

09 / 14

Financial Services Authority

The approved persons
regime – significant
influence function
review

Feedback on CP08/25 and final rules

July 2009



Contents

1	Overview	3
2	Consultation feedback and response	6

Annex 1: List of non-confidential respondents to CP08/25

Appendix 1: Final Handbook text

This Policy Statement reports on our consultation on the approved persons regime regarding changes to the significant influence functions (CP08/25).

Any comments or queries should be directed to:

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Copies of this Policy Statement 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.

1 Overview

- 1.1 In December 2008 we published Consultation Paper (CP) 08/25: *The approved persons regime – significant influence function review*.¹ There were five proposals in that document:
- Extending the scope and application of controlled functions CF1 (director) and CF2 (non-executive director) to include individuals such as directors, non-executive directors or senior managers employed by a parent undertaking or a holding company whose decisions, opinions or actions are regularly taken into account by the governing body of the authorised firm and therefore likely to have a significant influence on the conduct of the authorised firm’s affairs.
 - Clarifying the role of non-executive directors – amending the Code of Practice in our Handbook to clarify our expectation of the role of a non-executive director.
 - Extending controlled function CF29 (significant management function) to include proprietary traders who are not senior managers but who have the potential to exercise a significant influence on their firm through trading activities, and noting that it is the FSA’s expectation that firms would need to seek approval for all their proprietary traders.
 - Extending the approved persons regime to UK branches of third-country firms so that all controlled functions apply where appropriate.
 - Extending the rule obliging firms to provide references for applicants of the customer controlled function (CF30) to all controlled functions.
- 1.2 This Policy Statement (PS) sets out a summary of the responses received, and includes the final Handbook text that will carry out our proposals. However, in view of the publication of the Walker Review, we have decided to postpone issuing our response on the clarification of the role of non-executive directors until a later date.

1 www.fsa.gov.uk/pubs/cp/cp08_25.pdf

Responses and our final policy approach

- 1.3 The consultation period closed on 31 March 2009. We received 80 responses from trade associations, professional bodies and regulated firms of various sizes. We are very grateful to all the respondents for taking time to give us their views. A list of all non-confidential respondents can be found in Annex 1.
- 1.4 Overall, there was support for all of our proposals and the intended outcomes. However, clarification was sought mainly in relation to the extension to CF1 and CF2, the role of non-executive directors and our expectation that all proprietary traders would be included within the approved persons regime. We intend to proceed broadly on the basis outlined in CP 08/25, but have made some modifications to clarify the scope of application and address respondents' comments.

Our proposal on non-executive directors

- 1.5 We have decided to postpone implementation of our proposals to clarify the role of non-executive directors because the following, two separate reviews, are due to be published during July 2009 which relate to the same subject. We wish to consider the recommendations of these reviews before we make a final decision.
- 1.6 In February 2009 the Treasury announced a review to recommend measures to improve the corporate governance of UK banks, particularly with regard to risk management. This review is being chaired by Sir David Walker. A consultation document was published this month, with conclusions to be published in the autumn. The Financial Reporting Council (FRC) is currently reviewing the impact of the Combined Code on Corporate Governance, with which UK listed companies are required under the Listing Rules to 'comply or explain'. The Code and associated guidance set out best practice governance standards, including on the composition and balance of the board and some specific responsibilities of non-executive directors. The review began in March 2009 and the FRC will be publishing an interim report in July. The final report, together with any proposals to amend the Code, will be issued later in the year.

Who should read this Policy Statement?

- 1.7 This PS will be of particular interest to authorised firms (including their parent undertakings and holding companies where the proposals extend to persons based in those firms) and those applying for authorisation. It will also interest others involved in recruiting employees for controlled functions and in overseeing, developing and administering processes for complying with our approved persons regime.

Structure of the Policy Statement

1.8 The rest of the PS is set out as follows:

- Chapter 2 summarises the feedback we received and our response.
- Annex 1 includes a list of all non-confidential respondents who commented on our consultation.
- Appendix 1 contains the final Handbook text.

Consumers

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

2 Consultation feedback and response

- 2.1 This chapter sets out details of some of the responses we received to our proposals under the review of the significant influence function.
- 2.2 Our proposals and the intended outcomes received considerable support. However, respondents raised questions about the scope of the proposals, FSA's jurisdiction to extend the controlled functions CF1, CF2 and CF29, and raised practical issues in relation to implementation. We set out our response to the comments received and the reasons for our conclusions.

We asked:

Q1: Do you agree with our proposal to extend controlled functions CF1 (director) and CF2 (non-executive director) to those individuals exercising significant influence?

- 2.3 Most respondents supported the proposals to extend the definition of CF1 and CF2 to include those individuals within the parent or holding company that have a significant influence on an authorised firm. However, a number of respondents did request clarification on various issues, mainly in relation to the breadth of application. We have grouped the responses under the sub-headings below.

Who do we expect to be impacted?

- 2.4 Respondents asked for clarification on the scope of the proposals, as there was concern about the number of individuals who could potentially be caught, particularly given that the extended definition for CF1 included a director or senior manager '...whose decisions, opinions or actions are regularly taken into account'. In particular, there was concern that the definition was confusing and ambiguous, and that more specific guidance would be needed to help firms identify who would require approval. Some firms requested that support from supervisors be available to help them with this.
- 2.5 There was also comment that the proposals fell outside the FSA's powers under Section 59(1) of the Financial Services and Markets Act 2000 (FSMA).

- 2.6 Respondents also asked for clarification on how the proposals applied to matrix managed firms, shareholders, limited liability partnerships, and insurance companies where they have a stake in an intermediary firm (where it was suggested that the conflicts of interest arrangements should ensure that significant influence would not occur).
- 2.7 We have been asked to clarify if any action is required should a director of a parent company already be approved as a director of the authorised entity.

Issues raised regarding overseas firms/individuals

- 2.8 A number of respondents asked about the action that we would be able to take against individuals in non-regulated parent and holding companies and how their fitness and propriety would be assessed; particularly where the parent or holding company and individual is based overseas and operating outside the UK regulatory environment. There was concern that the deterrent effect will not be the same for those approved persons based in the UK and those approved persons based overseas. For example, individuals based overseas may be able to insure themselves against regulatory action including fines.
- 2.9 Some respondents expressed the view that the proposals have the potential to create an un-level playing field, as the proposals will not apply to UK branches of an EEA regulated company and UK incorporated authorised firms with an EEA regulated parent or holding company. It has also been suggested that the effectiveness of the proposals would be enhanced if they formed part of a coordinated international effort.

Practical issues

- 2.10 Questions on consistency were raised in terms of the:
- application of the proposals across firms; and
 - assessment of individuals that will potentially take place under two FSA processes – the controller’s regime and the approved persons regime.
- 2.11 Some firms questioned whether the proposals were consistent with obligations, set out in relation to directors and boards, in the Companies Act or codes of practice. For example, it was suggested that the extended definitions implied that individuals would be equivalent to Companies Act directors even where they are not, or by following codes of practice boards of holding companies will automatically be caught by the extended definitions.

- 2.12 Respondents have also observed that the proposals will require non-executive directors to fulfill the Statements of Principle and Code of Practice for Approved Persons (APER), and commented that compliance with Statements of Principle 5-7² in particular could be impractical if the individual has no executive role with the regulated firm.

Suggestions or alternatives

- 2.13 Some respondents expressed the view that the current regime is sufficient in capturing those exerting significant influence from outside of the authorised entity.
- 2.14 We have been asked why a new controlled function could not be created instead of extending the existing CF1 and CF2, and whether the legal definition of a shadow director³ could be used.

Unintended outcomes and cost benefit analysis (CBA) issues

- 2.15 In relation to the CBA we received a comment that the benefits to be gained had not been explained in sufficient detail, particularly where a firm's primary business may not be financial services. We have also been asked to justify why the current regime is inadequate.
- 2.16 Respondents also highlighted potential risks as a result of the proposals; the responsibility of existing CF1 and CF2s could be diluted, individuals could seek to devolve themselves of responsibility, or firms could re-structure to circumvent the system and potentially restrict the number of persons providing oversight or views to the regulated entity.

Our response

We continue to believe there is a need to extend the approved persons regime as proposed but understand the need to clarify the expected outcomes. The original intention of the approved person regime (set out in CP53) was to capture directors of holding companies whose directions and instructions the directors of an FSA regulated firm are accustomed to act. In practice, the approved persons regime does not sufficiently capture the persons in these structures exerting a significant influence over an authorised firm and the application of the regime in this regard has been historically uneven.

We did not propose creating a new controlled function as this would have systems and costs implications. It would also take longer to implement.

2 Statement of Principle 5 – An *approved person* performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function is organised so that it can be controlled effectively.

Statement of Principle 6 – An *approved person* performing a significant influence function must exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his controlled function.

Statement of Principle 7 – An *approved person* performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function complies with the relevant requirements and standards of the regulatory system.

3 S251 of the Companies Act

We do not think it appropriate to extend CF29, the significant management function, as an alternative to extending CF1 and CF2. This is because the persons we are seeking to bring within the scope of the approved persons regime are those whose influence on the authorised firm is closer to that of a director or a non-executive director.

We also believe that while some of these individuals exerting significant influence in parent and holding companies will fall within the definition of a shadow director, this may not always be the case.

As such, for clarity and consistency, we have opted to extend the definitions of CF1 and CF2 with some minor changes to the original proposals, which are explained below.

We have amended the extended definition of CF1 to also catch persons who are not directors of the parent or holding company but are employed by them in another position. By doing this we hope to make it clearer that it is not the position held by a person within the parent or holding company that will determine whether they fall within the extended definition, but rather the function fulfilled by a person in relation to the FSA regulated entity.

We have amended the extended definition for CF1 by removing the word 'opinions', in order to address concerns regarding ambiguity.

As is currently 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. We have added additional guidance to explain the need for an arrangement to exist in order for a function to be brought within our rules.⁴

Given the above, we expect authorised firms to be able to identify those in their parent or holding companies likely to exercise significant influence. However, we would encourage dialogue between firms and their supervisors, or our permissions department, before applications are submitted, as this will help to ensure a consistent application of the regime. Where a firm already has clear and appropriate apportionment of responsibility such that those exercising significant influence are already approved persons, these proposals may not result in additional applications for approval.

Where groups operate under a matrix managed structure, a firm will need to consider which of the significant influence functions is the most appropriate. There may be cases, for example, where a person is already approved under CF29 but whose function falls within the extended CF1 definition in which case they will cease to fall within CF29 and need to seek approval for CF1.

Shareholders are not included in the extended definition of CF1 or CF2. However, our rules – SYSC 2.1.1 R and 2.1.3 R – deal with apportionment and responsibility. Should a shareholder take a more 'hands on' approach and exercise significant influence, it may be appropriate for him or her to be approved for a significant influence controlled function, for example a senior manager (the firm thereby having clear and appropriate apportionment of responsibilities).

⁴ SUP 10.3.4 G explains that the person performing the function will only require approval if there is an arrangement or contract between the firm and holding company permitting this.

The fit and proper test (FIT) will be applied to new applications from candidates based either in the UK or overseas, as it is now using a principles based approach. 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 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 roles and responsibilities. Given this we do not consider that the extended regime will have a diluting effect or make it harder to identify those in a significant influence role in relation to an authorised firm. It is also important to remember that whilst tasks may be delegated the responsibility cannot be delegated, and remains with the approved person.⁵

Candidates who are refused approval would not be allowed to exercise significant influence over the UK regulated entity, regardless of where they are based. Those we approve and who then breach FIT or APER could face enforcement action and have their approval revoked; requiring them to cease exercising significant influence over the UK regulated entity. Refusals or revoked approvals are published, and may also have consequences for the individual in their home state. So we believe that the deterrent effect for overseas persons is comparable to those based in the UK.

FSMA requires individuals or corporate bodies wishing to acquire or increase control in a UK authorised firm, to seek approval from the FSA. The change in control process and approved persons process are distinct from one another, and will remain so following this change. 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 persons regime, in as far as qualifications and training is 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. We nevertheless believe that there is no overlap or inconsistency as a result of the changes detailed in this document.

We note the comments made about the proposal to exclude UK branches with an EEA regulated parent or holding company and UK incorporated authorised firms with an EEA regulated parent or holding company. However, these exclusions will remain for the reasons given in the CP.

Co-ordinating these proposals on an international level, or introducing grandfathering arrangements for those approved by overseas authorities would increase the costs of the exercise, and due to the time taken to get international consensus, would delay implementation, with limited additional benefit.

We do not agree with the feedback that our proposals are incompatible with the Companies Act or existing codes of practice. The approved persons regime, including the extended definition of CF1, is not restricted to the legal definition of a director under the Companies Act. We are not making any changes to the existing Statements of Principle set out in APER, 5 to 7 of which specifically apply to those in significant influence functions, including directors of a firm. The Statements of Principle apply only to the performance of

5 APER 4.6.14G

a controlled function (that is, to the activities carried on under the arrangement described in the firm's application for approval).

We do not agree that it is impractical for non-executive directors to fulfill APER Statements of Principle 5-7. It is important to note that these Statements already apply to a non-executive director of an authorised firm, so we do not see any reason why a non-executive director in a parent undertaking or holding company, whose decisions or actions are regularly taken into account by the governing body of an authorised firm, should not also be subject to the same principles.

We remain of the view that our estimated volume of applicants is reasonable. We hope the clarification provided on who we expect to be affected by these changes and the fact that we expect firms to have a dialogue with their supervisors or our permissions department before submitting any applications will provide reassurance on the expected volumes in our CBA.

In terms of the benefits, we would reiterate the statements made in the CP - in particular that the ability to hold individuals accountable for the carrying on of their responsibilities could assist prudent and sensible management, which could lead to a reduction in the wide costs potentially associated with failure of financial firms.

We asked:

Q2: Do you agree that a transitional period of 6 months is sufficient for implementation?

- 2.17 Of those that responded on this point, slightly more supported the six-month transitional period than those who opposed it. Those that disagreed suggested extending to either nine or twelve-months, the latter option having most support. Arguments in favour of an extension were to enable sufficient time to consider the full implications, take account of the FSA three-month turnaround time and the complexities and practicalities of dealing with potentially large volumes of applications from those based overseas.

Our response

We have given serious consideration to the reasons put forward for a nine or twelve-month transitional period. The main concern appeared to be around the practical issues involved for firms having to process potentially large volumes of applications. The clarification provided in response to Question 1 should provide reassurance that the volume of applicants should not be as high as perhaps some had thought. Given this, we consider that it is reasonable to expect and should be possible for firms to identify the relevant individuals, with support from their supervisors, and submit the relevant applications for an approval within the six-month transitional timeframe. This timeframe also reflects the importance we attach to these changes and on ensuring that the approved persons regime accurately reflects a firm's overall governance structure.

We asked

Q4: Do you agree with our proposal to extend the description of CF29 (the significant management function) to include more proprietary traders?

and

Q5: Do you agree with our judgment that the proposed guidance in the draft handbook text (Appendix 1) supports the expectation that all proprietary traders will be approved persons?

- 2.18 Most respondents did not respond to these questions. Those that did mostly supported the proposals and what we are trying to achieve. However, questions were raised as to whether our expectation that firms would need to seek approval for all their proprietary traders was correct and whether we have the power under FSMA⁶ to extend the approved persons regime as proposed.
- 2.19 We were also asked to clarify who is likely to be caught by the definition of a proprietary trader and how the proposals apply to third-country and EEA firms. Some respondents suggested using CF30, arguing that CF29 would not be appropriate as proprietary traders do not have a managerial influence^{7 8} and that this will impose a higher burden on those proprietary traders compared to those registered under CF30.

Our response

We remain of the view that because a proprietary trader has the ability to commit the firm's money, all proprietary traders have the potential to be able to exercise significant influence on the firm. However, we accept that 'having the potential to' exercise significant influence is not the test for the purposes of section 59 (4) and (5) of FSMA, it is whether the person is 'likely' to exercise significant influence, and we also accept the argument that not all proprietary traders are likely to exercise significant influence. We have modified our proposed guidance to reflect this, by explaining that it is our expectation that all firms will assess all of their proprietary traders to ascertain the ones that do require approval.

As explained in CP08/25, certain proprietary traders are currently caught by the approved persons regime; under CF29 if they are senior managers and either are the head of a trading desk or have trading limits that could expose their firms to significant risk if anything went wrong, or under CF30 (customer function) where a proprietary trader may deal with customers who are not market counterparties. We have extended the significant management function to include the function of committing the firm as part of its proprietary trading. For those already approved under CF29 no action will be required. For those already approved under CF30, it may be the case that these individuals also exercise a significant influence on their firm through their proprietary trading activities, and would also need to apply for CF29.

6 Section 59 (4) & (5)

7 APER 2.1.2 P Statements of Principle issued under section 64 of the Act

8 APER 3.3 factors relating to Statements of Principle 5 to 7

Given the significant risk that some proprietary traders might pose to the firm, we still think it is appropriate for them to be subject to the Statements of Principle set out in APER 5-7 within the context of their role, and that it would not be appropriate for these individuals to be approved under CF30.

While respondents asked for clarification on the definition of a proprietary trader, we have avoided being too prescriptive as to who is likely to be caught within this definition, as firms differ so much and many businesses operate in different ways, it is not possible to give any more than general guidance. It will depend on the nature of the firm's business and the role being undertaken by the individual. We would also expect firms to talk to their supervisor, or our permissions department, before submitting any applications in order to ensure a consistent application of the new requirement.

The application of CF29 to third-country and EEA-authorised firms remains unchanged and as set out in the Handbook (SUP 10.1 Application).

We asked

Q6: What are your views on the outcome of the cost benefit analysis [for the proprietary trader proposals] compared to other reasons why we might implement this proposal?

- 2.20 We received mixed comments in response to this question. Some provided strong support for the benefits to be gained and felt the proposals would help to ensure the approved person regime is applied fairly and effectively. Some also felt that the cost to firms would not be significant. However, while supporting the benefits, one respondent felt that the risks posed by proprietary traders had not been appropriately reflected in the CBA.
- 2.21 The main concern raised was with regard to the potential numbers of new applications; the figures in our CBA were seen by some as being conservative and therefore that the costs had been underestimated. Some felt the cost of submitting an application was in the region of £500 (particularly for senior staff and those based overseas) rather than the £200 we had estimated, and some noted that costs will vary between firms.
- 2.22 Some respondents questioned the benefits that the change would bring and suggested that the risk posed by rogue traders could be mitigated using other regulatory tools.

Our response

In terms of the cost of submitting an application, our estimate of £200 – as stated in the CP – was based on “Real Assurance Estimation of FSA Administrative Burdens” published in June 2006. We appreciate the actual cost of submitting an application will vary from firm to firm.

With limited additional information available, 2000 remains our best estimate of the number of additional applications expected under the original expectation that firms would need to seek approval for all their proprietary traders.

However, the policy has been modified (with the effect of reducing the number of expected applications). Under the modified policy proposal, it is our view that the number of new applications is unlikely to exceed 2000. The estimated costs as set out in the CBA in CP 08/25 therefore represents the upper bound.

The benefits again remain unchanged and as set out in CP08/25, but as also stated in CP08/25 it is not clear that the extension of CF29 alone can successfully address the issue of rogue traders. We also believe that firms should also ensure they have appropriate systems and controls in place over proprietary trading.

We asked

Q7: Do you agree that a transitional period of six months is sufficient for implementation?

- 2.23 Respondents felt that nine to twelve-months would be more appropriate. This mainly seemed to be due to the statutory three-months allowed for the FSA approval process and to deal with the practical problems of dealing with individuals overseas.
- 2.24 One respondent felt six-months would be achievable only if the clarification was provided on which traders would be required to seek approval.

Our response

As with Question 2, we have given serious consideration to the reasons put forward for a nine or twelve-month transitional period. We have also taken into account that the extension to CF29 is not as wide as originally planned (i.e. we are not expecting all proprietary traders to apply for approval) so volumes should be less, and the fact that strong support was received for these proposals. We have concluded it is reasonable to expect and should be possible for firms to identify the relevant individuals, with support from their supervisors if necessary, and submit the relevant applications for an approval within the six-month timeframe. This timeframe also reflects the importance we attach to this change to ensure that those likely to exert a significant influence on a firm are required to apply to become an approved person.

We asked

Q8. Do you agree that we should remove the limited application of the approved persons regime to UK branches of third-country firms?

- 2.25 Most respondents did not answer this question. Of those that did, the response was mostly supportive.
- 2.26 A few respondents noted that the systems and controls function, CF28, did not appear to be applied to overseas firms with UK branches in the draft Handbook text, which seemed to be at odds with the policy intentions set out in CP08/25 which stated that CF28 would apply to a UK branch of a third-country firm where appropriate. Clarification was requested as a result.
- 2.27 In addition, one respondent noted that limitations would still remain in relation to the application of significant management function (CF29) to overseas firms with an establishment in the UK⁹, and expressed the preference for these limitations also to be removed.
- 2.28 There was some concern that the guidance on significant management functions was not particularly clear as to who would need to apply for significant influence functions¹⁰ and significant management functions, particularly where a branch formed part of a potentially large group or matrix management structure. One stated that given the differing group structures it is essential that we continue to be non-prescriptive and flexible in how controlled functions are applied in the context of a UK branch.
- 2.29 A question was raised about our ability to take a proactive role in ensuring compliance or even gaining access to senior directors in third-countries where we have no regulatory jurisdiction. Concern was also expressed about directors overseas providing personal information to the FSA on their application forms due to the FSA's obligations under the Freedom of Information Act (FOIA).

Our response

We have implemented our proposals as set out in CP08/25, so that all controlled functions may apply to UK branches of third-country firms.

We confirm our intention is to amend the list of controlled functions applicable to an overseas firm which maintains an establishment in the UK from which a regulated activity is carried on to include the systems and controls function (CF28) and we have amended the Handbook text accordingly.

We have noted that some limitations remain in relation to the application of the significant management function (CF29) to overseas firms with an establishment in the UK. We have not removed this limitation as part of this review of the approved persons regime, but we will keep this matter under review.

9 SUP 10.1.7 R

10 SUP 10.9.5 & 6 (G) of the draft Handbook changes

It is not our intention that overseas firms seek approval for all their directors. Nor do we expect a firm to create a role in order to fulfil a particular controlled function, for example we would only expect to receive an application for approval of a non-executive director if one existed within the firm and he was likely to exert a significant influence on the regulatory activities of the UK branch. In addition, it may be the case that the control of the UK branch is within the branch itself or within a UK firm. The intention is to create a regime for UK branches which is consistent to that in place for overseas firms and UK subsidiaries of overseas firms. Overseas firms will need to consider how the changes in the approved persons regime apply to them individually.

As mentioned in our response under Question 1, candidates that are refused approval would not be allowed to exercise significant influence over the UK branch. Refusals or revoked approvals are published, and may have consequences for the individual in their home state. We therefore think a deterrent does exist for overseas individuals.

Should a request under the Freedom of Information Act (FOIA) be made to the FSA for personal details of (overseas) directors, it is highly likely that it would be exempt from disclosure under relevant provisions of the FOIA. We are also subject to restrictions on disclosing information we receive in carrying out our regulatory functions under FSMA.

We asked

Q9. Do you agree that we should extend the reference requirement in SUP 10.13.12R so it applies to all controlled functions?

- 2.30 Of those that commented on these proposals, most were supportive. However, some questioned the quality and usefulness of information provided in references given the unwillingness of firms to provide certain information due to fear of legal action. One of the main suggestions made to address this point was that we provide more guidance on what we would expect employers to provide.
- 2.31 A suggestion was made that the requirement should also apply where the collection of references is outsourced by a firm to an unregulated third party. A further suggestion was made to amend the rules to reflect the fact that references are requested from “current” as well as former employers.
- 2.32 Other suggestions included making references mandatory, and applying a time limit for the provision of references.
- 2.33 Some respondents felt the costs outweighed any benefits and felt that we had underestimated the time and cost of implementation.

Our response

Given the support for this change, we have implemented it largely as originally planned. We have added to our rules the suggested clarification that references are sought from current as well as former employers. We have also added guidance, as suggested, to clarify our expectation that the rule applies where the collection of references is outsourced by a firm to an unregulated third party.

We have not, however, been prescriptive on the format or nature of information we expect to be provided in references. The issue of some firms being unwilling to provide certain information in a reference for fear of litigation already exists in relation to the application of the rule to the customer function. Although we will keep this issue under review, any such requested guidance is unlikely to be comprehensive enough to address every possible scenario.

We do not consider it necessary to make it mandatory for firms to request references, or to be prescriptive on a response time for the provision of references, as this would increase the costs to the firms providing the reference.

We recognise – as stated in the CBA in CP 08/25 – that the incremental benefits of this proposal will depend on how effective those references are in shedding light on candidates' suitability for the proposed controlled functions.

List of non-confidential responses to CP08/25

A Wolters Kluwer Financial Services Company
Adam Samuel
Advanced Insurance Centres Limited
AIG UK Limited
AJS Consultancy Services Limited
Alternative Investment Management Association Limited
Altium Capital Limited
Association of British Insurers
Association of Friendly Societies
Aviva
AXA UK
Barclays
Bill Warren Compliance LLP
Bourse Consult
Brit Insurance Limited
Canada Life
CFA Society of the UK
Cofunds Limited
Compos Mentis (Training) Limited
Fidelity International
Financial Services Consumer Panel
Genworth Financial

HSH Nordbank AG
Ian W Lindsey
ICAP plc
International Financial Data Services
Investment and Life Assurance Group
Investment Management Association
International Underwriting Association
Jardine Lloyd Thompson Group plc
Lloyd's Market Association
Lloyd's
London Investment Banking Association
LPR Consulting LLP
Marcus Johnson
M G McCaig Limited
Mitsubishi UFJ Trust and Banking Corporation
Morgan Stanley
Mpac Consultancy LLP
Nabarro
National Australia Bank Limited
Northern Trust
O'Melveny & Myers LLP
Pacific Life Re
Prudential plc
Reuters Transaction Services Limited
R H Bird
Royal Liver Group
Royal & Sun Alliance Insurance plc
Standard Life
Stephen Gore
Sturgeon Ventures LLP
The Association of Finance Brokers

The Association of Independent Financial Advisors
The Association of Mortgage Intermediaries
The Bank of New York Mellon
The Bank of Tokyo-Mitsubishi UFJ
The British Bankers Association
The British Private Equity and Venture Capital Association
The Capita Group plc
The Carphone Warehouse
The Cattellyst Consultancy
The City of London Law Society
The Consulting Consortium
The Futures and Options Association
The Institute of Chartered Accountants in England and Wales
The Securities & Investment Institute
Unite the Union
Wesleyan Assurance Society
Zurich Financial Services Group

Final Handbook text

**SUPERVISION MANUAL (CONTROLLED FUNCTIONS) (AMENDMENT NO 2)
INSTRUMENT 2009**

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 64 (Conduct: statements and codes);
 - (3) section 138 (General rule-making power);
 - (4) section 156 (General supplementary powers); and
 - (5) section 157(1) (Guidance).
- B. The rule-making powers referred to above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 August 2009.

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
Statements of Principle and Code of Practice for Approved Persons (APER)	Annex B
Supervision manual (SUP)	Annex C

Citation

- E. This instrument may be cited as the Supervision Manual (Controlled Functions) (Amendment No 2) Instrument 2009.

By order of the Board
23 July 2009

Annex A

Amendments to the Glossary of definitions

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

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

proprietary trader (in SUP 10 (Approved Persons) and APER) a *person* (A) whose responsibilities include committing another *person* (B) as part of B's *proprietary trading*.

proprietary trading (in SUP 10 (Approved Persons) and APER) *dealing in investments as principal* as part of a business of trading in *specified investments*. For these purposes *dealing in investments as principal* includes any activities that would be included but for the exclusion in Article 15 (Absence of holding out) or Article 16 (Dealing in contractually based investments) of the *Regulated Activities Order*.

Amend the following as shown.

required function any of *controlled functions* 8 to 12B in the *table of controlled functions* (SUP 10.4.5R).

Annex B

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

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

4.7 Statement of Principle 7

...

4.7.2 E In the opinion of the *FSA*, conduct of the type described in *APER* 4.7.3E, *APER* 4.7.4E, *APER* 4.7.5 E, *APER* 4.7.7E, *APER* 4.7.9E, ~~*APER* 4.7.10E~~ or *APER* 4.7.11AE does not comply with *Statement of Principle 7* (*APER* 2.1.2P).

...

4.7.11A E Where the *approved person* is a *proprietary trader* under *SUP* 10.9.10R(1A), failing to maintain and comply with appropriate systems and controls in relation to that activity falls within *APER* 4.7.2E.

...

Annex C

Amendments to the Supervision manual (SUP)

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

10.1 Application

...

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 chief executive function~~ 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.
 - (2) ~~the required functions~~ 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.
 - (3) ~~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~~ the chief executive function;
 - (4) ~~[deleted]~~ the required functions;

- (5) ~~the customer function~~ the systems and controls function;
- (6) 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
- (7) the customer function.

...

10.4.5 R Controlled functions

....

Type	CF	Description of controlled function
...		
	28	[to follow]
	29	[to follow]

...

What the governing functions include

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:

...

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 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 *required functions* or the *customer function*.

...

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 *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 *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):~~ 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*.

...

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* is an *EEA firm*) whose decisions, or actions are regularly taken into account by the governing body of the *firm*.

...

- 10.6.9 G ~~{deleted}~~ 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*.

Guidance on CF1 and CF2

- 10.6.10 G (1) ~~{deleted}~~ 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).
- (2) The basic position is set out in SUP10.3.4G. 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.

...

10.9 Significant management functions

Application

- 10.9.1 R SUP 10.9 applies only to a firm which;
- (1) under SYSC 2.1.1R or SYSC 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.
- 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, are likely to exercise all the significant influence at senior management level.
- 10.9.2A G A proprietary trader undertakes activities with the firm's money and has the ability to commit the firm. By virtue of this role, all proprietary traders have potential to be able to exercise significant influence on the firm for the purposes of section 59(4) and (5) of the Act. It is therefore the FSA's expectation that all firms will assess all their proprietary traders to ascertain the ones for whom approval is required.
- 10.9.3 G ~~However, the~~ The scale, nature and complexity of the firm's business may be such that a firm apportions under SYSC 2.1.1R or SYSC 4.4.3R 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. ...

...

10.9.5 G The question may arise whether a manager who is based overseas will be performing the *significant management function* under SUP 10.9.10R(1) and should therefore be an *approved person*. This is especially true where the *firm* operates matrix management. The fact there is a *person* performing the *apportionment and oversight function*, and who has responsibility for activities subject to regulation by the *FSA*, may have a bearing on this. It is a factor to take into account when assessing the likely influence of the overseas manager.

10.9.6 G Generally, in relation to a *branch* of a *firm*, or a *firm* which is part of an overseas *group*, where an overseas *manager* is responsible for strategy, he will not need to be an *approved person* under SUP 10.9.10R. However, where he is responsible for implementing that strategy in the *United Kingdom*, and has not delegated that responsibility to a *senior manager* in the *United Kingdom*, he is likely to be performing a that controlled function.

...

Significant management function (CF29)

- 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, *client money* and similar matters.
- (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*.
- 10.9.10A G A *senior manager* carrying on the significant management function under SUP 10.9.10R(1) with significant responsibility for a significant business unit that carries on activities other than *designated investment business* for the purposes of SUP 10.9.10R(1)(a) could, for example, be the head of a unit carrying on the activities of: retail banking, personal lending, corporate

lending, salvage or loan recovery, or ~~proprietary trading~~; *proprietary trading*, or a member of a committee (that is, a *person* who, together with others, has authority to commit the *firm*) making decisions in these functions. ~~The *senior manager* could also be a proprietary trader whose trading limits are such that he may put, or potentially put, his *firm* at significant risk. This function would not extend to every proprietary trader.~~

10.9.10B G A *proprietary trader* also undertakes activities which may have a significant influence on the *firm*. Such activities may require approval for CF29 under SUP 10.9.10R(1A).

...

Who should make the application?

10.12.3 G (1) In accordance with section 60 of the *Act* (Applications for approval), applications must be submitted by, or on behalf of, the *firm* itself, not by the *candidate* or (where the *candidate* works for the *firm's parent undertaking* or *holding company*) by the *firm's parent undertaking* or *holding company*).

(2) Usually this will be the *firm* that is employing the *candidate* to perform the *controlled function*. Where a *firm* has outsourced the performance of a *controlled function*, the details of the outsourcing determine where responsibility lies and whom the *FSA* anticipates will submit *approved persons application* forms. SUP 10.12.4G describes some common situations. The *firm* which is outsourcing is referred to as "A" and the *person* to whom the performance of the ~~function~~ *controlled function* has been outsourced, or which makes the *arrangement* for the ~~function~~ *controlled function* to be performed, is referred to as "B". In each situation, A must take reasonable care to ensure that, in accordance with section 59(2) of the *Act*, no *person* performs a *controlled function* under an *arrangement* entered into by its contractor in relation to the carrying on by A of a *regulated activity*, without approval from the *FSA*. See also SYSC 3.2.4G and SYSC 8.1.1R, and for *insurers* SYSC 13.9.

...

Ceasing to perform a controlled function

10.13.12 R (1) If a *firm* (A):

- (a) is considering appointing a *person* to perform any of the ~~*customer*~~ *controlled functions*;
- (b) requests another *firm* (B), as a current or former *employer* *employer* of that *person*, for a reference or other information in connection with that appointment; and
- (c) indicates to B the purpose of the request;

B must, as soon as reasonably practicable, give to A all relevant information of which it is aware.

....

10.13.12A G The requirement in SUP 10.13.12(1)R for firm (B) to give to firm (A) all relevant information of which it is aware concerning a person firm A is considering appointing to perform any of the controlled functions, also applies where firm A has outsourced the collection of that information to another (unregulated) third party, where firm B has been made aware that the unregulated third party is acting on behalf of firm A.

...

TP 1 Transitional provisions

...

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
...					
8E	<u>SUP 10.6.4R(2)</u>	<u>R</u>	<p><u>(1) This rule deals with a person (a “director”) who would otherwise have been performing the director function for a firm under SUP 10.6.4R(2) on 6 August 2009 but who was not otherwise performing the director function for that firm at that date. This rule only applies if he was not approved at that date to perform the director function for that firm.</u></p> <p><u>(2) Between the dates in column (5), the functions described in SUP 10.6.4R(2) are not treated as forming part of the director function as respects that firm and that director unless they also fall under SUP 10.6.4.R(1).</u></p>	<u>6 August 2009 to 6 February 2010</u>	<u>6 February 2010</u>

			<u>(3) If this transitional rule has not already expired under column (5), this rule comes to an end as respects that director and that firm if and when an application is made for the director to perform the <i>director function</i> for that firm and that application is granted.</u>		
<u>8F</u>	<u>SUP 10.6.8R(1)(b)</u>	<u>R</u>	<p><u>(1) This rule deals with a person (a “non-executive director”) who would otherwise have been performing the <i>non-executive director function</i> for a firm under SUP 10.6.8R(1)(b) on 6 August 2009 but who was not otherwise performing the <i>non-executive director function</i> for that firm at that date. This rule only applies if he was not approved at that date to perform the <i>non-executive director function</i> for that firm.</u></p> <p><u>(2) Between the dates in column (5), the functions described in SUP 10.6.8R(1)(b) are not treated as forming part of the <i>non-executive director function</i> as respects the firm and that non-executive director unless they also fall under SUP 10.6.8.R(1)(a).</u></p> <p><u>(3) If this transitional rule has not already expired under column (5), this rule comes to an end as respects that non-executive director and that firm if and when an application is made for the non-executive director to perform the <i>non-executive director function</i> for that firm and that application is granted.</u></p>	<u>6 August 2009 to 6 February 2010</u>	<u>6 February 2010</u>
<u>8G</u>	<u>SUP 10.9.1R(2)</u>	<u>R</u>	<u>(1) This rule deals with a person (a “proprietary trader”) who would otherwise have been performing the <i>significant management function</i> for a firm under SUP 10.9.10R(1A) on 6 August 2009 but who was not otherwise performing the <i>significant management function</i> for that firm at that date. This rule only applies if he was not approved at that date to perform the <i>significant management function</i> for that firm.</u>	<u>6 August 2009 to 6 February 2010</u>	<u>6 February 2010</u>

		<p><u>(2) Between the dates in column (5), the functions described in SUP 10.9.10R(1A) are not treated as forming part of the <i>significant management function</i> as respects that <i>firm</i> and that proprietary trader unless they also fall under SUP 10.9.10R(1).</u></p> <p><u>(3) If this transitional rule has not already expired under column (5), this rule comes to an end as respects that proprietary trader and that <i>firm</i> if and when an application is made for the proprietary trader to perform the <i>significant management function</i> for that <i>firm</i> and that application is granted.</u></p>		
...				

PUB REF: 001865

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