. Also, a firm's exposure to risk may change over time, for instance as a result of implementing an alternative business strategy. And, for all insurers, the forthcoming implementation of the Solvency II Directive may act as a driver for firms to establish a risk committee. We propose to retain SYSC 21.1.1 G (3) as originally drafted in CP10/3.

Composition of the risk committee

Regarding whether to allow a risk committee to be non-executive or 'predominantly non-executive' for a body corporate, our position remains as expressed in SYSC 21.1.5 G (3): the majority of the committee's membership should be NEDs and the chairman should be a NED (i.e. independent of the executive). For other types of firm, e.g. a partnership or LLP, we envisage that, as stated in SYSC 2.1.6 G, most if not all partners or members will be either directors or senior managers (depending on the constitution of the partnership, particularly in the case of a limited partnership). Although in such structures there is no formal equivalent to a NED, we would expect the senior managers (or managing partners) to fulfil this role on risk committees, where they are established.

Relationship between the chairman of the risk committee and the FSA

We believe that APER Statement of Principle 4 satisfactorily captures the suggested requirement for a formal relationship to exist between the chairman of the risk committee and ourselves: 'An approved person must deal with the FSA and with other regulators in an open and cooperative way and must disclose appropriately any information of which the FSA would reasonably expect notice'. We will consider in the course of our work on culture, whether there is a need to amend Principle 4 in respect of chairmen.

Systemic risk

We welcome the suggestion to strengthen our guidance that firms whose failure might have systemic, adverse consequences for the UK financial system (in line with s.59 of FSMA) should establish a risk committee and appoint (see Q.14) a chief risk officer. However, our rules (SYSC 21.1.1) focus on what is appropriate for the firm rather than, more generally for the UK financial system. On balance, if a firm is managing its risks robustly and commensurate with its risk profile and complexity, then this should, all things being equal, prevent any wider and systemic risk exposure to other firms and to the UK.

Risk committees' terms of reference

We do not believe that it is necessary or appropriate for firms to submit to us for approval their risk committees' terms of reference; our expectation of the committee's role is described in SYSC 21.1.5 G (1) – (3). It is for the firm's governing body to decide: (a) whether it wishes to delegate to a risk committee the day-to-day management and monitoring of risk; and (b) what the committee's precise terms of reference should be to fulfil that role.

We asked:

Q15: Do you agree with the content of our proposed guidance on CROs?

- 2.68 The vast majority of the 53 responses that we received to this question agree wholly or in principle with our proposed guidance on chief risk officers. The responses include a number of suggestions, in particular to reinforce the position of the chief risk officer (CRO), not least to protect the role's independence.
- 2.69 To emphasise the independence of the CRO from the executive in relation to risk oversight, we are asked to define the 'operational purposes' that require the CRO to report to the senior member of the executive; and that in relation to risk oversight, they are primarily accountable to the risk committee.
- 2.70 We have been asked to incorporate expressly into our guidance (within SYSC 21.1.2) the principle that the CRO should have a power of veto and that SYSC 21.4(2) is strengthened to ensure that the CRO is protected in the event of a disagreement over raising important challenges. This protection could be reinforced still further by our having the right to approve the dismissal of the CRO before it can take effect (i.e. to ensure that the governing body is not seeking to dismiss the CRO because the CRO reasonably exercised the veto). This, it is argued, will give us the opportunity (and duty) to investigate the reasons for the dismissal itself and for us to be satisfied that the firm's proposal is a proper one in the circumstances.
- 2.71 If we decide to approve the action to dismiss the CRO, it is suggested that the decision should be made by the Regulatory Decisions Committee, and the CRO or the firm should have a right of appeal to the Tribunal. Respondents argue that the desirable effect of such a procedure would be to entrench further the CRO's independence.
- 2.72 More fundamentally, we are asked to confirm whether all firms are required to appoint a CRO and that the individual holding this position should be an executive with CF14 status.
- 2.73 One respondent has also cautioned that, without further guidance on which firms we would expect to have a CRO in place, a disparity may be created within the UK financial sector and/or firms falling short of our expectations.
- 2.74 We are requested to make it explicit that finance and risk experts should work closely together for some reporting (e.g. a CF13 reporting on capital should rely on the CF14's assessment of extreme risks).
- 2.75 Respondents have said it would be helpful to have (in relation to the proposed guidance at SYSC 21.1.1 G (2) & (3)) the intended interaction between the CRO at parent company level and the roles and responsibilities at the level of regulated entity within the group clarified. Where these requirements are in place at group level (as expected by draft guidance at SYSC 21), we have been asked to confirm whether or not they have to be replicated at the level of subsidiary regulated entities. We were also asked whether a CRO with a group responsibility would need to hold the CF14 for each individual regulated firm within the group.

- 2.76 One respondent asserts that, for SYSC 21.1.2(1) G (d), responsibility for reporting risk exposures to the firm's governing body should not be limited to the remit of the CRO, but to others in the firm generally, and that the reporting of risks should not be restricted to those only having a material impact.
- 2.77 We have been asked to clarify the proposed interaction between the CRO and actuarial function holders within life insurers. Similarly, for the with-profits actuary in respect of risk arising for with-profits liabilities, where there exists the potential for these responsibilities to conflict with the proposed role of the CRO.

Our response: As with the risk committee (Q.14), the appointment of a CRO is a matter for the firm, in consultation with their supervisor. Where a CRO is appointed (including at group level, where exerting significant influence on a regulated subsidiary), they will first have to be granted approval as a CF14. However, a person who exerts significant influence may not automatically be a CRO – Question 9 in the FAQs relating to the 'Parent entity' SIF role provides clarification on this. Regarding the types of firm where we would expect to see a CRO in place, this will depend on their nature, scale and complexity, but in cases where it is unclear whether a CRO would be appropriate, our supervisors will help firms to decide whether or not a CRO is required, based on a considered view of the firm.

We believe that the expression 'operational purposes' is well understood by the industry and, as such, we do not propose to amend SYSC 21.1.3 G (2).

The power of veto

The Walker Review stated (paragraph 6.22) that the CRO should have a power of veto, to deploy where necessary, if a course of action proposed by the executive was inconsistent with the risk tolerance determined by the risk committee and board. It could be a concern that such a rule might undermine collective responsibility and decision making by the governing body. However, it is a matter for the governing body to decide whether or not the CRO should be granted a power of veto and in what circumstances it might be used. Our expectation is that the 'challenge' role (see above) should normally suffice and that we would expect the CRO to challenge and alert the board in instances where it is seeking to act beyond its already agreed risk appetite/tolerances.

Dismissal of the CRO

We do not believe that our having the right to approve the dismissal of the CRO before it takes effect would be helpful.

The CRO at group/subsidiary level

In relation to the proposed guidance at SYSC 21.1.1 G(2) and (3) and the intended interaction between the CRO at parent company level and the roles and responsibilities at the level of regulated entity within the group, our focus is primarily at the regulated level. However, if the function is carried out at the parent entity, we will require evidence that appropriate risk management mechanisms are in place.

Further guidance is provided in the FAQs about the 'Parent entity' SIF.

Reporting of risks

We agree that responsibility for reporting risk exposures to the firm's governing body should not be limited to the remit of the CRO. Challenging the executive and, where necessary, disclosing to us instances and/or providing evidence of wrongdoing is incumbent on all directors and, for NEDs in particular, it is an implicit requirement of their overarching obligations.

Material impact

With regard to SYSC 21.1.2(1) G (d), it is not our intention to limit this provision to that of 'material impact' only. Such a description is a subjective concept – what might be 'material' for one firm, might not be for another and what is material to an individual firm can be determined with the advice of their supervisor. We propose to amend SYSC 21.1.2 G (1) (d), to provide that the CRO should have unlimited access to all parts of the firm's business that are capable of having an impact on the firm's risk profile.

The CRO and the Actuarial Function Holder (AFH) / With-profits Actuary

Some respondents suggested that, given the responsibilities of the Actuarial Function Holder (AFH) relating to the assessment of risks (as set out in SUP 4.3.13), there could be a conflict or overlap between the role of the CRO and that of the AFH. We intend that the AFH will retain their current responsibilities regarding assessing and reporting risks. We would expect the CRO to consider the work performed by the AFH in this regard and the extent to which such work might benefit from being validated or challenged, or supplemented by further work within a risk management framework. In performing their duties, it would be acceptable (where appropriate) for the CRO to refer to certain reports produced by the AFH rather than to seek to duplicate such work. The Solvency II Directive continues to require firms to appoint an AFH, but the position of the CRO as presented here is not likely to be impacted by the new regime.

To avoid doubt, we also do not intend any change to the responsibilities of the With-profits Actuary.

3 Approving and supervising Significant Influence Functions (SIFs) – our more intrusive approach

- 3.1 Consumers' and end-beneficiaries' long-term financial well-being depends on effective governance. To achieve this, respondents have emphasised the need to ensure the governing body of a financial services firm has the right balance of individuals, in terms of their experience and skills, and that board members are properly equipped to deal with the full range of issues they are likely to face.
- 3.2 Our intention to focus more on the competence and capability of candidates for SIFs has been welcomed. We have been asked to focus not only on the attributes of each individual director, but also on the overall composition of the governing body in relation to the firm itself and the extent to which the governing body encourages appropriate behaviour and culture to improve the outcomes for firms and consumers.
- 3.3 One respondent has said it would be helpful if we could provide firms with pre-interview briefs containing standard information relating to the interview (e.g. the composition of the panel, the focus of information gathering and assessment).
- 3.4 A number of respondents have said that they value our feedback, asking us to consider providing, at short-list stage, a report to firms about the potential fitness and propriety of candidates, especially information from sources (e.g. overseas), which firms cannot themselves access. Respondents have also requested a standard post-interview report to provide feedback to firms.
- 3.5 It has been observed that extreme sensitivities arise in submitting approved person applications at 'final short listing' for positions that have yet to be announced to the stock market. Respondents asked that we consider creating some form of overriding obligation about confidentiality in the event that the NED applicant is not approved.
- 3.6 Concern has also been expressed about our process for assessing applications (and delays in securing CRB clearance), which could delay the appointment of key executives in a way that may not operate in the best interests of shareholders and the capital markets.

- 3.7 We have been asked to ensure that, when an individual is seeking permission to undertake a governing function in tandem with a systems and control function, that both of these applications are considered in parallel, without the requirement to submit separate application forms for each function.
- 3.8 Respondents have emphasised the need for us to ensure that SIF interviews are conducted ‘by suitably experienced’ interviewers, to ensure that the maximum benefit (bearing in mind costs to applicants, which will be greater for major firms) is derived by both parties.
- 3.9 We have also been asked to explain, regarding the role of our panel of senior advisers in SIF interviews, to what extent and how we deal with any conflict of interest arising from the adviser’s outside business interests.
- 3.10 Respondents have asked whether we will allow SIF applicants to be accompanied at interview by an independent representative, to ensure that, if the applicant is refused approved person status, they can seek redress based on an independent record of the interview.
- 3.11 More generally, one respondent has suggested that the core competencies for SIFs should include reference to ethics and integrity. It was also suggested that it would be desirable for a statement about ‘Treating Customers Fairly’ to be included in the annual reports of large firms.
- 3.12 A number of respondents have questioned how our assessing of a firm’s adherence to equal pay and non-discrimination fits in with our statutory objectives. The initiative will, it is asserted, only duplicate obligations that are already imposed on firms.

Our response: We welcome the favourable response that we have received to our explanation of the approved person application and SIF interview processes.

Composition of the governing body

In accordance with FIT⁷, we focus on the competencies and capabilities of individuals, in parallel with our taking a view on an individual’s role in relation to the wider composition of the governing body. Such an approach will, we believe, help to allay concerns that our focus on experience and qualifications could increase the conformity and homogeneity of individuals at the top of the UK financial services industry, with the risk that levels of challenge and alternative points of view are reduced.

Composition of the interview panel

Where applicants are requested to attend an interview to assess their suitability for a SIF role, we endeavour to ensure that we have the correct balance of individuals on the interview panel, including in seniority. In selecting interview panel members, we are mindful of the need to avoid any conflicts of interest. We select from a range of advisers and senior advisers appropriate to the candidate and nature of the role being applied for.

7 The Fit and Proper test for Approved Persons (FIT).

We will not include on the interview panel anyone who has or may be seen to have a conflict of interest. We also remain aware of the need to avoid delays in the approval process by having to wait on the availability of individuals to sit as panel members.

The interview process

The decision about whether or not to call an applicant to interview is a risk-based one, dependent on our assessment of their competencies, the role sought and the existing/ proposed composition of the governing body of the firm.

For each interviewee, we examine specific competencies and behaviours at interview, as appropriate. The approval process already considers such things as non-technical skills and behaviours and 'culture' is a core component of the ARROW framework. Our own, internal audit function determines whether or not we apply our approval process uniformly, but noting that each application is specific to the individual concerned.

For candidates seeking approval to carry out a SIF function, our primary purpose is to establish their competence and suitability for the role they are seeking to fulfil. For those candidates who are called for interview, this is potentially a two-stage process. The first interview is an unrecorded, minuted interview with the candidate, followed, if necessary, by a second, recorded interview. As a matter of practice, we usually disclose the minutes of the first interview only at the 'Warning Notice' stage (where we propose to refuse an application). As a general rule, we interview candidates alone (i.e. without their being accompanied by an independent observer), except for disability reasons. However, we endeavour always to ensure that the interview process is fair and reasonable. As such, at the second interview stage, should this be required, the candidate is advised that they may be accompanied by a lawyer and should they avail themselves of this, we too would be legally represented. Second interviews are always recorded, with the candidate being given a copy of this. If the candidate wishes to bring a lawyer to the first interview, we would not prevent this, but under such circumstances we would have our own legal representation present and, if appropriate, we may do so, even where the candidate has no legal representation.

We already provide a standard interview feedback form. Paragraph 4.40 of CP10/3 states that we will normally write to the firm and candidate, setting out the key points arising from the interview.

The importance of 'due diligence'

We expect all firms to undertake their own due diligence checks on candidates and are seen to be doing so. We will, where necessary and where we are legally permitted to do so, provide information to firms at the short list stage about the potential fitness and propriety of candidates. Paragraph 4.13 of CP10/3 says that we will, at a firm's request, carry out certain due diligence checks on its behalf, as well as undertaking our own, risk-based due diligence, including speaking to foreign supervisors.

We are scrupulous in ensuring confidentiality surrounding approved person applications. Information regarding a candidate does not get into the public domain until we publish a notice or a firm discloses this information itself.

To avoid delays in securing Criminal Records Bureau (CRB) clearance for candidates, there is nothing to stop firms getting the CRB clearance themselves and with the permission of

the individual sending this to us. As a general rule, we would encourage firms to approach us at an early stage, where an appointment is sensitive or urgent. Depending on the circumstances of the individual case, we may be prepared to say that we are minded to approve an individual, subject to CRB clearance being secured.

With respect to ensuring that, when an individual is seeking permission to undertake a governing function in tandem with a systems and control function, both of these applications are considered in parallel, we refer to our answer in response to Question 3.

Treating Customers Fairly (TCF)

TCF is central to the delivery of our retail regulatory agenda, which aims to ensure an efficient and effective market and thereby help consumers achieve a fair deal. We expect firms to deliver on TCF and in particular the TCF outcomes we have published on our website.

Equality and diversity considerations

As a public authority, we are required to comply with the relevant provisions of current legislation relating to equality and diversity issues. This obligation on us comes in two main parts. The first concerns our obligation to follow the basic duty - i.e. to ensure that we do not directly or indirectly discriminate against a range of protected characteristics specified by equality legislation. The second is to show 'due regard' to the need to promote equality, eliminate discrimination and foster good relations in carrying out our public duty functions, including under FSMA. The intention is that our work in these areas should complement the work of individual firms in meeting their own specific obligations under current equality legislation.

In meeting our general duty, we are currently exploring a variety of options for promoting diversity issues through the course of the senior appointments process. This follows the recent publication of the *UK Governance Code* by the Financial Reporting Council (FRC), which recommended that firms actively take diversity issues into account when considering senior board appointments, and follows on from the March 2010 Treasury Select Committee publication *Women in the City*, which highlighted the gender imbalance within the UK financial services industry in terms of senior appointments and boardroom representation.

4 The Walker Review and other proposals

- 4.1 CP10/3 focused on the outcome of Sir David Walker's review into the corporate governance of banks and other financial institutions and, in particular, those of his recommendations where we have a role in their implementation. This chapter reports on those areas where progress has been made since CP10/3 was published in January 2010. We also report on those other topics that we addressed in Chapters 1 and 6 of the CP.

ARROW and our review of governance

- 4.2 Our review of the ARROW framework regarding governance, management and culture is continuing.
- 4.3 As explained in CP10/3, our ARROW visits now focus more on firms' governance mechanisms and the role played by directors – especially NEDs. In addition, increased focus will be brought on the roles and responsibilities of the chairs of the key board committees through the approved person requirements for these roles (that may involve a SIF interview) and through continuing supervisory review. We are also focusing attention on risk governance and will be paying additional attention to the effectiveness of the group-wide risk function and firms' risk management frameworks.

Stewardship code

- 4.4 Our Quarterly Consultation Paper (CP10/15) of July 2010 included a proposal to amend the Conduct of Business sourcebook (COBS) to incorporate recommendation 20 of Sir David Walker's review, which concluded that there was a need for better engagement between asset managers acting on behalf of their clients, and the boards of the companies they invested in. The consultation closed on 6 September 2010.

UCITS schemes

- 4.5 In CP10/3, we mentioned that ‘Level 2’ legislation applying to managers of UCITS schemes would touch on voting disclosure. That legislation has now been adopted and will be the subject of a separate consultation for incorporation into the FSA Handbook.

Remuneration code

- 4.6 CP10/19, *Revising the Remuneration Code*, was published on 29 June 2010. In it, we announced plans to update our Remuneration Code (the Code) to take on board remuneration rules required by the Capital Requirements Directive (CRD 3) and the Financial Services Act 2010. We also reported on the implementation of the Code so far, lessons learned from last year’s implementation and discussed progress made in achieving international alignment. The consultation period closes on 8 October 2010 and we intend to issue a Policy Statement in November 2010, with rules effective from 1 January 2011.

Client assets controlled function

- 4.7 We published CP10/9 on 30 March 2010, on changes to our client asset rules. The aim of the consultation is to ensure that clients have confidence that their money and assets are safe and will be returned within a reasonable timeframe in the event that a firm becomes insolvent. We intend to finalise rules in a Policy Statement that will be published shortly.

Cost-benefit analysis and compatibility statement

Cost-benefit analysis

1. We published a cost-benefit analysis (CBA) at Annex 1 to CP10/3, which provided an estimate of the costs and an analysis of benefits of our proposals, measured using our current rules and guidance as a baseline. We also published a compatibility statement, setting out our views on how our proposals are compatible with our objectives and the principles of good regulation.
2. We received no responses to our CBA in CP10/3 that have required us to reconsider any of the analysis that was set out within it – the CBA therefore remains valid. As already noted in this Policy Statement (PS), we intend to implement the proposals in CP10/3 in full, subject to some minor refinements. Most of the amendments aim to provide clarification and therefore do not have material CBA implications.
3. Appointed representatives (ARs) were included within the scope of the proposals in CP10/03. However, following publication of the CP, we were made aware that ARs would face significant systems change-related costs, which were not captured in the original CBA. After considering this additional information, we decided not to apply our proposals to ARs and we have therefore not had to revise the CBA in CP10/3 (see more detailed discussion in the response section of this PS).
4. This PS also announces our intention to issue guidance advising firms to prohibit the person responsible for internal audit (CF15) from being at the same time responsible also for another governing function. We discuss the CBA implications below.

'Ring-fencing' the internal audit (CF15) function

Benefits

5. We believe that most medium and large-sized firms already have independent audit functions. So the benefits of this proposal will arise only to the extent to which it improves the effectiveness of internal audit and the quality of risk management in the firms that at present do not have an independent audit function and are not exempted from the proposal.

Costs

6. We do not expect this proposal to impose material incremental costs on medium and large firms, as we believe that most of this population of firms already has independent audit functions.
7. Nor will our proposal impose costs on the population of very small firms with impact scores below ten, since the guidance will not be applied to them.
8. The guidance will apply to c.14,500 small firms with impact scores of ten and above.¹ However, we believe that most of these firms will not incur significant costs as a result of the guidance because they will be able to ring-fence the internal audit function using existing staff resource.
9. We estimate that only 26 firms might find it difficult to meet the guidance using existing staff resource. Such firms may therefore have to recruit an additional member of staff, rather than relying on existing staff to carry out two or more controlled functions simultaneously, as they do currently.
10. These firms cover the following sectors:

Type of small firm (Impact score ten or greater, but <20)	Number
Credit union	4
Discretionary investment manager	2
Financial adviser	3
General insurance intermediary	4
General insurance	5
Home finance broker	1
Life insurer	5
Stockbroker	2
Total	26

11. Assuming that all these 26 firms need to recruit an additional person and the employment cost is £75,000 pa, the incremental cost of the proposal is in the region of £2m pa. However, this is likely to be an over-estimate. In some of these 26 firms, an individual may already be carrying out the internal audit function under the CF28 authorisation and be operationally independent within the firm, in which case we do not anticipate any additional costs.
12. We estimate that the additional cost to us of processing the notifications or applications for the CF15 controlled function does not materially affect the cost estimates in the CBA in CP10/3.

Compatibility statement

13. We received no comments from respondents on the compatibility statement in CP10/3, so we propose to leave it unchanged.

¹ Which were in place until May 2010, but which are currently being revised.

14. Our intention to provide guidance for firms, advising them to prohibit the person responsible for CF15 from being at the same time responsible for another governing function, is compatible with our statutory objectives and meets the wider issues that were covered by the compatibility statement that was provided in CP10/3. We consider that this proposal is proportionate and is consistent with the principles of good regulation.

Equality Impact Assessment (EIA)

1. Name of policy, strategy, service or function

A new framework of classification of significant influence functions (SIF) controlled functions and other changes to the approved person regime, including the scope and definition of certain, already existing controlled functions.

2. Responsible manager

Rosalie Langley Judd – Manager, Governance Policy Team, Prudential Policy Division

3. Date EIA completed

24 September 2010.

4. Description and aims of policy, strategy, service or function (including relevance to equalities)

Our policy aims (set out in our consultation paper, CP10/3 – *Effective corporate governance (Significant influence controlled functions and the Walker Review)*) – are designed both to improve the quality of governance within firms and the intensity of our supervisory regime.

5. Brief summary of research and relevant data

The House of Commons Treasury Select Committee report *Women in the City* (Tenth Report, 2009-10 Session) highlighted the fact that, in general, women are in the minority at senior levels in financial institutions - especially at the top. The boards of FTSE 100 banks are only 9% female and the proportion of women executive directors is even lower at 1-2%.

6. Methods and outcome of consultation

Applications for approved person and SIF controlled function status are administered and assessed by our Authorisation and Central Reporting Division. While the FSA does not have a specific equality and diversity objective or have targets for the number of women or other groups being authorised to carry out SIF roles, we are permitted under the public sector equality duty to monitor which groups are represented among those individuals we approve and to act as advocates for equality and diversity generally within the firms that we regulate and will do so from when these Handbook changes come into effect.

7. Results of initial screening or full equality impact assessment:

Equality group	Assessment of impact
Age	<p>Potential for non-compliance</p> <p>Individuals are assessed on their honesty, competence and solvency. The competency assessment is based on their competency and capabilities to carry out the role applied for. For certain roles, e.g. chairman of the governing body and/or its committees, due regard is given also to the individual's experience, which, by definition, may only be acquired with time (and, hence, age). However, this does not depart from our existing practice.</p>
Disability	<p>Neutral</p> <p>The competency assessment of individuals (including where appropriate by interview) to fulfil SIF roles, as described in our Handbook, is based only on their competency and capabilities to carry out the role applied for.</p>
Gender	<p>Potential for non-compliance</p> <p>We are aware that if we did not allow for more than one person performing a particular controlled function, then our rules would be indirectly discriminatory (i.e. to persons involved in a job-share).</p>
Pregnancy and maternity	<p>Neutral</p> <p>Our proposals permit SIF controlled functions to be held by more than one person, e.g. through a job share arrangement in order to accommodate maternity leave.</p>
Race	<p>Neutral</p> <p>The competency assessment of individuals (including where appropriate by interview) to fulfil SIF roles, as described in our Handbook, is based only on their competency and capabilities to carry out the role applied for.</p>
Religion or belief	<p>Neutral</p> <p>The competency assessment of individuals (including where appropriate by interview) to fulfil SIF roles, as described in our Handbook, is based only on their competency and capabilities to carry out the role applied for.</p>

Equality group	Assessment of impact
Sexual orientation	<p>Neutral</p> <p>The competency assessment of individuals (including where appropriate by interview) to fulfil SIF roles, as described in our Handbook, is based only on their competency and capabilities to carry out the role applied for.</p>
Transgender	<p>Neutral</p> <p>The competency assessment of individuals (including where appropriate by interview) to fulfil SIF roles, as described in our Handbook, is based only on their competency and capabilities to carry out the role applied for.</p>

8. Decisions and/or recommendations (including supporting rationale)

Although there are potential risks to certain groups (in respect of age and gender) resulting from the implementation of our proposals, we believe them to be a justified and proportionate means of achieving our legitimate aim of ensuring that the correct people fill the correct roles to facilitate effective corporate governance within the firms that we regulate.

9. Equality Action Plan (if required)

Not required.

10. Monitoring and review arrangements (including date of next full review)

Applications for approved person and SIF controlled function status are administered and assessed by our Authorisation and Central Reporting Division.

While we do not have a specific equality and diversity objective or have targets for the number of women or other groups being authorised to carry out SIF roles, we are permitted under the public sector equality duty to monitor which groups are represented among those individuals we approve and to act as advocates for equality and diversity generally within the firms that we regulate and will do so from when these Handbook changes come into effect.

List of non-confidential responses to CP10/3

Aegon	FairPensions
Association of Foreign Markets in Europe	Financial Services Consumer Panel
Association of British Credit Unions Ltd.	Fleming McGillivray & Co. Ltd.
Association of British Insurers	Futures and Options Association
Association of Financial Mutuals	HSBC
Association of Foreign Banks	Hermes Equity Ownership Services
Association of Independent Financial Advisers	Hermes Fund management Ltd.
Association of Mortgage Intermediaries	ING Direct UK
Aviva plc	International Research Centre of Banking & Corporate Governance, Ukrainian Academy of Banking of the National Bank of Ukraine
BGL Group	Independent Audit Ltd.
Baillie Gifford & Co.	Institute of Chartered Accountants in England & Wales
Bank of New York Mellon	Institute of Internal Auditors
Blue Fin Insurance Services Ltd.	International Financial Data Services
British Bankers' Association	International Underwriting Association of London Ltd.
CFA Society UK	Investment Management Association
Chartered Institute for Securities and Investment	John Webb
Chaucer Holdings plc	Kinetic Partners LLP
City of London Law Society	Leeds Building Society
Co-operative Financial Services	
Ernst & Young	

Lloyd's
Lockton Insurance
M&G Investments
Moore, Carter & Associates
National Australia Group UK
Old Mutual
P H I Associates
Pacific Life Re
Pegasus Corporate Governance
Peter Hamilton
Prudential UK & Europe
RAB Capital plc
Richard Horton, FCA
Royal Bank of Canada
Sir Adam Ridley
Skipton Group
St James's Place Wealth management
Standard Life plc
The Actuarial Profession
The Capita Group plc
Three Lions Underwriting Ltd.
Universities Superannuation Scheme Ltd.
Unum Ltd.
Virgin Money Holdings (UK) Ltd.
Wholesale Markets Brokers' Association

The new controlled functions

Significant Influence Function	Current function	New/changed/unchanged	Proposed new function
Governing functions		New	CF00 (Parent entity SIF)
	CF1 (Director)	Changed	<i>Decreased scope</i>
	CF2 (NED)	Changed	<i>Decreased scope</i>
		New	CF2a (Chairman)
			CF2b (Senior independent director)
			CF2c (Chairman of risk committee)
			CF2d (Chairman of audit committee)
			CF2e (Chairman of remuneration committee)
	CF3 (Chief executive)	Unchanged	n/a
	CF4 (Partner)		
	CF5 (Director of unincorporated association)		
CF6 (Small friendly society)			
Required functions	CF8 (Apportionment and oversight)	Unchanged	n/a
	CF10 (Compliance oversight)		
	CF11 (Money laundering reporting)		
	CF12 (Actuarial)		
	CF12A (With-profits actuary)		
	CF12B (Lloyd's actuary)		

Significant Influence Function	Current function	New/changed/unchanged	Proposed new function
Systems and controls functions		New	CF13 (Finance function)
			CF14 (Risk function)
			CF15 (Internal audit function)
	CF28 (Systems and controls)	Changed	Deleted
Significant management function	CF29 (Significant management)	Changed	Increased scope

Implementation

New controlled functions	Required action by firms where the individual currently performing the role is already approved to perform a relevant controlled function for firm	Required action by firms where the individual currently performing the role is already approved to perform a relevant controlled function for the UK parent firm	Required action by firms where the individual currently performing the role is not an approved person ¹	Required action by firms where the individual currently holds a governing function but now requires separate approval for a systems and control function
CF00	Must notify us ² on specified form between 1 May 2011 and 31 July 2011.	Must notify us on specified form between 1 May 2011 and 31 July 2011.	Must apply for approval between 1 May 2011 and 31 October 2011, though transitional period will extend beyond 31 October if necessary for all applications submitted before 31 July 2011.	N/A
CF2a-e	Must notify us on specified form between 1 May 2011 and 31 July 2011	As above.	As above.	N/A
CF13-15	Firm must notify us on specified form between 1 May 2011 and 31 July 2011	N/A	N/A	Firms currently subject to Remuneration Code ³ must notify us on specified form between 1 May 2011 and 31 July 2011 Firms not currently subject to Remuneration Code must notify us on specified form between 1 May 2011 and 30 April 2012

- 1 This column is only applicable where applications are required as a result of the extension of scope of the approved person regime, as confirmed in this Policy Statement. Those already within scope and requiring approval will be 'business as usual'.
- 2 This applies to those individuals based in parent entities that sought approval for the extended CF1 and CF2 definitions as a result of the changes to the approved person regime confirmed in PS09/14.
- 3 Proposals to extend the Remuneration Code as set out CP 10/19 will not affect the transitional arrangements for firms in this PS.

New controlled functions	Required action by firms where the individual currently performing the role is already approved to perform a relevant controlled function for firm	Required action by firms where the individual currently performing the role is already approved to perform a relevant controlled function for the UK parent firm	Required action by firms where the individual currently performing the role is not an approved person ¹	Required action by firms where the individual currently holds a governing function but now requires separate approval for a systems and control function
CF 29	N/A	N/A	Must apply for approval between 1 May 2011 and 31 October 2011, though transitional period will extend beyond 31 October if necessary for all applications submitted before 31 July 2011.	N/A

All notifications and applications must be submitted through the Online Notifications and Applications System (ONA). ONA is available between 7am and 8pm Monday to Friday, with all scheduled downtime taking place at weekends so firms should not be impacted.

Firms will receive an automated acknowledgement of all notifications and approvals received by us.

Instruments

CONTROLLED FUNCTIONS (AMENDMENT) INSTRUMENT 2010**Powers exercised**

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 59 (Approval for particular arrangements);
 - (2) section 60 (Applications for approval);
 - (3) section 64 (Conduct: statements and codes);
 - (4) section 138 (General rule-making power);
 - (5) section 156 (General supplementary powers); and
 - (6) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 1 May 2011

Amendments to the Handbook

- D. The modules of the FSA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2) below:

(1)	(2)
Glossary of definitions	Annex A
Senior Management Arrangements, Systems and Controls sourcebook (SYSC)	Annex B
Statements of Principle and Code of Practice for Approved Persons (APER)	Annex C
The Fit and Proper test for Approved Persons (FIT)	Annex D
Supervision manual (SUP)	Annex E
Credit Unions sourcebook (CRED)	Annex F

Citation

- E. This instrument may be cited as the Controlled Functions (Amendment) Instrument 2010.

By order of the Board
23 September 2010

Annex A

Amendments to the Glossary of definitions

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

<i>chairman function</i>	<i>controlled function</i> CF2a in the <i>table of controlled functions</i> , described more fully in SUP 10.6.9AR.
<i>chairman of the audit committee function</i>	<i>controlled function</i> CF2d in the <i>table of controlled functions</i> , described more fully in SUP 10.6.9BR.
<i>chairman of the remuneration committee function</i>	<i>controlled function</i> CF2e in the <i>table of controlled functions</i> , described more fully in SUP 10.6.9CR.
<i>chairman of the risk committee function</i>	<i>controlled function</i> CF2c in the <i>table of controlled functions</i> , described more fully in SUP 10.6.9DR.
<i>finance function</i>	<i>controlled function</i> CF13 in the <i>table of controlled functions</i> , described more fully in SUP 10.8.1R.
<i>internal audit function</i>	<i>controlled function</i> CF15 in the <i>table of controlled functions</i> , described more fully in SUP 10.8.3R.
<i>parent entity significant influence function</i>	<i>controlled function</i> CF00 in the <i>table of controlled functions</i> , described more fully in SUP 10.6.30R.
<i>risk function</i>	<i>controlled function</i> CF14 in the <i>table of controlled functions</i> , described more fully in SUP 10.8.2R.
<i>senior independent director function</i>	<i>controlled function</i> CF2b in the <i>table of controlled functions</i> , described more fully in SUP 10.6.9ER.

Amend the following as shown. Underlining indicates new text and strikethrough indicates deleted text.

<i>governing function</i>	any of <i>controlled functions</i> 4 <u>CF00</u> to 6 in the <i>table of controlled functions</i> (<u>SUP 10.4.5R</u>).
<i>systems and controls function</i>	<u>any of</u> <i>controlled functions</i> CF28 <u>13 to 15</u> in the <i>table of controlled functions</i> (<u>SUP 10.4.5R</u>), <u>and</u> described more fully in SUP 10.8. 1R .

Annex B

Amendments to the Senior Management Arrangements, Systems and Controls sourcebook (SYSC)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

1.1A Application

- 1.1A.1 G The application of this sourcebook is summarised at a high level in the following table. The detailed application is cut back in SYSC 1 Annex 1 and in the text of each chapter.

Type of firm	Applicable chapters
<i>Insurer</i>	Chapters 2, 3, 11 to 18, <u>21</u>
<i>Managing agent</i>	Chapters 2, 3, 11, 12, 18, <u>21</u>
<i>Society</i>	Chapters 2, 3, 12, 18, <u>21</u>
Every other <i>firm</i>	Chapters 4 to 12, 18, 19, <u>21</u>

...

1.4 Application of SYSC 11 to SYSC ~~19~~21

What?

- 1.4.1 G The application of each of chapters SYSC 11 to SYSC ~~19~~21 is set out in those chapters.

Actions for damages

- 1.4.2 G A contravention of a *rule* in SYSC 11 to SYSC ~~19~~21 does not give rise to a right of action by a *private person* under section 150 of the *Act* (and each of those *rules* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action).

...

2.1 Apportionment of Responsibilities

...

- 2.1.1A G *Firms* should also consider the additional *guidance* on risk-centric governance arrangements for effective risk management contained in SYSC

21.

- 2.1.2 G The role undertaken by a *non-executive director* will vary from one *firm* to another. For example, the role of a *non-executive director* in a *friendly society* may be more extensive than in other *firms*. Where a *non-executive director* is an *approved person*, for example where the *firm* is a *body corporate*, his responsibility and therefore liability will be limited by the role that he undertakes. ~~Provided that he has personally taken due care in his role, a *non-executive director* would not be held disciplinarily liable either for the failings of the *firm* or for those of individuals within the *firm*. The *non-executive director function*, for the purposes of the *approved persons regime*, is described in *SUP 10*.~~

...

3.1 Systems and controls

...

- 3.1.2A G *Firms* should also consider the additional *guidance* on risk-centric governance arrangements for effective risk management contained in *SYSC 21*.

...

3.2 Areas covered by systems and controls

...

Risk assessment

- 3.2.10 G (1) Depending on the nature, scale and complexity of its business, it may be appropriate for a *firm* to have a separate risk assessment function responsible for assessing the risks that the *firm* faces and advising the *governing body* and *senior manager* on them.
- (2) ...
- (3) The term 'risk assessment-function' refers to the generally understood concept of risk assessment within a *firm*, that is, the function of setting and controlling risk exposure. The 'risk assessment function' is not a *controlled function* itself, ~~but is part of the *systems and controls functions* (CF28).~~ However, the *person* who reports to the *governing body* of a *firm*, or its risk committee (or its equivalent) in relation to setting and controlling a *firm's* risk exposure, may perform the *risk function*, which is *controlled function 14*, as described in *SUP 10.8.2R*.
- (4) The *FSA* expects that where a *person* is performing the *risk function* as described in *SUP 10.8.2R*, that *person* will be an employee, partner or officer of the *firm*. The *FSA* would expect *firms* not to outsource *controlled function 14* to an employee of an external

service provider.

...

Internal audit

- 3.2.16 G (1) Depending on the nature, scale and complexity of its business, it may be appropriate for a *firm* to delegate much of the task of monitoring the appropriateness and effectiveness of its systems and controls to an internal audit function. An internal audit function should have clear responsibilities and reporting lines to an audit committee or appropriate *senior manager*, be adequately resourced and staffed by competent individuals, be independent of the day-to-day activities of the *firm* and have appropriate access to a *firm*'s records.
- (2) The term 'internal audit function' refers to the generally understood concept of internal audit within a *firm*, that is, the function of assessing adherence to and the effectiveness of internal systems and controls, procedures and policies. The 'internal audit function' is not a *controlled function* itself, but is part of the *systems and controls function* (CF28). However, the *person* who reports to the *governing body* of a *firm*, or its audit committee (or its equivalent) in relation to controlling adherence to a *firm*'s internal systems and controls, may perform the *internal audit function*, which is *controlled function 15*, as described in SUP 10.8.3R.
- (3) The FSA expects that where a *person* is performing the *internal audit function* as described in SUP 10.8.3R, that *person* will be an *employee, partner or officer of the firm*. The FSA would expect *firms* not to outsource *controlled function 15* to an employee of an external service provider.

...

4.1 General requirements

...

Risk control: additional guidance

- 4.1.13 G *Firms* should also consider the additional *guidance on risk-centric governance arrangements for effective risk management contained in SYSC 21.*

Apportionment of responsibilities: the role of the non-executive director

- 4.1.14 G The role undertaken by a *non-executive director* will vary from one *firm* to another. Where a *non-executive director* is an *approved person*, for example where the *firm* is a *body corporate*, his responsibility and therefore liability will be limited by the role that he undertakes.

...

4.4 Apportionment of Responsibilities

...

Maintaining a clear and appropriate apportionment

...

- 4.4.4 G ~~The role undertaken by a *non-executive director* will vary from one *firm* to another. Where a *non-executive director* is an *approved person*, for example where the *firm* is a *body corporate*, his responsibility and therefore liability will be limited by the role that he undertakes. Provided that he has personally taken due care in his role, a *non-executive director* would not be held disciplinarily liable either for the failings of the *firm* or for those of individuals within the *firm*. The *non-executive director* function, for the purposes of the *approved persons* regime is described in SUP 10. [deleted]~~

...

6.2 Internal audit

...

- 6.2.2 G The term ‘internal audit function’ in SYSC 6.2.1R (and SYSC 4.1.11G) refers to the generally understood concept of internal audit within a *firm*, that is, the function of assessing adherence to and the effectiveness of internal systems and controls, procedures and policies. The ‘internal audit function’ is not a *controlled function* itself, ~~but is part of the *systems and controls function* (CF28).~~ However, the person who reports to the governing body of a *firm*, or its audit committee (or its equivalent) in relation to controlling adherence to a *firm*’s internal systems and controls, may perform the *internal audit function*, which is *controlled function* 15, as described in SUP 10.8.3R.
- 6.2.3 G The FSA expects that where a *person* is performing the *internal audit function* as described in SUP 10.8.3R, that *person* will be an employee, partner or officer of the *firm*. The FSA would expect *firms* not to outsource *controlled function* 15 to an employee of an external service provider.

...

7.1 Risk control

...

- 7.1.7C G *Firms* should also consider the additional *guidance* on risk-centric governance arrangements for effective risk management contained in SYSC 21.

- 7.1.8 G (1) SYSC 4.1.3R requires a *BIPRU firm* to ensure that its internal control mechanisms and administrative and accounting procedures permit the verification of its compliance with *rules* adopted in accordance with the *Capital Adequacy Directive* at all times. In complying with this obligation, a *BIPRU firm* should document the organisation and responsibilities of its risk management function and it should document its risk management framework setting out how the risks in the business are identified, measured, monitored and controlled.
- (2) The term ‘risk management function’ in SYSC 7.1.6R and SYSC 7.1.7R refers to the generally understood concept of risk assessment within a *firm*, that is, the function of setting and controlling risk exposure. The ‘risk management function’ is not a *controlled function* itself, ~~but is part of the *systems and controls function* (CF28).~~ However, the *person* who reports to the *governing body* of a *firm*, or its risk committee (or its equivalent) in relation to setting and controlling a *firm’s* risk exposure, may perform the *risk function*, which is *controlled function 14*, as described in SUP 10.8.2R.
- (3) The *FSA* expects that where a *person* is performing the *risk function* as described in SUP 10.8.2R, that *person* will be an employee, partner or officer of the *firm*. The *FSA* would expect *firms* not to outsource *controlled function 14* to an employee of an external service provider.

...

14 Prudential risk management and associated systems and controls for insurers

...

Internal controls: risk assessment

...

- 14.1.39 G (1) In accordance with SYSC 3.2.10G a *firm* should consider whether it needs to set up a separate risk assessment function (or functions) that is responsible for assessing the risks that the *firm* faces and advising its *governing body* and *senior managers* on them.
- (2) The term ‘risk assessment function’ refers to the generally understood concept of risk assessment within a *firm*, that is, the function of setting and controlling risk exposure. The ‘risk assessment function’ is not a *controlled function* itself, ~~but is part of the *systems and controls function* (CF28).~~ However, the *person* who reports to the *governing body* of a *firm*, or its risk committee (or its equivalent) in relation to setting and controlling a *firm’s* risk exposure, may perform the *risk function*, which is *controlled function 14*, as described in SUP 10.8.2R.
- (3) The *FSA* expects that where a *person* is performing the *risk function*

as described in SUP 10.8.2R, that *person* will be an employee, partner or officer of the *firm*. The FSA would expect *firms* not to outsource *controlled function* 14 to an employee of an external service provider.

...

Internal audit

...

- 14.1.43 G (1) In accordance with SYSC 3.2.15G and SYSC 3.2.16G, a *firm* should consider whether it needs to set up a dedicated internal audit function.
- (2) The term ‘internal audit function’ refers to the generally understood concept of internal audit within a *firm*, that is, the function of assessing adherence to and the effectiveness of internal systems and controls, procedures and policies. The ‘internal audit function’ is not a *controlled function* itself, ~~but is part of the *systems and controls function* (CF28).~~ However, the *person* who reports to the *governing body* of a *firm*, or its audit committee (or its equivalent) in relation to controlling adherence to a *firm*’s internal systems and controls, may perform the *internal audit function*, which is *controlled function* 15, as described in SUP 10.8.3R.
- (3) The FSA expects that where a *person* is performing the *internal audit function* as described in SUP 10.8.3R, that *person* will be an employee, partner or officer of the *firm*. The FSA would expect *firms* not to outsource *controlled function* 15 to an employee of an external service provider.

...

After SYSC 20, insert the following new chapter. The text is not underlined.

21 Risk control: additional guidance

21.1 Risk control: guidance on governance arrangements

Additional guidance on governance arrangements

- 21.1.1 G (1) This chapter provides additional guidance on risk-centric governance arrangements for effective risk management. It expands upon the general organisational requirements in SYSC 2, SYSC 3, SYSC 4 and SYSC 7, and so applies to the same extent as SYSC 3.1.1R (for *insurers, managing agents* and the *Society*) and SYSC 4.1.1R (for every other *firm*).

- (2) *Firms* should, taking account of their size, nature and complexity, consider whether in order to fulfil the general organisational requirements in *SYSC 2*, *SYSC 3*, *SYSC 4* and *SYSC 7* their risk control arrangements should include:
- (a) appointing a Chief Risk Officer; and
 - (b) establishing a *governing body* risk committee.

The functions of a Chief Risk Officer and *governing body* risk committee are explained further in this section.

- (3) The *FSA* considers that *banks* and *insurers* that are included in the FTSE 100 Index are examples of the types of *firm* that should structure their risk control arrangements in this way. However, this *guidance* will also be relevant to some similar sized *firms* (whether or not *listed*) and some smaller *firms*, by virtue of their risk profile or complexity.

Chief Risk Officer

- 21.1.2 G (1) A Chief Risk Officer should:
- (a) be accountable to the *firm's governing body* for oversight of *firm-wide* risk management;
 - (b) be fully independent of a *firm's* individual business units;
 - (c) have sufficient authority, stature and resources for the effective execution of his responsibilities;
 - (d) have unfettered access to any parts of the *firm's* business capable of having an impact on the *firm's* risk profile;
 - (e) ensure that the data used by the *firm* to assess its risks are fit for purpose in terms of quality, quantity and breadth;
 - (f) provide oversight and challenge of the *firm's* systems and controls in respect of risk management;
 - (g) provide oversight and validation of the *firm's* external reporting of risk;
 - (h) ensure the adequacy of risk information, risk analysis and risk training provided to members of the *firm's governing body*;
 - (i) report to the *firm's governing body* on the *firm's* risk exposures relative to its risk appetite and tolerance, and the extent to which the risks inherent in any proposed business strategy and plans are consistent with the *governing body's* risk appetite and tolerance. The Chief Risk Officer should also alert the *firm's governing body* to and provide challenge on, any business

strategy or plans that exceed the *firm's* risk appetite and tolerance;

- (j) provide risk-focused advice and information into the setting and individual application of the *firm's remuneration* policy (where the *Remuneration Code* applies, see Remuneration Principle 2 at SYSC 19.3.3E).

(2) *Firms* will need to seek the *FSA's* approval for a Chief Risk Officer to perform the *risk function* (see SUP 10 (Approved persons)).

(3) The *FSA* expects that where a *firm* is part of a *group* it will structure its arrangements so that a Chief Risk Officer at an appropriate level within the *group* will exercise functions in (1) taking into account *group-wide* risks.

Reporting lines of Chief Risk Officer

- 21.1.3 G (1) The Chief Risk Officer should be accountable to a *firm's governing body*.
- (2) The *FSA* recognises that in addition to the Chief Risk Officer's primary accountability to the *governing body*, an executive reporting line will be necessary for operational purposes. Accordingly, to the extent necessary for effective operational management, the Chief Risk Officer should report into a very senior executive level in the *firm*. In practice, the *FSA* expects this will be to the *chief executive*, the chief finance officer or to another executive *director*.

Appointment of Chief Risk Officer

- 21.1.4 G (1) *Firms* should ensure that a Chief Risk Officer's *remuneration* is subject to approval by the *firm's governing body*, or an appropriate sub-committee.
- (2) *Firms* should also ensure that the Chief Risk Officer may not be removed from that role without the approval of the *firm's governing body*.

Governing body risk committee

- 21.1.5 G (1) The *FSA* considers that, while the *firm's governing body* is ultimately responsible for risk governance throughout the business, *firms* should consider establishing a *governing body* risk committee to provide focused support and advice on risk governance.
- (2) Where a *firm* has established a *governing body* risk committee, its responsibilities will typically include:
- (a) providing advice to the *firm's governing body* on risk strategy, including the oversight of current risk exposures of the *firm*,

with particular, but not exclusive, emphasis on prudential risks;

- (b) development of proposals for consideration by the *governing body* in respect of overall risk appetite and tolerance, as well as the metrics to be used to monitor the *firm's* risk management performance;
 - (c) oversight and challenge of the design and execution of stress and scenario testing;
 - (d) oversight and challenge of the day-to-day risk management and oversight arrangements of the executive;
 - (e) oversight and challenge of due diligence on risk issues relating to material transactions and strategic proposals that are subject to approval by the *governing body*;
 - (f) provide advice to the *firm's remuneration committee* on risk weightings to be applied to performance objectives incorporated in the incentive structure for the executive;
 - (g) providing advice, oversight and challenge necessary to embed and maintain a supportive risk culture throughout the *firm*.
- (3) Where a *governing body* risk committee is established, its chairman should be a *non-executive director*, and while its membership should predominantly be non-executive it may be appropriate to include senior executives such as the chief finance officer.

- 21.1.6 G In carrying out their risk governance responsibilities, a *firm's governing body* and *governing body* risk committee should have regard to any relevant advice from its audit committee or internal audit function concerning the effectiveness of its current control framework. In addition, they should remain alert to the possible need for expert advice and support on any risk issue, taking action to ensure that they receive such advice and support as may be necessary to meet their responsibilities effectively.

...

Annex C

Amendments to the Statements of Principle and Code of Practice for Approved Persons (APER)

In this Annex, all the text is new and is not underlined.

After APER 3.2 insert the following new section.

3.2A Factors relating to the conduct of an approved person performing the parent entity significant influence function

- 3.2A.1 G A list of frequently asked questions concerning the application of the *Statements of Principle* to an *approved person* performing the *parent entity significant influence function* is at Schedule 7 to the *Code of Practice for Approved Persons*.

After APER 4, insert the following new appendix.

Appendix 1 Frequently Asked Questions concerning the conduct of Approved Persons performing the Parent Entity Significant Influence Function

Q1 What do these questions cover?

These questions consider how *APER* applies to a person carrying out the *parent entity significant influence function* (*SUP* 10.6.30R to *SUP* 10.6.32G, and *SUP* 10.6.33G for FAQs) when he is not formally appointed as an officer or official of the *firm*.

Use of the term “firm” in these FAQs refers to the authorised subsidiary.

Q2 What are the general principles?

All *approved persons* are required to abide by *APER*, including those performing the *parent entity significant influence function*.

APER applies to the *parent entity significant influence function* as it does to the other significant influence functions. As such, (as well as *Statements of Principle* 1 to 4, which apply to all *approved persons*) *Statements of Principle* 5 to 7, which relate to the exercise of significant influence, will apply to persons performing the *parent entity significant influence function*.

Part of the definition of the *parent entity significant influence function* is that the person concerned is one whose decisions or actions are regularly taken into account by the *governing body* of the firm. Therefore, in assessing the standards applicable to the *parent entity significant influence function*, it should be treated as a *governing body* level role. The standards expected of a person carrying out this role are similar to those of a *director* or a *non-executive director* (or equivalent), of the firm, and the same as the standards that would apply if the firm had formally appointed the person to carry out the functions from a position within the firm.

Q3 What parts of the business is a person carrying out this function responsible for?

Several provisions of *APER* 5 to 7 refer to the business for which the *approved person* is responsible. In the case of a person performing the *parent entity significant influence function*, this refers to areas of the business to which the decisions or actions regularly taken into account by the *governing body* of the firm relate.

A CF00's responsibilities do not necessarily extend to the whole of the firm's business. They will only extend to the part of the firm's business covered by his decisions or actions that the firm's governing body regularly takes into account (see *SUP* 10.6.33G for FAQs). This is in contrast to the role of the *director*, which covers the whole of a firm's business.

Q4 Does a person carrying out this function manage the business?

The parts of *APER* 5 to 7 that deal with how an *approved person* performing a *significant influence function* should manage the business of a firm for which he is responsible in his *controlled function* will generally apply. The seniority of the role combined with the tasks that have to be carried out to perform the role properly will mean that the individual is carrying out a management role.

Q5 Does a person carrying out this function control any part of the business?

Various parts of *APER* deal with how an *approved person* should carry out his responsibilities for the areas of the business under his control. These parts of *APER* may not apply to someone carrying out the *parent entity significant influence function*. That is because that function will often fall short of controlling part of the firm's business.

The way in which a person performing the *parent entity significant influence function* discharges his responsibilities under *APER* may differ from an executive of the firm. As he may not have any direct control over areas of the firm's business, he may only need to satisfy himself that the firm has the appropriate systems and controls in place to address the requirements set out in *APER*, rather than implementing those controls personally. In this respect his role may be similar to that of a *non-executive director*.

Q6 What level of understanding does a person carrying out this function need to

have?

A person performing the *parent entity significant influence function* will need to have whatever level of understanding of the firm's business is appropriate in order to carry out his role properly and to meet the requirements of *APER* relating to that role. The fact that the *approved person* may not have been formally appointed by the firm or that his functions are exercised indirectly does not reduce the level of understanding he is expected to have. The same principle applies to establishing what it is reasonable to expect him to know and what steps are reasonable for him to take to inform himself about the affairs of the firm. (See also Q2).

...

Annex D

Amendments to the Fit and Proper test for Approved Persons (FIT)

In this Annex, underlining indicates new text and striking through indicates deleted text.

2.2 Competence and capability

- 2.2.1 G In determining a *person's* competence and capability, the *FSA* will have regard to all relevant matters including but not limited to:
- (1) whether the *person* satisfies the relevant *FSA* training and competence requirements in relation to the *controlled function* the *person* performs or is intended to perform;
 - (2) whether the *person* has demonstrated by experience and training that the *person* is suitable, or will be suitable if approved, to perform the *controlled function*;
 - (3) whether the *person* has adequate time to perform the *controlled function* and meet the responsibilities associated with that function.

...

- 2.2.3 G In considering whether a *person* performing the *controlled functions* 2 and 2a to 2e inclusive has adequate time to perform that *controlled function*, the *FSA* may take into account the process a *firm* has undertaken to determine the time commitment required.

...

Annex E

Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

10.1 Application

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Overseas firms: UK establishments

10.1.7 R Only the following *controlled functions* apply to an *overseas firm* which maintains an establishment in the *United Kingdom* from which *regulated activities* are carried on:

(1) ~~the *director function* where the *person* performing that function:~~

(a) ~~has responsibility for the *regulated activities* of a *UK branch* which are likely to enable him to exercise significant influence over that branch; or~~

(b) ~~is someone whose decisions or actions are regularly taken into account by the *governing body* of that branch.~~

the following *governing functions* where the *person* performing that function either has responsibility for the *regulated activities* of a *UK branch* which are likely to enable him to exercise significant influence over that branch or is someone whose decisions or actions are regularly taken into account by the *governing body* of that branch:

(a) the *director function*;

(b) the *non-executive director function*;

(c) the *chairman function*;

(d) the *chairman of the audit committee function*;

(e) the *chairman of the remuneration committee function*;

(f) the *chairman of the risk committee function*;

(g) the *senior independent director function*;

(h) the *chief executive function*;

(i) the *parent entity significant influence function*;

- (2) ~~the non-executive director function where the person performing that function:~~
- (a) ~~has responsibility for the regulated activities of a UK branch which is likely to enable him to exercise significant influence over that branch; or~~
 - (b) ~~is someone whose decisions or actions are regularly taken into account by the governing body of that branch. [deleted]~~
- (3) ~~the chief executive function; [deleted]~~
- (4) the *required functions*;
- (5) the *systems and controls function functions*;
- (6) the *significant management function* in so far as the function relates to:
- (a) *designated investment business business* other than *dealing in investments as principal*, disregarding article 15 of the *Regulated Activities Order*; or
 - (b) the processing confirmations, payments, settlements, insurance claims, *client money* and similar matters in so far as this relates to *designated investment business*; and
- (5) the *customer function*.

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Incoming EEA firms: passported activities from a branch

- 10.1.13 R Only the following *controlled functions* apply to an *incoming EEA firm* with respect to its *passported activities* carried on from a *branch* in the *United Kingdom*:
- (1) [deleted]
 - (2) [deleted]
 - (3) the *money laundering reporting function*;
 - (4) the *significant management function* in so far as the function relates to:
 - (a) *designated investment business* other than *dealing in investments as principal*, disregarding article 15 of the *Regulated Activities Order*; or
 - (b) processing confirmations, payments, settlements, insurance claims, *client money* and similar matters in so far as this

relates to *designated investment business*; ~~and~~ or

(c) the activity of *accepting deposits* from *banking customers* and activities substantially connected to that activity to the extent that it does not fall within (a) or (b); and

(5) [deleted]

(6) the *customer function* other than where this relates to the function in SUP 10.10.7AR(4).

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Incoming EEA firms with a top-up permission activities from a UK branch

- 10.1.14 R In relation to the activities of a *firm* for which it has a *top-up permission*, only the following *controlled functions* apply:
- (1) the *required functions*, other than the *apportionment and oversight function* and the *compliance oversight function*;
 - (2) the *significant management function* in so far as it relates to:
 - (a) *designated investment business* other than *dealing in investments as principal*, disregarding article 15 of the *Regulated Activities Order*; or
 - (b) processing confirmations, payments, settlements, insurance claims, *client money* and similar matters in so far as this relates to *designated investment business*; ~~and~~ or
 - (c) the activity of *accepting deposits* from *banking customers* and activities substantially connected to that activity to the extent that it does not fall within (a) or (b); and
 - (3) [deleted]
 - (4) the *customer function*.

- 10.1.15 ~~G~~ R ~~[deleted]~~ A *person* does not perform the *significant management function* for a *firm* under SUP 10.1.13R or SUP 10.1.14 R if that *person* would not have been treated as performing any *controlled function* for that *firm* if that *firm* had been a *UK firm*.

Appointed Representatives

- 10.1.16 R The descriptions of the following *controlled functions* apply to an *appointed representative* of a *firm*, except an *introducer appointed representative*, as they apply to a *firm*:
- (1) the *governing functions* 1 to 6 (excluding 2a to 2e), subject to SUP 10.1.16AR and except for a *tied agent* of an *EEA MIFID investment*

firm; and

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10.4 Specification of functions

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Controlled Table of controlled functions

10.4.5 R

Type	CF	Description of controlled function
<i>Governing functions*</i>	<u>00</u>	<u><i>Parent entity significant influence function</i></u>
	1	<i>Director function</i>
	2	<i>Non-executive director function</i>
	<u>2a</u>	<u><i>Chairman function</i></u>
	<u>2b</u>	<u><i>Senior independent director</i></u>
	<u>2c</u>	<u><i>Chairman of the risk committee function</i></u>
	<u>2d</u>	<u><i>Chairman of the audit committee function</i></u>
	<u>2e</u>	<u><i>Chairman of the remuneration committee function</i></u>
	3	<i>Chief executive function</i>
	4	<i>Partner function</i>
	5	<i>Director of unincorporated association function</i>
	6	<i>Small friendly society function</i>
<i>Required functions*</i>	8	<i>Apportionment and oversight function</i>
	10	<i>Compliance oversight function</i>
	11	<i>Money laundering reporting function</i>
	12	<i>Actuarial function</i>
	12a	<i>With-profits actuary function</i>

	12b	<i>Lloyd's actuary function</i>
<i>Systems and controls function functions*</i>	28	<i>Systems and controls function</i>
	13	<i>Finance function</i>
	14	<i>Risk function</i>
	15	<i>Internal audit function</i>
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10.5 Significant influence functions

What are the significant influence functions?

- 10.5.1 G The *significant influence functions*, which are specified in SUP 10.4.1R, comprise the *governing functions* (see SUP 10.6), the *required functions* (see SUP 10.7), the *systems and controls function functions* (see SUP 10.8) and the *significant management functions* (see SUP 10.9). SUP 10.5 applies to each of the *significant influence functions*.

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10.6 Governing functions

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- 10.6.2 R Each of the *governing functions* (other than the *non-executive director function* and the function described in SUP 10.6.4R(2)) includes where apportioned under SYSC 2.1.1R or SYSC 4.3.1R and SYSC 4.4.3R:
- (1) ~~the systems and controls function;~~ and
- (2) the *significant management function*.
- 10.6.3 G The effect of SUP 10.6.2R is that a person who is approved to perform a *governing function* (other than the *non-executive director function* and the function described in SUP 10.6.4R(2)) will not have to be specifically approved to perform the ~~systems and controls function~~ or the *significant management function*. A person who is approved to perform a *governing function* will have to be additionally approved before he can perform any of the systems and controls functions, the *required functions* or the *customer function*.

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Director function (CF1)

- 10.6.4 R If a *firm* is a *body corporate* (other than a *limited liability partnership*), the *director function* is the function of acting in the capacity of either a:
- ~~(1) director (other than a *non-executive director*) of that *firm*; or~~
 - ~~(2) a person:~~
 - ~~(a) who is a *director*, partner, officer, member (if the *parent undertaking* or *holding company* is a *limited liability partnership*), *senior manager*, or employee (other than a *non-executive director*) of a the *parent undertaking* or *holding company* (except where that *parent undertaking* or *holding company* is an *EEA firm*); and~~
 - ~~(b) whose decisions or actions are regularly taken into account by the *governing body* of the *firm*.~~
- 10.6.5 G Examples of where *SUP 10.6.4R(2)* would apply include (but are not limited to):
- ~~(1) a chairman of an audit committee of a *parent undertaking* or *holding company* of a *UK firm* where that audit committee is working for that *UK firm* (that is, functioning as the audit committee for the *group*); or~~
 - ~~(2) a director (other than a *non-executive director*) of a *parent undertaking* or *holding company* of a *UK firm* exercising significant influence by way of his involvement in taking decisions for that *UK firm*; or~~
 - ~~(3) an individual (such as a *senior manager*) of a *parent undertaking* or *holding company* of a *UK firm* who is responsible for and/or has significant influence in setting the objectives for and the remuneration of executive *directors* of that *UK firm*; or~~
 - ~~(4) an individual who is a *director* (other than a *non-executive director*) or a *senior manager* of a *parent undertaking* or *holding company* of a *UK firm* who is accustomed to influencing the operations of that *UK firm*, and acts in a manner in which it can reasonably be expected that an executive *director* or *senior manager* of that *UK firm* would act; or~~
 - ~~(5) an individual of an *overseas firm* which maintains an establishment in the *United Kingdom* from which *regulated activities* are carried on where that individual has responsibilities for those *regulated activities* which are likely to enable him to exercise significant influence over the *UK branch*. [deleted]~~

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Non-executive director function (CF2)

- 10.6.8 R (1) If a *firm* is a *body corporate*, the *non-executive director function* is the function of acting in the capacity of either a:
- (a) *non-executive director* of that *firm*; or
 - (b) ~~*non-executive director of a parent undertaking or holding company* (except where that *parent undertaking or holding company* has a *Part IV permission* or is regulated by an *EEA regulator*) whose decisions, or actions are regularly taken into account by the *governing body* of the *firm*.~~
- (2) If a *firm* is a *long-term insurer*, the *non-executive director function* is also the function of acting in the capacity of an individual (other than an individual performing the *director function* or the *non-executive director function* under (1)) who, as a member of a committee having the purpose of a *with-profits committee*, has responsibility in relation to corporate arrangements for *with-profits business* under COBS 20.3 (Principles and Practices of Financial Management).
- 10.6.9 G ~~Examples of where SUP 10.6.8R(1)(b) would apply include (but are not limited to):~~
- (1) ~~an individual who is a *non-executive director* of a *parent undertaking or holding company* who takes an active role in the running of the business of a *UK firm*, for example, as a member of a board or committee (on audit or remuneration) of that *firm*; or~~
 - (2) ~~an individual who is a *non-executive director* of a *parent undertaking or holding company* having significant influence in setting and monitoring the business strategy of the *UK firm*; or~~
 - (3) ~~an individual who is a *non-executive director* of a *parent undertaking or holding company* of a *UK firm* involved in carrying out responsibilities such as scrutinising the approach of executive management, performance, or standards of conduct of the *UK firm*; or~~
 - (4) ~~an individual who is a *non-executive director* of a *parent undertaking or holding company* of a *UK firm* who is accustomed to influence the operations of the *UK firm*, and acts in a way in which it can reasonably be expected that a *non-executive director* of the *UK firm* would act; or~~
 - (5) ~~an individual who is a *non-executive director* of an *overseas firm* which maintains a branch in the *United Kingdom* from which *regulated activities* are carried on where that individual has responsibilities for those *regulated activities* which are likely to enable him to exercise significant influence over the *UK branch*.~~
- [deleted]

Chairman function (CF2a)

- 10.6.9A R The *chairman function* is the function of acting in the capacity of the chairman of the *governing body* of a *firm*.

Senior independent director function (CF2b)

- 10.6.9B R The *senior independent director function* is the function of acting as a *non-executive director* who has been appointed by the *non-executive directors* to act as the senior independent director.

Chairman of the risk committee function (CF2c)

- 10.6.9C R The *chairman of the risk committee function* is the function of acting in the capacity of the chairman of the *governing body* risk committee of a *firm* (if there is such a committee). For these purposes, the *governing body* risk committee means the committee described in SYSC 21.1.5G.

Chairman of the audit committee function (CF2d)

- 10.6.9D R The *chairman of the audit committee function* is the function of acting in the capacity of the chairman of the audit committee of the *governing body* of a *firm* (if there is such a committee).

Chairman of the remuneration committee function (CF2e)

- 10.6.9E R The *chairman of the remuneration committee function* is the function of acting in the capacity of the chairman of the remuneration committee of the *governing body* of a *firm* (if there is such a committee).

Application of ~~CF1 and~~ CF2a to CF2e

- 10.6.10 G (1) This paragraph explains the basis on which the *director function* and *non-executive director function* are applied to persons who have a position with the *firm's parent undertaking* or *holding company* under SUP 10.6.4R(2) or SUP 10.6.8R(1)(b). The *chairman function*, the *senior independent director function*, the *chairman of the risk committee function*, the *chairman of the audit committee function* and the *chairman of the remuneration committee function* are not subsumed within *controlled functions* 00, 1, 2, 3, 4, 5 or 6.
- R (2) The basic position is set out in SUP 10.3.4G. As is the case with all *controlled functions*, SUP 10.6.4R(2) and SUP 10.6.8R(1)(b) are subject to the overriding provisions in SUP 10.3.1R, which sets out the requirements of sections 59(1) and (2) of the Act. This means that unless the *firm* has an *arrangement* or a contract permitting the performance of these roles by the *persons* concerned, these *persons* will not be performing these *controlled functions*. Therefore, the FSA accepts that there will be cases in which a *person* performing these roles will not require approval.

- (3) ~~However the FSA expects that in general a person who performs these roles will perform the *director function* or the *non-executive director function*. This is because the FSA would expect that a firm that allows major decisions to be taken by a group decision making body will do so on the basis of a formal delegation from the firm's governing body. This delegation will amount to an arrangement for the purposes of section 59 of the Act.~~

10.6.10A G The effect of SUP 10.6.10R is that a person who is approved for the chairman function, the senior independent director function, the chairman of the risk committee function, the chairman of the audit committee function and the chairman of the remuneration committee function will also require approval for whichever of controlled functions 1, 2, 3, 4, 5 or 6 are applicable unless his role does not come within controlled functions 1, 2, 3, 4, 5 or 6. For example, a non-executive director who is also the chairman of a firm's audit committee will require approval for the non-executive director function and the chairman of the audit committee function.

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Parent entity significant influence function (CF00)

- 10.6.30 R ~~[deleted]~~ The parent entity significant influence function is the function of acting in the capacity of a person:
- (1) who is a director, non-executive director, partner, officer, member (if the parent undertaking or holding company is a limited liability partnership), senior manager, or employee of a parent undertaking or holding company of that firm (except where that parent undertaking or holding company is an EEA firm or is set up in another EEA state and is regulated by an EEA regulatory body); and
 - (2) whose decisions, or actions are regularly taken into account by the governing body of the firm.
- 10.6.31 G R (1) ~~[deleted]~~ Each of the governing functions 1 to 6 (but excluding controlled functions 2a to 2e inclusive) includes, with respect to a firm, the parent entity significant influence function where performed in relation to that firm.
- (2) The parent entity significant influence function does not include any of the activities described in any other controlled function.
- 10.6.32 G ~~[deleted]~~ The effect of SUP 10.6.31R(1) is that where a person is approved to perform governing functions 1 to 6 (but excluding controlled functions 2a to 2e inclusive) in relation to a firm and, through his position with the firm's parent undertaking or holding company, he would also otherwise perform the parent entity significant influence function in relation to that subsidiary, that person will not have to be specifically approved to perform the parent entity significant influence function in relation to the subsidiary.

10.6.33 G A list of frequently asked questions concerning *controlled function* 00 is at SUP 10 Annex 9.

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10.8 Systems and controls functions

~~Systems and controls function (CF28)~~ The finance function (CF13)

10.8.1 R The *finance function* is the function of acting in the capacity of an employee of the *firm* with responsibility for reporting to the *governing body* of a *firm*, in relation to its financial affairs.

~~The *systems and control function* is the function of acting in the capacity of an *employee* of the *firm* with responsibility for reporting to the *governing body* of a *firm*, or the audit committee (or its equivalent) in relation to:~~

- ~~(1) its financial affairs;~~
- ~~(2) setting and controlling its risk exposure (see SYSC 3.2.10G and SYSC 7.1.6R);~~
- ~~(3) adherence to internal systems and controls, procedures and policies (see SYSC 3.2.16G and SYSC 6.2).~~

10.8.1 A G The FSA expects that where a *person* is performing the *finance function* as described in SUP 10.8.1R, that *person* will be an employee of the *firm*. The FSA would expect *firms* not to outsource *controlled function* 13 to an employee of an external service provider.

The risk function (CF14)

10.8.2 G ~~[deleted]~~ The *risk function* is the function of acting in the capacity of an employee of the *firm* with responsibility for reporting to the *governing body* of a *firm*, or its risk committee (or its equivalent) in relation to setting and controlling a *firm's* risk exposure (see SYSC 3.2.10G and SYSC 7.1.6R).

10.8.2A G ~~Where an *employee* performs the *systems and control function* the FSA would expect the *firm* to ensure that the *employee* had sufficient expertise and authority to perform that function effectively. A *director* or *senior manager* would meet this expectation. [deleted]~~

The internal audit function (CF15)

10.8.3 R ~~[deleted]~~ The *internal audit function* is the function of acting in the capacity of an employee of the *firm* with responsibility for reporting to the *governing body* of a *firm*, or the audit committee (or its equivalent), in relation to controlling adherence to and effectiveness of a *firm's* internal systems and controls, procedures and policies (see SYSC 3.2.16G and SYSC 6.2).

Guidance on CF13, CF14 and CF15

- 10.8.4 G ~~{deleted}~~ Where an employee performs one of the *systems and controls functions* the FSA would expect the *firm* to ensure that the employee had sufficient expertise and authority to perform that function effectively. A director or senior manager would meet this expectation.
- 10.8.5 G ~~{deleted}~~ A *firm* may have more than one employee performing one of the *systems and controls functions*. Where this is the case, the FSA would only expect an employee to be approved for the relevant *controlled function* where that employee is responsible for the whole function, whether individually or jointly with others.
- 10.8.6 R ~~{deleted}~~ The FSA would expect the *firm* to ensure that an employee approved to perform the *internal audit function* is independent from any functions of the *firm* on which he audits, and therefore does not perform any of the *governing functions* for that *firm*.
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- 10.8.7 G ~~{deleted}~~ A list of frequently asked questions concerning the *systems and controls functions* is at SUP 10 Annex 9.

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10.9 Significant management functions

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- 10.9.1 R SUP 10.9 applies only to a *firm* which:
- (1) under SYSC 2.1.1R or SYSC 4.4.4G 4.4.3R, apportions a significant responsibility, within the description of the *significant management function*, to a *senior manager* of a significant business unit; or
 - (2) undertakes *proprietary trading*; or
 - (3) (in the case of an EEA firm) undertakes the activity of *accepting deposits from banking customers* and activities connected with this.
- 10.9.2 G The FSA anticipates that there will be only a few *firms* needing to seek approval for an individual to perform the *significant management function* set out in SUP 10.9.1R(1). In most *firms*, those approved for the *governing functions*, *required functions* and, where appropriate, the *systems and controls function functions*, are likely to exercise all the significant influence at senior management level.
- 10.9.3 G The scale, nature and complexity of the *firm's* business may be such that a *firm* apportions under SUP 10.9.1R(1) a significant responsibility to an individual who is not approved to perform the *governing functions*, *required functions* or, where appropriate, the *systems and controls function functions*. If so, the *firm* should consider whether the functions of that individual fall within the *significant management function*. For the purposes of the description of the *significant management functions*, the following additional factors about the *firm* should be considered:

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- 10.9.10 R (1) The *significant management function* is the function of acting as a *senior manager* with significant responsibility for a significant business unit that:
- (a) carries on *designated investment business* or other activities not falling within (b) to (d);
 - (b) *effects contracts of insurance* (other than *contractually based investments*);
 - (c) makes material decisions on the commitment of a *firm's* financial resources, its financial commitments, its assets acquisitions, its liability management and its overall cash and capital planning;
 - (d) processes confirmations, payments, settlements, insurance claims, and similar matters;
 - (e) (in the case of an *EEA firm*) undertakes the activity of *accepting deposits* from *banking customers* and activities connected with this.
- (1A) The *significant management function* also includes the function of acting as a *proprietary trader*.
- (2) This *controlled function* does not include any of the activities described in any other *controlled function* (except for the *parent entity significant influence function*) if that other *controlled function* applies to the *firm*.

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10.12 Application for approval and withdrawing an application for approval

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How to apply for approval

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- 10.12.2B D Where a *person* performs the *parent entity significant influence function* in relation to a *UK firm*, and is already approved to perform another *governing function* in relation to the *parent undertaking* or *holding company* of that *UK firm*, the *UK firm* seeking approval should use the short Form A available on the *FSA's website*:
- <http://www.fsa.gov.uk/Pages/Doing/Regulated/Approved/persons/process/index.shtml>

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10.13 Changes to an approved person's details

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Ceasing to perform a controlled function

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10.13.7A G (1) The obligations to supply information to:(a) the FSA under either SUP 10.13.6R or SUP 10.13.7R;(b) another firm under SUP 10.13.12R;

apply notwithstanding any agreement (for example a 'COT 3' Agreement settled by the Advisory, Conciliation and Arbitration Service (ACAS)) or any other arrangements entered into by a firm and an employee upon termination of the employee's employment. A firm should not enter into any such arrangements or agreements that could conflict with its obligations under this section.

(2) Failing to disclose relevant information to the FSA may be a criminal offence under section 398 of the Act.

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Changes to an approved person's personal details

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10.13.16 R (1) If a firm becomes aware of information which would reasonably be material to the assessment of an approved person's, or a candidate's, fitness and propriety (see FIT), it must inform the FSA on Form D, or (if it is more practical to do so and with the prior agreement of the FSA) by fax or e-mail, as soon as practicable.

(2) SUP 10.13.14R applies to the submission of Form D.

10.13.16A G Failing to disclose relevant information to the FSA may be a criminal offence under section 398 of the Act.

After 10 Annex 8, insert the following new annex. The text is not underlined.

10 Annex 9 Frequently Asked Questions concerning the Parent Entity Significant Influence Function

Q1 What do these FAQs cover?

These FAQs cover *controlled function 00: parent entity significant influence function*.

Use of the term “firm” in these FAQs refers to the authorised subsidiary.

Q2 What is the test that an individual would have to meet in order to fall within the scope of CF00?

CF00 captures those individuals, based in a *parent undertaking* or *holding company* (“parent entity”), whose decisions or actions are regularly taken into account by the *governing body* of the firm. This requirement looks at whether the *governing body* as a whole takes into account the individual’s decisions or actions in the parent entity, not whether individual members of the *governing body* have reporting lines to him.

It is not the job title held by a person within the parent entity that will determine whether they fall within the scope of the *approved persons* regime, but rather the exercise of the function fulfilled by a *person* in relation to the *regulated activities* of the firm.

There are various other conditions that need to be met as well:

- As is the case for all *controlled functions*, a function is a *controlled function* only to the extent that it is performed under an “arrangement” entered into by a firm in relation to the carrying on by the firm of a *regulated activity*. See Q6 for more on this.
- The function to be performed must be likely to enable the *person* responsible for it to exercise a significant influence on the conduct of the firm’s affairs, so far as relating to a *regulated activity*.
- The person exerting the significant influence must be a *director, non-executive director*, partner, officer, *senior manager*, or employee of one of the firm’s parent entities. If the parent entity is a limited liability partnership, this includes a member of that limited liability partnership.

Q3 When does the parent entity significant influence function apply?

Firms should be able to identify those persons in their parent entities likely to exercise significant influence, from the governance structures in place. However, we acknowledge that the situation may not always be clear cut (for example, in some cases the influence being exerted may be indirect or the “arrangement” may be informal in nature). In such cases we would encourage firms to speak with their supervisors, particularly for major complex, international groups with

subsidiaries or branches in the UK managed on a matrix basis.

Examples of where the *parent entity significant influence function* may apply are where the person:

- (1) takes an active role in the running of the business of a UK firm, for example, as a result of being a member of a group board or committee (on audit, risk or remuneration); or
- (2) has a significant influence in setting or approving the business strategy of the UK firm; or
- (3) is involved in carrying out responsibilities such as assessing the approach of executive management, performance, or standards of conduct of the UK firm; or
- (4) is accustomed to influence the operations of the UK *firm*, and acts in a way in which it can reasonably be expected that a director of the UK firm would act; or
- (5) is exercising significant influence by way of his involvement in taking decisions for that UK firm and acts in a manner in which it can reasonably be expected that a director or senior manager of that UK firm would act; or
- (6) is responsible for and/or has significant influence in setting the objectives for and the remuneration of executive directors of that UK firm; or
- (7) (in the case of an overseas firm which maintains a *branch* in the United Kingdom from which *regulated activities* are carried on) has responsibilities for those *regulated activities* which are likely to enable him to exercise significant influence over the UK *branch*.

Broadly speaking there are therefore two main situations in which the *parent entity significant influence function* may apply.

One is where the individual is formally included in the firm's reporting lines and decision-making structures. See the answers to Q4 and Q8 for more on this.

Another is where the individual has a direct but informal influence on the firm's *governing body* that is sufficiently strong that his decisions or actions are regularly taken into account by that *governing body*.

If the firm's governing body has sufficient discretion on how it applies and responds to directions or proposals coming from group committees or individuals based in parent entities, the influence is unlikely to be significant and therefore approval would not be required. This distinguishes someone who is simply carrying on a group-level function from someone who is performing a function on behalf of the firm. If the firm is unable to evidence sufficient independence or autonomy within the *governing body* of the firm, it may be that the individual will be performing the *parent entity significant influence function*.

So, where a firm (a) has in place the required functional SIFs at the local level and (b) they are effective and have sufficient control over the firm, we would not routinely expect them to have Parent CF00 SIFs in place.

Q4 Do individuals on Group Committees fall within the scope of CF00?

It is not our assumption that members of group committees will automatically exert a significant influence by virtue of their membership of the committee in question, but it may be appropriate for certain members to be approved. For example where the group committee is acting as a committee of the firm itself (see Q8 for more on this). However, as explained in Q7 to Q9, this sort of arrangement will sometimes result in the individual carrying on one of the other *controlled functions* rather than the *parent entity significant influence function*.

If the group committee is not acting as a committee of the firm itself then, even if it carries out an important role in relation to the firm, it does not necessarily follow that the individuals on that committee will fall within the scope of CF00. The question is whether the particular individual meets the tests under Q2. In practice this is only likely to be the case if the group's reporting lines are set up so that there is a reporting line between the individual and the firm's *governing body* or if the individual has the sort of informal influence described in the answer to Q3.

In determining whether or not members of group committees require approval, consideration should be given to the extent to which the group committee has the power to direct the *governing body* of the firm to take or refrain from taking certain actions.

Q5 Could shareholders require approval under CF00?

No, unless the shareholder is also a *director, non-executive director, partner, officer, senior manager, or employee* of the parent entity and is exerting significant influence over it through that role.

Q6 What is meant by an "arrangement"?

As is the case with all controlled functions, the parent entity significant influence function is subject to the overriding provisions in SUP 10.3.1R, which sets out the requirements of sections 59(1) and (2) of the *Act*. This means that unless the firm (or its contractor) has an arrangement permitting the performance of the role by the *person* concerned, he will not be performing the *parent entity significant influence function*. Therefore, the *FSA* accepts that there could be cases in which a person exercising significant influence over a firm from its parent entity will not require approval.

If a firm allows major decisions to be taken by a group decision-making body or by a person based in a parent entity on the basis of a formal delegation from the firm's governing body, such a formal delegation will amount to an arrangement for the purposes of section 59 of the *Act*. However, formal delegation of this kind **is not** the only form of "arrangement" adopted by firms. As explained in SUP

10.3.4G an arrangement can arise, for example, by conduct, custom and practice.

The *FSA* would also be likely to regard an “arrangement” as being in place between a parent entity and a firm in the following examples (NB these are not exhaustive):

- (1) where the parent entity imposes a requirement on the firm to seek prior approval from the parent entity in respect of material business decisions such as approving the firm’s strategy and business plan, making capital investments, acquiring or disposing of other companies etc.;
- (2) where the parent entity requires the firm to take certain actions affecting its risk profile: for example the taking on or limiting of significant financial risk exposures;
- (3) where the parent entity requires the firm to amend aspects of its internal control arrangements: for example to change its approach to risk or compliance monitoring arrangements;
- (4) where ‘dotted’ or functional reporting lines exist between executive management of certain functions in the firm, and executive management in the parent entity, through which group management has influence over the staffing, budgets and activities of the relevant functions within the firm. For example, this could be where business heads or control functions in the firm report to equivalent group business heads or control functions, in addition to established management reporting lines within the firm.

The above arrangements are common, but are not enough in themselves to mean that a person is automatically performing the *parent entity significant influence function*. The other requirements in Q2 must also be met.

However, although an “arrangement” does not need to be a formal contract or appointment, in any form of “arrangement” it is our expectation that both the firm and the person carrying on the *parent entity significant influence function* will be fully aware of the circumstances of that arrangement i.e. the responsibilities of the function being performed by the person on behalf of the firm, in relation to the firm’s *regulated activities*.

Q7 **If a person is fulfilling one of the governing functions, CF1 to CF6 for an authorised firm, would the individual also need to be approved for the Parent SIF function, if he is also performing a role at group level or from a parent entity?**

No. *SUP* 10.6.31R(1) and *SUP* 10.6.32G explain that he does not need to get approval for the *parent entity significant influence function* if he is already approved for one of the *governing functions* CF1 to CF6 (excluding CF2a to CF2e) in relation to the firm.

Q8 **Please explain how the granular governing functions (i.e. CF2a-CF2e) and the parent significant influence function interact when the person is performing a role at the group level.**

If the group committee is also acting as a committee of the firm itself, the chairman of the committee will require the relevant granular governing function (CF2c to CF2e). He will not require the *parent entity significant influence function* as the committee will be a committee of the firm. He would only need the *parent entity significant influence function* in addition where he has substantial influence on the *firm* that comes outside his role on the group committee. It is unlikely though that the *chairman function* or the *senior independent director function* will be exercised through a group committee in this way.

A group committee will be acting as a committee of the firm if the firm formally appoints it as one. It may also function as a committee of the firm if in practice the group committee performs that function, but only if it does so under an arrangement as described in the answer to Q6.

If, as will often be the case, the group committee is not functioning as a committee of the firm, the chairman will not be performing the granular *governing function*. If he is performing a *controlled function* at all it will be the *parent entity significant influence function*. Q4 has more on this.

Q9 Please explain how the systems and controls functions (CF13-CF15) and the parent significant influence function interact when the person is performing a role at the group level.

This deals with the group finance, risk and internal audit officers.

Two of the main features of these *controlled functions* are that the person must be an employee, partner or officer of the firm in question and that he must be responsible for reporting to the firm's *governing body* or the relevant sub-committee. In many cases these two requirements will mean that the group officer will not be performing any of the *systems and controls functions*.

If the person based in a parent entity is also an employee, officer or partner of the *firm* and is responsible for reporting to the firm's *governing body* or the relevant sub-committee, he will be carrying out a *systems and controls function* for the firm. In that case he will require approval for that *controlled function*. He would only need the *parent entity significant influence function* in addition where he has substantial influence on the firm that comes outside his *systems and controls function*.

Q10 How will the FSA assess those requiring the parent entity significant influence function?

We aim to assess the individual's fitness and propriety to perform the *controlled function* according to the requirements and responsibilities of the particular role(s) performed by them. The assessment process may include an interview. The fit and proper test (*FIT*) will be applied to *candidates* wherever they are based. The *firm* submitting applications for approval is required to have undertaken their own due diligence on the *candidate* before submitting the application to us. It is the applicant firm that is required to satisfy the *FSA* of a *candidate's* fitness and propriety, regardless of whether the individual is based in the UK or overseas. As with any *approved person's* role we would expect firms to have clear

documentation of a *candidate's* role and responsibilities.

Q11 What happens to candidates who are refused CF00 approval, or where CF00 approval is withdrawn by the FSA?

In either case the person would not be allowed to exercise significant influence over the firm, in relation to its *regulated activities*. This could mean that the *firm's* governance arrangements would need to be revised accordingly. If the person continued to exert significant influence without approval, the firm would be in breach of the *Act* and both the firm and the individual would be open to enforcement action.

Those we approve and who then breach *FIT* or *APER* could face enforcement action and have their approval withdrawn, requiring them to cease exercising significant influence over the firm, in relation to its *regulated activities*. A person may also be prohibited from carrying out any function in relation to any *regulated activity* carried out by an *authorised person*. Refusals, withdrawn approvals and prohibitions are published, and may also have consequences in their home state for the individuals based outside the UK.

Q12 Does CF00 apply where the parent entity is an EEA regulated entity?

No. See *SUP* 10.6.30R (1).

Q13 How does CF00 apply to branches of third country firms, operating in the UK?

The application of the *approved persons* regime to third country *branches* is comparable to the application of the regime to an authorised subsidiary, except that the question is whether the individual's decisions or actions are regularly taken into account by the *governing body* of that *branch*, rather than the *governing body* of the firm as a whole.

Q14 Is CF00 held for the parent entity or for the authorised firm?

As with all applications for a *controlled function*, an application should be submitted by the firm for which the person is carrying out the function, i.e. the firm on which the person will have a significant influence (and not by the parent entity).

...

Insert the following new rows in the SUP Transitional Provisions. The text is not underlined.

TP 1 Transitional provisions

Transitional provisions applying to the Supervision manual only

...

TP 1.2

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...					
8K	SUP 10.6.9AR to SUP 10.6.9ER	R	<p>(1) This <i>rule</i> applies to a <i>person</i> who meets the following conditions immediately before the transitional start date:</p> <ul style="list-style-type: none"> (a) he was approved to carry on one of the existing <i>governing functions</i> for a <i>firm</i>; and (b) he would otherwise have been performing one of the granular <i>governing functions</i> if those functions had existed then. <p>(2) The <i>firm</i> must notify the <i>FSA</i> of each <i>approved person</i> falling into (1). The <i>firm</i> must give that notification before the second date in column (5). The notification must include the granular <i>governing functions</i> referred to in (1)(b).</p> <p>(3) The functions described in (1)(b), as respects that <i>person</i> and that <i>firm</i>, are not treated as forming part of the granular <i>governing functions</i> until the earlier to occur of the date on which the <i>firm</i> gives the notification under (2) and the second date in column (5).</p> <p>(4) If the notification in (2) is given in accordance with that paragraph, the approval referred to in paragraph (1)(a) covers the granular <i>governing functions</i> referred to in (1)(b) as respects that <i>person</i> and that <i>firm</i>.</p> <p>(5) SUP TP 8TR contains various supplemental provisions applicable to this <i>rule</i>.</p>	1 May 2011 to 31 July 2011	1 August 2011

8L	SUP 10.6.30AR and SUP 10.13.6AR	R	<p>(1) This <i>rule</i> applies to a <i>person</i> who immediately before the transitional start date.</p> <p>(a) was approved to carry on an existing <i>governing function</i> for a subsidiary <i>firm</i>; and</p> <p>(b) would have been performing the <i>parent entity significant influence function</i> with respect to that subsidiary <i>firm</i> if that function had existed then.</p> <p>(2) SUP 10.6.31R(1) applies, so that the approval referred to in paragraph (1) covers the <i>parent entity significant influence function</i> as respects that <i>person</i> and that <i>firm</i>.</p> <p>(3) The subsidiary <i>firm</i> must notify the FSA of any <i>person</i> to whom this <i>rule</i> applies who has ceased to perform the <i>governing function</i> referred to in (1)(a) because of the removal of the functions forming part of the <i>parent entity significant influence function</i> from the <i>director function</i> and the <i>non-executive director function</i> by the Controlled Functions (Amendment) Instrument 2010. The <i>firm</i> must give that notification within three months of the date in (1). Form C does not apply for the purpose of that notification.</p> <p>(4) SUP TP 8TR contains various supplemental provisions applicable to this <i>rule</i>.</p>	Not applicable	Not applicable
8M	SUP 10.6.30R	R	<p>(1) This <i>rule</i> applies to a <i>person</i> who meets the following conditions immediately before the transitional start date:</p> <p>(a) he would otherwise have been performing the <i>parent entity significant influence function</i> with respect to a subsidiary <i>firm</i> if that function had existed then;</p> <p>(b) he is not approved to perform a <i>governing function</i> for the subsidiary <i>firm</i>;</p> <p>(c) he was not performing the <i>director function</i> or the <i>non-executive director function</i> for the subsidiary <i>firm</i> (as those <i>controlled functions</i> were defined before the Controlled Functions (Amendment) Instrument 2010); and</p>	1 May 2011 to 31 October 2011	

			<p>(d) either the parent was not a <i>UK firm</i> or he is not approved to perform any <i>governing function</i> for the parent.</p> <p>(2) The <i>parent entity significant influence function</i>, as respects that <i>person</i> and that subsidiary <i>firm</i>, is not treated as a <i>controlled function</i></p> <p>(3) If this transitional <i>rule</i> has not already expired under column (5), this <i>rule</i> comes to an end as respects that <i>person</i> and that subsidiary <i>firm</i> if and when an application is made for the person to perform the <i>parent entity significant influence function</i> for that <i>firm</i> and that application is granted.</p> <p>(4) If the <i>FSA</i> has received a completed application for that <i>person</i> to perform the <i>parent entity significant influence</i> no later than three months after the first date in column (5) and that application has not been finally decided by the time that the transitional period in column (5) would otherwise have come to an end, that transitional period is extended until the application has been finally decided.</p> <p>(5) <i>SUP TP 8TR</i> contains various supplemental provisions applicable to this <i>rule</i>.</p>		
8N	<i>SUP</i> 10.6.30R	R	<p>(1) This <i>rule</i> applies to a person who meets the following conditions immediately before the transitional start date:</p> <p>(a) he would otherwise have been performing the <i>parent entity significant influence function</i> with respect to a subsidiary <i>firm</i> if that function had existed then;</p> <p>(b) he is not approved to perform a <i>governing function</i> for that subsidiary <i>firm</i>;</p> <p>(c) the parent was a <i>UK firm</i>;</p> <p>(d) he was not performing the <i>director function</i> or the <i>non-executive director function</i> for the subsidiary <i>firm</i> (as those <i>controlled functions</i> were defined before the Controlled Functions (Amendment) Instrument 2010); and</p> <p>(e) he was approved to carry on a <i>governing function</i> for the parent.</p>	1 May 2011 to 31 July 2011	1 August 2011

			<p>(2) The subsidiary <i>firm</i> must notify the <i>FSA</i> of each <i>approved person</i> falling into (1). The <i>firm</i> must give that notification before the second date in column (5).</p> <p>(3) The <i>parent entity significant influence function</i> , as respects that <i>person</i> and that subsidiary <i>firm</i>, is not treated as a <i>controlled function</i> until the earlier to occur of the date on which the <i>firm</i> gives the notification under (2) and the second date in column (5).</p> <p>(4) If the notification in (2) is given in accordance with that paragraph, the approval referred to in paragraph (1)(e) covers the <i>parent entity significant influence function</i> as respects that <i>person</i> and that subsidiary <i>firm</i>.</p> <p>(5) <i>SUP</i> TP 8TR contains various supplemental provisions applicable to this <i>rule</i>.</p>		
80	<i>SUP</i> 10.8.1R to <i>SUP</i> 10.8.3R	R	<p>(1) This <i>rule</i> applies to a person who meets the following conditions immediately before the transitional start date:</p> <p>(a) he was approved to carry on what prior to the Controlled Functions (Amendment) Instrument 2010 was <i>controlled function 28</i> (the systems and controls function) for a <i>firm</i>; and</p> <p>(b) he would otherwise have been performing any of the <i>systems and controls functions</i> for that <i>firm</i> if those functions had existed then.</p> <p>(2) The <i>firm</i> must notify the <i>FSA</i> of each <i>approved person</i> falling into (1). The <i>firm</i> must give that notification before the second date in column (5). The notification must include the <i>systems and controls functions</i> the <i>approved person</i> would otherwise have been performing.</p> <p>(3) The deletion of what was <i>controlled function 28</i>, as respects that <i>person</i> and that <i>firm</i>, does not take effect until the earlier to occur of the date on which the <i>firm</i> gives the notification under (2) and the second date in column (5).</p> <p>(4) If the notification in (2) is given in accordance with that paragraph, the approval referred to in paragraph (1)(a) covers the <i>systems and controls functions</i> referred to in (1)(b) as respects that <i>person</i> and that <i>firm</i>.</p>	1 May 2011 to 31 July 2011	1 August 2011

			(5) <i>SUP</i> TP 8TR contains various supplemental provisions applicable to this <i>rule</i> .	
8P	<i>SUP</i> 10.8.1R to <i>SUP</i> 10.8.3R	R	<p>(1) This <i>rule</i> applies to a <i>person</i> who meets the following conditions:</p> <p>(a) immediately before the transitional start date he was approved to perform a <i>governing function</i> for a <i>firm</i>; and</p> <p>(b) as a result of the deletion of <i>SUP</i> 10.6.2R(1) by the Governance Instrument 2010 he would on the transitional start date otherwise have required approval to perform one of the <i>systems and controls functions</i> for that <i>firm</i>.</p> <p>(2) The <i>firm</i> must notify the <i>FSA</i> of each <i>approved person</i> falling into (1).</p> <p>(3) The <i>firm</i> must give the notification in (2) within the period specified in (4) or (5). The period begins from the transitional start date.</p> <p>(4) (a) The notification period is three months for a <i>firm</i> that meets at least one of the conditions in this <i>rule</i>.</p> <p>(b) The first condition is that the <i>firm</i> is a <i>UK bank</i> or <i>building society</i> that had <i>capital resources</i> exceeding £1 billion on its last <i>accounting reference date</i>.</p> <p>(c) The second condition is that the <i>firm</i> is a <i>BIPRU 730K firm</i> that had <i>capital resources</i> exceeding £750 million on its last <i>accounting reference date</i>.</p> <p>(d) The third condition is that:</p> <p>(i) the <i>firm</i> is a <i>full credit institution</i>, a <i>BIPRU 730K firm</i> or a <i>third country BIPRU 730K firm</i>;</p> <p>(ii) the <i>firm</i> is part of a <i>group</i>; and</p> <p>(iii) on the <i>firm's</i> last <i>accounting reference date</i> total <i>capital resources</i> held within the <i>group</i>:</p> <p>(A) by <i>UK banks</i> or <i>building societies</i> exceeded £1 billion; or</p>	<p>As specified in column 4</p> <p>1 August 2011</p>

			<p>(B) by <i>BIPRU 730K firms</i> exceeded £750 million.</p> <p>(5) The notification period is twelve months for all other <i>firms</i>.</p> <p>(6) The deletion of what was <i>controlled function</i> 28, the deletion referred to in paragraph (1) and the introduction of the <i>controlled functions</i> referred to in paragraph (1)(b), as respects that <i>person</i> and that <i>firm</i>, do not take effect until the earlier to occur of the date on which the <i>firm</i> gives the notification under (2) and the end of the notification period.</p> <p>(7) If the notification in (2) is given in accordance with that paragraph, the approval referred to in paragraph (1)(a) covers the <i>systems and controls functions</i> referred to in (1)(b) as respects that <i>person</i> and that <i>firm</i>.</p> <p>(8) <i>SUP TP 8TR</i> contains various supplemental provisions applicable to this <i>rule</i>.</p>		
8Q	<i>SUP</i> 10.1.13R to <i>SUP</i> 10.1.14R	R	<p>(1) This <i>rule</i> deals with the extension of the <i>significant management function</i> through the amendment to <i>SUP</i> 10.1.13R (Incoming EEA firms: passported activities from a branch) and <i>SUP</i> 10.1.14R (Incoming EEA firms etc with top-up permission activities from a UK branch) by the Controlled Functions (Amendment) Instrument 2010.</p> <p>(2) This <i>rule</i> applies to a <i>person</i> who would otherwise have been performing the <i>significant management function</i> with respect to a <i>firm</i> immediately before the first date in column (5) if the extension described in (1) had been in force then.</p> <p>(3) The functions that would otherwise have formed part of the <i>significant management function</i> because of the extension described in (2), as respects that <i>person</i> and that <i>firm</i>, are not treated as forming part of <i>significant management function</i>.</p> <p>(4) If this transitional <i>rule</i> has not already expired under column (5), this <i>rule</i> comes to an end as respects that <i>person</i> and that <i>firm</i> if and when an application is made for the person to perform the <i>significant management function</i> for that <i>firm</i> and that application is granted.</p>	1 May 2011 to 31 October 2011	1 November 2011

			<p>(5) If the <i>FSA</i> has received a completed application for that <i>person</i> to perform the <i>significant management function</i> no later than three months after the first date in column (5) and that application has not been finally decided by the time that the transitional period in column (5) would otherwise have come to an end, that transitional period is extended until the application has been finally decided.</p> <p>(6) <i>SUP TP 8TR</i> contains various supplemental provisions applicable to this <i>rule</i>.</p>		
8R	<i>SUP</i> 10.6.9AR to <i>SUP</i> 10.6.9ER	R	<p>(1) This <i>rule</i> applies to a <i>person</i> who meets the following conditions immediately before the transitional start date:</p> <p>(a) he was not approved to carry on one of the existing <i>governing functions</i> for a <i>firm</i> and was not performing any of those functions for that <i>firm</i>; and</p> <p>(b) he would otherwise have been performing one of the granular <i>governing functions</i> if those functions had existed then.</p> <p>(2) The granular function described in (1)(b), as respects that <i>person</i> and that <i>firm</i>, is not treated as being a <i>controlled function</i>.</p> <p>(3) If this transitional <i>rule</i> has not already expired under column (5), this <i>rule</i> comes to an end as respects that <i>person</i> and that <i>firm</i> if and when an application is made for the person to perform the granular <i>governing function</i> for that <i>firm</i> and that application is granted.</p> <p>(4) If the <i>FSA</i> has received a completed application for that <i>person</i> to perform the granular <i>governing function</i> no later than 3 months after the first date in column (5) and that application has not been finally decided by the time that the transitional period in column (5) would otherwise have come to an end, that transitional period is extended until the application has been finally decided.</p> <p>(5) <i>SUP TP 8TR</i> contains various supplemental provisions applicable to this <i>rule</i>.</p>	1 May 2011 to 31 July 2011	1 August 2011

8S		G	<p>(1) <i>SUP TP 8KR</i> deals with the introduction of the granular <i>governing functions</i> by the Controlled Functions (Amendment) Instrument 2010. It deals with a <i>firm</i> for which an <i>approved person</i> has been approved to perform any of the <i>governing functions</i> and will require approval for one of the granular <i>governing functions</i>. The <i>firm</i> is required to notify the <i>FSA</i> of all such <i>approved persons</i>. If it does, the <i>approved person</i> will be approved to carry out that granular <i>governing function</i> and no new approval to perform that <i>controlled function</i> will be required. Otherwise the <i>approved person</i> will need to apply for approval.</p> <p>(2) <i>SUP TP 8LR</i> deals with a <i>person</i> who is performing the <i>parent entity significant influence function</i> for a subsidiary <i>firm</i> and is approved to carry out one of the <i>governing functions</i> for the subsidiary. The policy in <i>SUP 10.6.31R(1)</i> is that approval for an existing <i>governing function</i> also includes approval for the <i>parent entity significant influence function</i>. The purpose of this transitional <i>rule</i> is that this should be the case for all those who fall into this category when the <i>parent entity significant influence function</i> was introduced by the Controlled Functions (Amendment) Instrument 2010.</p> <p>(3) Before the Controlled Functions (Amendment) Instrument 2010, the functions forming the <i>parent entity significant influence function</i> formed part of the <i>director function</i> and the <i>non-executive director function</i>. <i>SUP TP 8LR</i> also deals with an <i>approved person</i> who only required approval for the <i>director function</i> or the <i>non-executive director function</i> because he was performing a role that after the Controlled Functions (Amendment) Instrument 2010 falls under the <i>parent entity significant influence function</i>. As a result of the Controlled Functions (Amendment) Instrument 2010 the <i>approved person</i> will have ceased to perform the <i>director function</i> or the <i>non-executive director function</i>. The <i>firm</i> is required to notify the <i>FSA</i> of such <i>persons</i>. The result is that such <i>persons</i> will be approved for the <i>parent entity significant influence function</i> in place of the <i>director function</i> or the <i>non-executive director function</i>.</p>		
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- (4) *SUP TP 8OR* deals with the splitting into the three *systems and controls functions* of what was a single *controlled function* by the *Controlled Functions (Amendment) Instrument 2010*. A *firm* must notify the *FSA* of its *approved person* who is covered by this change. If it does, the *approved person* will be approved to carry out the *systems and controls function* that he has been performing and no new approval to perform that *controlled function* will be required. Otherwise the *approved person* will need to apply for approval.
- (5) *SUP TP 8PR* deals with the same issue in the case of those also affected by the removal of the *rule* that said that a *person* performing certain of the *governing functions* did not need separate approval for the *controlled function* that was split to form the *systems and controls functions*. The same procedures apply.
- (6) *SUP TP 8MR* and *SUP TP 8NR* deal with the *parent entity significant influence function* in relation to those who are not approved to carry out a *governing function* for the subsidiary *firm*. A *person* carrying on that function for a subsidiary *firm* whose parent is a *UK firm* will not need a new approval to perform that *controlled function* as long as notice is given in accordance with *SUP TP 8TR* and he is already approved to carry on a *governing function* for the parent. In other cases *SUP TP 8MR* sets out a period within which the *person* may get approval without having to cease to carry on that function in the mean time. An example of a *firm* to which *SUP TP 8MR* applies is a *UK firm* that is a limited liability partnership.
- (7) *SUP TP 8MR*, *SUP TP 8QR* and *SUP TP 8RR* provide a period in which applications can be made. They say that if an application for approval is still being processed at the end of the transitional period, the *person* is still able to carry on performing the function while the approval is being processed. However this only applies if the application for approval is made within a specified period. If the application is made later than that there is a risk that the application will not have been decided before the end of the transitional period, in which case the *person* will have to stop carrying out the function.

			(8) <i>SUP</i> TP 8RR deals with the possibility (perhaps unlikely) that some of the granular <i>governing functions</i> are not carried out by a director or partner. It provides a transitional period during which application for approval can be made.		
8T	<i>SUP</i> TP 8KR to <i>SUP</i> TP 8SG	R	<p>(1) This <i>rule</i> defines various terms used in <i>SUP</i> TP 8KR to <i>SUP</i> TP 8SG and sets out various other supplemental matters.</p> <p>(2) An application for a <i>person</i> to perform a <i>controlled function</i> is finally decided on the earliest of the following dates:</p> <p>(a) when the application is withdrawn;</p> <p>(b) when the <i>FSA</i> grants approval;</p> <p>(c) where the <i>FSA</i> has refused the application and the matter is not referred to the <i>Tribunal</i>, on the date on which the right to refer the matter to the <i>Tribunal</i> expires;</p> <p>(d) where the <i>FSA</i> has refused the application and the matter is referred to the <i>Tribunal</i>, when the reference is determined by the <i>Tribunal</i> and the time for bringing an appeal has expired;</p> <p>(e) if the application is determined by the court, when the court makes that determination.</p> <p>(3) The notification under <i>SUP</i> TP 8KR, <i>SUP</i> TP 8LR, <i>SUP</i> TP 8NR, <i>SUP</i> TP 8OR and <i>SUP</i> TP 8PR must include sufficient information for the <i>FSA</i> to identify the <i>person</i> concerned and at a minimum must contain (i) the <i>person's</i> full name; (ii) his individual register reference number and (iii) the <i>firm's</i> register reference number. The register means the register maintained by the <i>FSA</i> under section 347 of the <i>Act</i> (The record of authorised persons etc).</p> <p>(4) The granular <i>governing functions</i> mean <i>controlled functions</i> 2a, 2b, 2c, 2d and 2e as set out in the <i>table of controlled functions</i>.</p> <p>(5) The existing <i>governing functions</i> mean <i>controlled functions</i> 1, 2, 3, 4, 5 and 6 as set out in the <i>table of controlled functions</i>.</p>		

			<p>(6) The terms subsidiary <i>firm</i> and parent refer to the <i>parent entity significant influence function</i>. The subsidiary <i>firm</i> is the <i>firm</i> referred to SUP 10.3.1R. The parent refers to the <i>holding company</i> or <i>parent undertaking</i> from which that function is being carried on.</p> <p>(7) Transitional start date means 1 May 2011.</p>		
...					

Annex F

Amendments to the Credit Unions sourcebook (CRED)

In this Annex, underlining indicates new text and striking through indicates deleted text.

4.3 Systems and Controls

...

Rules and evidential provisions

...

- 4.3.12 G The term ‘internal audit function’ in *CRED* 4.3.11E refers to the generally understood concept of internal audit within a *firm*, that is, the function of assessing adherence to and the effectiveness of internal systems and controls, procedures and policies. ~~The internal audit function is not a *controlled function* itself, but is part of the *systems and controls function* (CF28). *Guidance* on internal audit is given in *CRED* 4.3.50G to *CRED* 4.3.60G.~~ However, the *person* who reports to the *governing body* of a *firm*, or its audit committee (or its equivalent) in relation to controlling adherence to a *firm's* internal systems and controls, may perform the *internal audit function*, which is *controlled function* 15, as described in *SUP* 10.8.3R.

...

6.3 Approved persons

...

SUP 10.8: the systems and controls ~~function~~ functions

...

- 6.3.9A G Where an *employee* performs any of the *systems and controls function functions* the *FSA* would expect the *credit union* to ensure that the *employee* had sufficient expertise and authority to perform that function effectively, for example be a *director* or *senior manager*.

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