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Financial Services Authority

Effective corporate governance

(Significant influence controlled
functions and the Walker review)

January 2010

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The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by 28 April 2010.

Comments may be sent by electronic submission using the form on the FSA's website at (www.fsa.gov.uk/Pages/Library/Policy/CP/2010/cp10_03_response.shtml).

Alternatively, please send comments in writing to:

Nigel Fray
Operational and Reporting Policy Team
Permissions, Decisions and Reporting Division
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Telephone: 020 7066 0442
Fax: 020 7066 0443
E-mail: cp10_03@fsa.gov.uk

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A confidential response may be requested from us under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Tribunal.

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.

1 Overview

Background

Developments in governance and regulatory policy

- 1.1 The events of the financial crisis exposed material shortcomings in the governance and risk management of some regulated firms. Although poor governance was only one of many factors contributing to the crisis, it has widely been acknowledged to have been an important one. This has led to substantial regulatory activity in relation to governance, both in the UK and internationally.
- 1.2 Our regulatory approach has for a long time placed considerable emphasis on good governance, and on the capability of individuals in governance roles, recognising the overarching and pervasive influence that these have over the establishment of effective systems and controls in firms. However, in light of recent events, we recognise that our focus on the quality of governance and the intensity of our previous supervisory assessment of it did not adequately reflect its importance. This Consultation Paper (CP) outlines the latest in a series of initiatives¹ we have taken to correct this.
- 1.3 In the wider arena of public policy, Sir David Walker has now completed his Treasury-commissioned review of corporate governance in banks and other financial industry entities. Sir David's recommendations address many current governance concerns and, as we have said publicly, we intend to play our part in supporting their delivery alongside the Financial Reporting Council (FRC) and their work in relation to the Corporate Governance Code (formerly the Combined Code).
- 1.4 Internationally, there is also increased emphasis on effective governance. The Organisation for Economic Cooperation and Development (OECD), the Corporate Governance Task Force of the Basel Committee and the International Association of Insurance Supervisors (IAIS) are each reviewing their corporate governance

¹ In October 2008, we made changes to way we approve persons performing significant influence functions; in July 2009, we made changes to the scope of some of the significant influence controlled functions in our Handbook (PS 09/14); and in October 2009, we wrote to CEOs of all relationship-managed firms explaining our more intensive approach to supervising the approved persons regime.

principles and we are engaging actively with each of these organisations as they develop this work.

Delivering effective governance in regulated firms

- 1.5 Effective governance enables a firm's board and executive to interact effectively and deliver an agreed strategy, to share a clear understanding of the related risk appetite and to establish a robust control framework to manage risk effectively across the business. Those structures, controls and processes should enable the executive to implement and monitor outcomes, strategy and risks arising, under the effective oversight and challenge of the board. High quality management information is crucial to enable appropriate decision-making and monitoring and the right judgements to be made. The structures, controls and processes must be operated by suitably experienced people, incentivised in the right way, supported by – and themselves supporting – a strong culture.
- 1.6 The effectiveness of governance in a firm is demonstrated by evidence of its practical operation, as well as by the design of governance structures and processes. The level of a Board's interest in and engagement with the businesses it governs, its strength of understanding and challenge of the risks and issues in play at any time, the visibility and accessibility of its members and the clear evidence of active oversight through the regular scrutiny and challenge of management information and reporting are all contributing factors in what we would consider good governance.
- 1.7 We have made many public statements within the context of our existing ARROW framework and completion of the Supervisory Enhancement Programme, about the increase in the intensity of our supervision and the degree of intrusiveness in areas of high risk. This strategic development applies equally to our oversight of governance arrangements in firms as it does to other prudential concerns.
- 1.8 At the same time, we have been making similar changes to the way we operate our approved persons regime, recognising that an increased intensity in our regulation of approved persons could drive improvements in the effectiveness of firm governance. We have always made clear that firms must make sure that the right people are in place for all key roles and that they take the necessary actions to deliver the right outcomes. To support this, they should ensure that topics such as succession planning, role definition, apportionment, diversity and oversight are regularly addressed in their conversations with supervisors.
- 1.9 In October 2009, we wrote to the CEOs of all relationship-managed firms to remind them of their responsibilities for approved person applications and to explain our more intensive approach to supervising the approved persons regime. In particular, we highlighted that, in the past, our approval focused in practice on seeking to ensure that approved persons were of the required probity. We made clear that we are now seeking to ensure that firms are adequately assessing the individual's competence, particularly in terms of technical skills. We explained our decision to include a searching, competence-based interview in our assessment process for key roles in certain firms and set out the results of a pilot we had been running since October 2008 to develop this framework. We also noted that the fitness and

propriety of approved persons is not a test restricted to the point of approval – their competence is liable to be critically reviewed on an ongoing basis, as part of our normal supervisory processes.

- 1.10 However, we recognise that there is further work to be done to ensure that we have the necessary regulatory foundations in place to support our efforts to deliver effective governance, and this CP seeks to address these gaps.

Significant influence controlled functions and our response to the Walker Review

- 1.11 To support our current activity and change in approach, this CP necessarily comprises a relatively disparate range of proposals for consultation:
- a new framework of classification of controlled functions (Chapter 2);
 - other changes to the approved persons regime, including the scope and definition of some controlled functions (Chapter 3);
 - some guidance on our expectations in relation to non-executive directors (NEDs) (Chapter 5); and
 - risk governance guidance and our plans for other implementing measures in support of Sir David Walker’s recommendations (Chapter 6).

We are also taking the opportunity to provide more information on our Significant Influence Function (SIF) process (Chapter 4).

A new framework of classification of controlled functions

- 1.12 We set out in Chapter Two a number of measures focusing on the role that individuals carrying out a significant influence controlled function play in the delivery of effective governance. We are aware that an individual can carry out a number of roles under one significant influence controlled function: some of those underlying roles we consider critical to delivering effective governance. We indicate which key roles we propose to identify separately from existing significant influence controlled functions. We have sought to minimise the impact of the changes that we propose on current approved persons as we transition to the new regime; but going forward, our proposed changes will enable us to assess the capability of individuals in key roles more effectively, both at the point of approval and afterwards.

Clarifying the scope of the approved persons regime

- 1.13 In Chapter Three, we detail further proposals within the approved persons regime that build on changes to the Handbook we made in July 2009, as recorded in our Policy Statement (PS) PS09/14, to ensure a consistent approach to individuals exercising significant influence over regulated firms. These include extending the regime to capture more individuals who are based outside a UK-regulated firm but who exert a significant influence upon that UK-regulated firm. We also propose to

amend controlled function (CF) 29 so that it applies to senior managers responsible for retail banking activities carried out by UK branches of EEA-authorised firms.

Approving and supervising individuals carrying out significant influence controlled functions

- 1.14 Chapter Four does not contain any consultative proposals. In that chapter we build on the contents of our October 2009 ‘Dear CEO’ letter and explain our current thinking on the approval and supervision of individuals carrying out certain SIFs. We explain our expectations of firms in terms of the information they must provide when sponsoring a candidate for approval and we emphasise the responsibility that the firm carries to assess and evidence the fitness and propriety of their proposed appointees. We also explain in detail our assessment process for applicants for approval in SIF roles, including our assessment criteria and our purpose and approach to interviewing certain applicants. We are very clear that responsibility to appoint appropriate people for key roles rests with the nomination committees of the board and executive management. The greater reliance and comfort we can obtain from the firm’s own process, the less work we will look to do.
- 1.15 We have listened carefully to concerns from both recruitment agencies and firms around the risk that these measures may deter individuals from applying to become board members. It is not our intention to deter competent individuals from providing their services to boards. However, we will address these concerns through offering to work with firms and recruitment agencies earlier in the process to provide assurances around probity upfront where possible. We also plan to develop our relationships with NEDs generally to assist them in the execution of their responsibilities. One way to give greater insights into areas of concern or focus would be, for example, to provide relevant sectoral updates. However, we wish to be clear that there is no reason for our oversight processes to have a deterrent effect where firms themselves have adequately assessed their candidates.

Non-executive directors (NEDs)

- 1.16 In Chapter Five, we acknowledge the feedback we received on our proposal to clarify our expectations of NEDs contained in our December 2008 CP (CP08/25). When we published our subsequent July 2009 PS (PS09/14) we confirmed that we would not make a final decision on that topic until we knew the outcome of Sir David Walker’s final report and recommendations. Our approach now acknowledges the variety of roles undertaken by NEDs in authorised firms. However, we consider that there are some standards that should apply universally, such as the need for firms to establish clearly the level of time commitment required of NEDs and Chairmen and we propose this should be taken into account in their appointments. Overall, we have tried to balance the need to ensure that strong candidates are attracted and appointed versus the need to develop a proportionate approach to relevant experience, with more emphasis on overall board balance and the necessary skills for the role.

Implementing the Walker Review

- 1.17 Although many of the measures proposed within this CP are highly relevant to Sir David Walker's recommendations, Chapter Six covers our specific responses to his recommendations on risk and stakeholder engagement where we have a role to play in implementation. We do not address his recommendations on remuneration in this consultation – these will be dealt with as part of our separate ongoing work on that topic.
- 1.18 The key proposals here are to set out guidance on the need for some firms, particularly listed banks and insurers, to establish board risk committees and appoint Chief Risk Officers, consistent with Sir David's recommendations. We also set out our proposals to update our rules to reflect the introduction of a revised version of the Combined Code.
- 1.19 We explain our intentions on shareholder engagement and the disclosure of firms' adherence to the Stakeholder Code. The Financial Reporting Council (FRC) is currently consulting on the terms of this code. We also explain our plans to consult, in the second quarter of 2010, on guidance on 'acting in concert'.

Client assets controlled function

- 1.20 The Treasury published a CP on 15 December 2009 titled 'Establishing resolution arrangements for investment banks'.² Their paper outlines a package of more than 30 policy initiatives designed to mitigate the impacts of any future investment firm failures, which were highlighted by the insolvency of Lehman Brothers. As part of this package, the Treasury has asked us to consider enhancing, through our approved persons regime, the regulatory controls over two roles. The first role comprises individuals who are responsible for firms' protection of clients' assets and money. The second is a new senior role, the Business Resolution Officer (BRO).
- 1.21 With the timing of the Treasury paper, we have not yet analysed the costs and benefits of creating or amending our controlled functions to capture these new requirements, or the costs that firms would incur in their ongoing compliance. So we have not proposed specific implementing measures in this CP. However, we invite views on how the approved persons regime should apply to these roles, including any relevant cost data. This will help us to identify the right approach.
- 1.22 We will be publishing a separate CP on client assets in the first quarter of 2010, where we will consider the proposal for a protection of client assets controlled function. We will respond in detail to the Treasury's wider proposals once they have been finalised, and we will address the question of the BRO role then.

2 http://www.hm-treasury.gov.uk/consult_investment_banks2.htm

Regulatory measures proposed in this CP

- 1.23 Related Handbook changes are set out in Chapters 2, 3, 5 and 6. Our analysis of the costs and benefits of our proposals, and their compatibility with our statutory objectives, can be found in Annex 1.

Who should read this CP?

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

Although some changes are made to our listing rules, they do not vary the current meaning of the rules except to reflect that a revised version of the Combined Code is expected to be introduced from 29 June 2010.

Next steps

- 1.25 Consultation on these proposals will close on 28 April 2010. We will then finalise the proposals and aim to publish the final rules in a PS during the third quarter of 2010.

CONSUMERS

The proposals in this paper extend the scope of the approved persons regime and will be of interest to both consumers and consumer bodies.

2 A new framework of classification of significant influence controlled functions

- 2.1 Under the Financial Services and Markets Act (FSMA) we have powers to regulate two types of individuals – those who have a significant influence on the conduct of a firm’s affairs and those who deal with customers (or the property of customers).
- 2.2 We created the significant influence controlled functions to capture those individuals who, in our opinion, exercise a significant influence on a firm. Both the governing body and senior management of firms have a crucial role to play in ensuring that effective governance structures, systems and controls are developed and operate well. Without the right behaviours and competence on the part of those who govern and manage firms, the establishment of sound governance structures will not succeed fully in ensuring that firms are well-run.

Identifying key significant influence roles

- 2.3 In order to improve the support our current regime provides to our regulatory objectives, we have reviewed the structure of our significant influence controlled functions. We have concluded that they are not currently sufficiently detailed to allow us to segregate and capture specific key roles within governance structures.
- 2.4 Three of the six current functions capture, within their scope, too broad a range of individual roles. This means that we are currently unable to track and vet individuals who may change roles within one of those functions, even though the competences required for each role might be different. For example, an individual approved as a CF2 (non-executive director (NED) controlled function) may, in addition to being a NED, take on the role of chair of a key board committee without any further assessment from us of the individual’s competence and capability to perform that new role.
- 2.5 We now propose to introduce a number of new, more specific, controlled functions capturing key roles in organisations. We would expect all of these roles to fall currently within the scope of the governing controlled functions (notably CF1 (director), CF2 (NED), CF4 (Partner) or CF28 (systems and controls)) and therefore we do not expect to increase, overall, the number of approved persons currently in the system. However, we see merit in separately identifying these key roles as this

will enable us to identify and assess individuals against competences we consider necessary to perform these key roles.

- 2.6 The approved persons regime currently describes 14 significant influence controlled functions, of which six are aimed at individuals who make up the governing body of a firm.

The new controlled functions

- 2.7 We propose to introduce nine new significant influence controlled functions (comprising six new governing functions and three new systems and controls functions) to capture key roles that currently fall within an existing significant influence controlled function. They are:

- chairman
- chairman of risk committee
- chairman of audit committee
- chairman of remuneration committee
- senior independent director (SID)
- parent entity SIF (see paragraphs 2.12 and 2.13)
- finance function
- risk function
- internal audit Function

- 2.8 The table below shows where these new roles will fit in the existing significant influence controlled function structure:

Significant Influence Function	Current function	New/ changed/ unchanged	Proposed new function	Section of this CP (paragraphs)
Governing functions		New	CF00 (Parent entity SIF)	2.12 to 2.13 and 3.2 to 3.14
	CF1 (Director)	Changed	Decreased scope	2.12
	CF2 (NED)	Changed	Decreased scope	2.12
		New	CF2a (Chairman)	2.3 to 2.10
			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	n/a
	CF4 (Partner)			
CF5 (Director of unincorporated association)				
CF6 (Small friendly society)				
Required functions	CF8 (Apportionment and oversight)	Unchanged	n/a	n/a
	CF10 (Compliance oversight)			
	CF11 (Money laundering reporting)			
	CF12 (Actuarial)			
	CF12A (With-profits actuary)			
	CF12B (Lloyd's actuary)			
Systems and controls functions		New	CF13 (Finance function)	2.7 to 2.11 and 2.14 to 2.16
			CF14 (Risk function)	
			CF15 (Internal audit function)	
	CF28 (Systems and controls)	Changed	Deleted	
Significant management function	CF29 (Significant management)	Changed	Increased scope	3.19 to 3.23

2.9 Where any of the new functions is performed by a director, the individual concerned should be approved for both the specific function and the appropriate executive or NED role. For example, a NED who chairs the firm's audit committee would need to hold both CF2 and CF2d. In line with this approach, we have set out in paragraphs 2.14 to 2.16 our proposal to remove the current rule that relieves individuals approved for one of the governing functions from the need to seek separate approval for a systems and controls function where that has been apportioned to them.

Which firms will these new controlled functions apply to?

- 2.10 All firms who currently have individuals carrying out these roles within their current approval as one of the governing functions or CF28 (systems and controls) will be affected by this proposal. Our transitional arrangements for existing approved persons are designed to minimise the short-term impact of this change (see paragraphs 2.17 to 2.22 below). However, we wish to make clear that we will be assessing their continuing capability to perform these specific roles as part of our normal supervisory activities.
- 2.11 Most firms will be aware that our proposal to split CF28 (systems and controls) into three separate roles reinstates the former controlled functions of finance, risk and internal audit. In November 2007, we reviewed the approved persons regime as part of our broader programme of Handbook simplification and we decided to merge the separate systems and controls controlled functions into one. While simplicity and clarity remain key objectives in our rule-making, we must also ensure that our regulatory regime is structured in a way that supports our objectives. In line with our more intrusive supervisory approach, we wish to be able to vet and regulate individuals appropriately according to their specific roles. We are therefore proposing to reinstate the separate functions.

The parent entity SIF controlled function (CF00)

- 2.12 In our July 2009 PS (PS09/14), we set out the Handbook changes that extended the approved persons regime to individuals who are likely to exert significant influence over a regulated firm from a position in that firm's holding company or parent undertaking (parent entities), except where the parent entity is authorised by us or an EEA equivalent authority. Individuals based in a parent entity who are likely to exert a significant influence downwards were, at that time, brought into the scope of CF1 (director) or CF2 (NED). However, to ensure overall consistency with our proposal in paragraphs 2.3 to 2.5 above, we consider it useful to identify and assess these individuals separately from CF1 (director) and CF2 (NED). Therefore, this proposal includes removing the extended CF1 and CF2 definitions introduced in July 2009.
- 2.13 The transitional arrangements for those 'parent entity SIFs' already approved as CF1 or CF2 are explained in paragraph 2.19.

Q1: Do you agree with our proposal to separately identify certain key roles that are performed within the CF1 (director) CF2 (NED) or CF 28 (systems and controls) controlled functions?

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

Separate approval for systems and controls functions

- 2.14 Under our rules an individual approved for one of the governing functions is not currently required to also apply for approval as CF28 (systems and controls)

function) or CF29 (significant management function), even though they may be performing that controlled function within the responsibilities of their governing function role.

- 2.15 We think that this remains the correct approach for CF29 as, for example, a director could require the same, if not higher, types and levels of competence as a senior manager of a material business unit. However, we consider that this argument does not apply equally to the roles currently comprised in CF28, where there are likely to be specific technical competences required that are distinct from those required of the governing functions. Our proposal for CF28 will also give us a greater understanding of the governance structure within the larger firms. For example, we will be able to identify those firms that have appointed a chief risk officer in line with our new SYSC guidance proposed in Chapter 6.
- 2.16 We therefore propose to require all individuals who perform one of the three new proposed systems and controls functions (CF13, CF14 or CF15) to seek specific approval for that function irrespective of whether they are also approved or seeking approval to perform any of the governing controlled functions.

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?

Transitional arrangements

Existing approvals

- 2.17 The new controlled functions will come into effect for new applications after we have made our new rules. However, we recognise that these proposals will also affect individuals already carrying out the proposed new controlled functions within their existing approval for a governing function or CF28.
- 2.18 In such cases, it is our intention to transition such individuals as seamlessly as possible into our new framework. We consider that to require individuals to seek explicit approval for roles they are already performing within their existing approvals would be excessively burdensome and unlikely to be cost-effective. We therefore propose that firms will submit a notification to us identifying which of their approved persons are performing any of the new controlled functions already, within their existing approvals. We intend to make a specific notification form available to firms for this in time for our final rules. The new controlled functions will be recorded on our Register from the date of notification.
- 2.19 This notification arrangement will also operate for individuals who have been approved as CF1 or CF2 as a result of PS09/14 (which established the need for certain individuals likely to exercise significant influence over regulated firms to be approved).

2.20 We do not propose to use the notification process to assess the competence of individuals to perform these roles, but firms and individuals should note the requirement to be fit and proper for any controlled function applies throughout an individual's tenure in a controlled function role. Our competence-based assessment approach applies not only at the application stage but also as part of our ongoing supervisory processes.

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

2.21 We propose that firms should have three months to submit these notifications telling us which of their current approved persons are performing any of the new roles.

2.22 The one exception to this is where there are individuals who currently hold a governing function but will now require additional approval for a systems and control function (CF13, 14, or 15) as this will no longer be absorbed under their governing function (as discussed in paragraphs 2.14 to 2.16 above). Here, we propose a phased approach, allowing smaller firms longer to notify us, as we believe that smaller firms are more likely to have individuals with these combined functions. We will use the previously announced scope of our Remuneration Code³ as the basis for identifying the firms that we wish to move more swiftly to the new regime. Therefore firms who are subject to the Remuneration Code will be subject to a transitional period of three months and for other firms (who will generally be smaller firms) we propose a transitional period of 12 months.

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?

New approvals

2.23 Any new applications for approval, from the date final rules are made, will need to include the new proposed controlled functions where appropriate. We will make the necessary changes to our approved persons application forms to include the new controlled functions.

3 In SYSC 19

3 Significant influence controlled functions – other proposals

- 3.1 This chapter sets out further proposals for consultation that either relate to the policy changes confirmed in our July 2009 PS (PS09/14) or stem from our general review of existing requirements.

Extending the scope and application of the proposed parent entity SIF controlled function

- 3.2 In Chapter Two we proposed the creation of a new controlled function, CF00 (Parent entity SIF), to separate out individuals who were brought within controlled functions CF1 and CF2 of the approved persons regime by the rule changes made in July 2009.
- 3.3 The individuals whom we consider should fall within the scope of the Parent Entity SIF regime are those whose significant influence on the UK-regulated firm is comparable to that of a director or NED and whose decisions or actions are regularly taken into account by the governing body of the firm.
- 3.4 In our July 2009 PS (PS09/14), two groups of firms were excluded from our rules, in respect of the approved persons regime.
- 3.5 First, individuals who are likely to exert a significant influence from within a parent undertaking or holding company (parent entity) of a UK-regulated firm that is a Limited Liability Partnership (LLP) or a non-body corporate are currently excluded. We do not believe that the corporate status of the UK-regulated firm is relevant in considering whether the persons exercising that influence should be approved, and therefore propose to delete these exclusions, except (as now) where the parent undertaking or holding company is authorised in the EEA.
- 3.6 Second, we excluded from the regime those firms whose parent entity or holding company was itself FSA-authorized. We are aware that some individuals based in FSA-authorized parent entities may already be subject to the approved persons regime and may already be approved for a significant influence controlled function. However, although that individual's responsibilities may include exercising significant influence over a UK-regulated subsidiary, their current approval is for their controlled function within the parent authorised firm. It does not, therefore,

apply to their actions in respect of the subsidiary. Under our proposals, therefore, such individuals will need to seek approval for the subsidiary as well, subject to the transitional arrangements explained below.

- 3.7 We have provided, in Annex 3, a table showing the current and proposed future scope of the Parent Entity SIF regime.

Q6: Do you agree that we should extend the proposed CF00 (parent entity SIF) 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-authorized?

Practical issues and implementation

- 3.8 The impact of our proposals to extend the parent entity SIF regime will be two-fold: they will affect some individuals who are already approved for a significant influence controlled function and some who currently are not but whose roles will fall within the scope of the new controlled functions.

Current approved persons in an FSA-authorized parent entity

- 3.9 Where individuals are already approved for a governing controlled function in an FSA-authorized parent entity and, at the commencement of the new rules, also require CF00 in a UK-regulated subsidiary of that firm, we will devise a streamlined transitional process that relies largely on the current assessment of fitness and propriety. The regulated subsidiary firm will be required to tell us which of their parent entity's approved person(s) need to be approved for the new controlled functions for the subsidiary. Although the subsequent process will place reliance on our existing assessment of fitness and propriety for the purposes of granting approval, it will still be necessary for the firm to tell us whether anything has changed since the original assessment. And the individuals concerned will nonetheless be subject to our in-post supervisory processes, as are all approved persons.
- 3.10 It is important to note that the parent entity SIF role is a specific one and is not required in addition to other controlled functions in relation to the subsidiary. For example, if an individual is performing the controlled function of CF2c (chair of the audit committee) for all the authorized subsidiaries of an authorized parent entity, under our new proposals, appropriate notifications for CF2c, rather than CF00, should be made by each subsidiary.

New approvals

- 3.11 Any individual in an FSA-authorized parent entity who is likely to exert a significant influence on a UK-authorized subsidiary and who is *not* currently approved for a governing function for the parent entity will need to be approved for the CF00

controlled function. The subsidiary will need to submit a Long Form A⁴ application in the usual manner and the individual will be subject to our fit and proper process. We will make the necessary changes to our approved persons application forms to include the new CF00 controlled function before the rules begin.

Transitional periods

- 3.12 We aim to publish our PS in the third quarter of 2010, which will include our final rules and any new or amended forms.
- 3.13 We propose a transitional period of three months from the date the rules are published for firms to identify existing approved persons in a parent who will require approval to perform a significant influence controlled function in a subsidiary. We intend to make a specific notification form available to firms for this purpose.
- 3.14 We propose a transitional period of six months from the date the rules are published for firms to identify individuals in their authorised parent who are not currently approved in a governing function and to arrange for them to be approved. Applications should be submitted on a Long Form A. Where an application is submitted within the first three months, should the application not have been decided by the end of the six months, the transitional period will extend until the application has been finally decided.

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

Extending controlled function 29 (CF29) to UK Branches of EEA Banks

- 3.15 CF29, the significant management function, currently applies to individuals in UK branches of EEA-regulated firms, in relation to their responsibilities for designated investment business regulated in the UK. It does not apply to individuals in such firms in relation to retail banking activities regulated in the UK. The only controlled function that would currently apply to retail bank branches of EEA firms is CF11 (money laundering reporting officer).
- 3.16 Our regulatory interest in retail banking activities has increased following the introduction of our new banking conduct of business regime. While we fully respect the home/host distinctions that apply in EU law, we consider that our approved persons requirements for these firms should be brought into line with the requirements that apply to similar firms conducting designated investment business. We wish to be in a position to hold an individual accountable for these activities and we believe it is legitimate for us to take this action, as all retail banking conduct of business in the UK is subject to our regulation, including business by those authorised in other EU jurisdictions.
- 3.17 We are therefore considering a proposal to extend CF29 (significant management function) to UK Branches of incoming EEA firms accepting retail deposits. We

4 http://fsahandbook.info/FSA/docs/sup/sup10_annex4D.doc

are not seeking to approve individuals whose function relates solely to activities that fall within the home state authority's jurisdiction. We recognise, therefore, that the application of CF29 will vary from branch to branch depending on how responsibilities are allocated.

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

Transitional period

- 3.18 We aim to publish our PS in the third quarter of 2010 with our final rules. No changes to our Form A approved persons application will be required.
- 3.19 If, on the basis of this consultation, we proceed with the proposal, we propose a transitional period of six months from the date the rules are published for firms to identify individuals affected and arrange for them to be approved. Where an application is submitted within the first three months, should the application not have been decided by the end of the six months, the transitional period will extend until the application has been finally decided.

Clarification of our position on 'compromise agreements'

- 3.20 We propose to amend the Supervision manual (SUP 10) to give further guidance on our rules that require firms to disclose information where an individual is suspected of doing something that may result in dismissal, or resigns while under investigation by the firm, or there are issues that may affect our assessment of the individual's fitness and propriety to be able to perform a controlled function.
- 3.21 Occasionally, firms or candidates will cite confidentiality clauses in a 'compromise agreement' as a reason for not providing relevant information regarding the circumstances of an employee's departure from their previous employment.
- 3.22 In our view, the requirements of our principles and rules override any duty of confidentiality entered into between a firm and its employee. We therefore propose to add guidance to our rules to clarify this.

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

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

- 4.1 In this chapter we provide more detail on our approved person and SIF interview process. **This chapter does not contain any consultation proposals**, but instead sets out information to help firms understand our processes and what is expected of them.

Background

- 4.2 Our regulatory philosophy has for a long time placed considerable emphasis on good governance and, consequently, on the responsibilities of directors and senior managers of firms. Clearly though, the financial crisis exposed the shortcomings in the governance and risk management of some regulated firms. Many industry commentators have raised issues about the competence of firms' senior management, as well as the level of regulatory scrutiny those persons were subject to.
- 4.3 To address these concerns, we made changes in October 2008 to the way we approve persons performing SIFs. These changes related to the way we assess the fitness and propriety of persons applying to perform these functions and included the introduction of interviews for candidates applying to perform certain SIF roles in particular firms. Since October 2008 we have further refined and embedded our SIF interview procedures into our approved persons process, as explained in our October 2009 'Dear CEO' letter. This chapter reflects those refinements made to our operating framework.

Firms' responsibilities in recruiting and sponsoring candidates for controlled function roles

- 4.4 It is important to remember that, irrespective of any enhancements we make to our assessment processes, it is the firm that remains responsible for making the application to us for approval of a candidate. **It is the firm's responsibility to ensure that the candidate is fit and proper for the role in question.**
- 4.5 Firms must ensure they undertake sufficient due diligence on the candidate to ensure they are fit and proper to perform the role for which approval is sought. We expect

firms to assess the fitness and propriety of candidates thoroughly before proposing them for an approved person role. Regrettably, we continue to find that many firms fail to conduct adequate due diligence on their candidates, resulting in delays and more intensive investigations on our part.

- 4.6 The onus is on the firm to provide sufficient information in the application process to satisfy us that they have fully assessed the candidate and can confirm that they are fit and proper under section 61 of FSMA. Failure to do so can represent for us an important indicator of the quality of the firm's systems and controls for recruitment, and persistent failures to provide robust information in support of applications may result in us taking further supervisory action.
- 4.7 The type of information that will help us to make our approval decision includes details of the:
- responsibilities that the role involves and the competences that it requires;
 - recruitment, referencing, interview and appointment processes;
 - due diligence undertaken by the firm to ensure the candidate is fit and proper; and
 - firm's rationale for concluding that the candidate is fit and proper to perform the role in question, including an assessment of the competence of the candidate and information about any action to be taken post-appointment to address any developmental gaps or training needs that have been identified.

It may also include supporting documentation or reports from third parties, such as head-hunter or other similar reports.

- 4.8 In 2008 we made changes to Section 6 of the application form, which now asks firms to provide details of the due diligence undertaken on the candidate. During 2010, we intend to make further changes to this section of the application form to remind firms to supply the above information where appropriate.
- 4.9 Where firms can demonstrate they have undertaken appropriate due diligence this may remove the need for us to conduct an interview.
- 4.10 Firms will also note, in relation to 'referencing':
- our proposal on 'compromise agreements' outlined in paragraphs 3.20 to 3.22; and
 - our intention to provide guidance to clarify that the requirement upon firms to provide information on ex-employees who performed controlled functions for them overrides any confidentiality provision they may have agreed with their ex-employee.

Submitting applications in good time

- 4.11 We expect all firms to submit their applications for approval in a timely manner. We understand that certain appointments are particularly sensitive and subject to time pressures. However, we will wish to interview some candidates, and we will not do so until we have received a completed and signed application form, and completed our initial pre-interview checks. We therefore expect all firms subject to close and

continuous supervision to engage with us at an early stage in their recruitment process (we suggest at final short-listing of candidates) at least for the roles of chair, chief executive and senior independent director. Failure to do so may mean the firm's public announcement of an appointment has to include a caveat that the appointment is subject to regulatory approval. We would also expect firms to discuss any such announcement with us in advance of its publication.

- 4.12 To further assist firms in managing the time pressures that may arise when submitting applications that may involve an interview, firms can submit applications before they have fully completed their own due diligence checks (e.g. Criminal Records Bureau and/or credit checks outstanding). In these instances, firms must use Section 6 of the application form to detail the due diligence checks they have already performed on the candidate before submission, and those that are outstanding (which will be completed by the firm before appointment). This will allow us to take the process forward, but we will expect firms to provide supplementary information about the outcomes of their final checks before final approval can be granted.
- 4.13 In some circumstances, such as where an appointment is sensitive or urgent, or a candidate's background is opaque or complex, firms may also ask us at an early stage to carry out certain standard due diligence checks on one or more candidates. The purpose would be to identify whether there are any adverse indicators in information sources that the firm would not have access to (such as checks with overseas regulators). These checks, which would focus on probity issues, would not be intended to replace the general checks that we expect firms to undertake in the course of their own due diligence.

How we determine whether persons are fit and proper

- 4.14 Our 'fit and proper' test⁵ (FIT) sets out the minimum standards that we require of an approved person. Under Section 61(1) of FSMA (determination of applications), we may grant an application for approval only if we are satisfied that the candidate is fit and proper to perform the controlled function to which the application relates. Accordingly, applications are checked against our criteria of:
- honesty, integrity and reputation;
 - competence and capability; and
 - financial soundness.
- 4.15 In the past we placed more emphasis on the first and third criteria. We have not reduced the importance that we place on these areas – however, the changes introduced in October 2008 have concentrated largely on competence and capability, through the introduction of interviews as part of our approved person process (see paragraphs 1.7 to 1.9 for a note of the relevant recent changes to our regime).

5 <http://fsahandbook.info/FSA/html/handbook/FIT>

'Baseline' checks

- 4.16 As part of our assessment of any candidate's honesty, integrity, reputation and financial soundness we will determine whether or not the candidate is already (or was previously) an approved person and check for any existing negative indicators or concerns. Where a firm is subject to relationship-managed supervision, we will consult with the firm's supervisor to understand any concerns they may have and seek their views on any issues we identify. We will also carry out other 'intelligence' checks, such as credit checks. If necessary, we will make enquiries with other regulators (for example, where a candidate is, or was, based overseas).

Competence and capability: SIF applications

- 4.17 Under FSMA, we have always had the option of interviewing applicants for approval. The decision to interview a candidate applying to perform a SIF role does not imply the pre-existence of concerns about the application in question. It will depend on the type and size of the firm, the role being applied for, the candidate concerned and any matters arising from the application (which may relate to the candidate, the firm, or both).
- 4.18 Our assessment of applicants has always been, and will continue to be, conducted by a dedicated team separate from the day-to-day supervision of firms. By taking this approach, we are able in particular to ensure consistency in the application of our assessment standards and practices. However, this team works closely with its colleagues in the firm supervision teams to ensure that we also have a good understanding of factors specific to the firm, the role and the applicant. This approach provides a positive source of mutual challenge and insight.
- 4.19 For most SIF applicants, our competence and capability assessment will focus on the completeness of the information contained in the application form and accompanying CV. In most cases, we will be able to complete all our checks without the need to meet with the candidate concerned – particularly where the firm has provided sufficient supporting information with the application. However, in certain instances, we may decide to interview the candidate as part of the approvals process.
- 4.20 As a matter of course, in line with our risk-based approach, we will actively consider the need to interview candidates applying for any of the following roles in larger, more complex or risky firms: chairman; chief executive; senior independent director; finance director/chief finance officer; risk director/chief risk officer; and NEDs whose responsibilities include chair of audit, risk or remuneration committees. However, we may decide to interview, at our discretion, any candidate applying to perform a SIF role in circumstances where we have concerns about the candidate's fitness or propriety or concerns about the applicant firm.
- 4.21 For key roles in the largest firms, our panel will be joined by one of our recently-appointed senior advisors on governance. This is likely to apply to candidates for chair, chief executive, senior independent director and the chair of audit, remuneration or risk committees, particularly in the banking and insurance sector.

- 4.22 In certain cases, we may also decide to meet separately with appropriate representatives from the firm (for example, the chairman of the nomination committee) to gain additional insight into the due diligence the firm has undertaken on the candidate concerned.

The added value of interviews

- 4.23 The wide-ranging content of the interview, explained in paragraphs 4.34 to 4.37, reflects our desire to use it not only as an assessment tool, but also as a means of ensuring that candidates for key SIF roles have a clear understanding of our objectives, expectations and their responsibilities. The interview also allows us to alert the candidate to areas where we consider they need further development in order to meet and maintain our standards of fitness for approval.
- 4.24 In addition to the educative and development benefits the interview provides, we believe that it is a valuable tool for raising the standards of governance and control in many firms. Many candidates have fed back that they found the interview process to be helpful and constructive, and that it has given them an insight into our view of the firm and its regulatory risks. Topics discussed have regularly led to positive follow-up action in the firm, initiated by the new approved person.

Our competence-based approach

- 4.25 To support our assessment of candidates for SIF roles, we have identified the following key competences against which we may assess the majority of candidates before and during the interview.

Core competences for SIFs
Market knowledge – awareness and understanding of the wider business, economic and market environment in which the firm operates.
Business strategy and model – awareness and understanding of the firm’s business strategy and model appropriate to the role.
Risk management and control – the ability to identify, assess, monitor, control and mitigate risks to the firm. An awareness and understanding of the main risks facing the firm and the role the individual plays in managing them.
Financial analysis and controls – the ability to interpret the firm’s financial information, identify key issues based on this information and put in place appropriate controls and measures.
Governance, oversight and controls – the ability to assess the effectiveness of the firm’s arrangements to deliver effective governance, oversight and controls in the business and, if necessary, oversee changes in these areas.
Regulatory framework and requirements – awareness and understanding of the regulatory framework in which the firm operates, and the regulatory requirements and expectations relevant to the SIF role.

- 4.26 In developing and applying our competence criteria, we recognise that we cannot apply a ‘one size fits all’ approach to our assessments. Individuals holding SIFs perform a broad range of roles within the scope of our controlled functions, and they do so in a range of firms that may vary widely by size, nature and complexity. Therefore the level of competence each candidate will be expected to demonstrate will depend on the role to be performed and the type and size of the firm concerned.
- 4.27 We do not propose to assess the competence of every candidate for SIF approval against each of these criteria. To do so would be disproportionate and excessively resource-intensive. In each case, we will expect the firm to provide sufficient evidence that they have themselves considered these matters in their recruitment processes. When recruiting new board members we will also look to see if a firm has taken into account its statutory duties in relation to equal pay and non-discrimination. The level of our scrutiny and challenge of this evidence and any gaps or concerns will reflect the level of risk inherent in the role, the individual and the recruiting firm.
- 4.28 We also recognise that in some circumstances, the level of competence required for an individual will depend on the balance of the team in which they are going to operate. This is particularly relevant when looking at the knowledge, skills and experience of a firm’s board as a whole. As an example, we would generally expect NEDs to have a good level of market knowledge appropriate to the business of the firm concerned. However, there may be cases where an individual lacking such knowledge would otherwise be an excellent candidate for a firm. In those circumstances, we will expect the firm to assess the impact of this in the context of the board as a whole, and be able to demonstrate that:
- there will be enough industry knowledge across all the NEDs for the board to meet its collective responsibilities; and
 - they have prepared a structured development plan to bring the candidate in question up to speed in a timely way.
- 4.29 This example illustrates the important contribution that the firm’s information will make to our decisions about the matters we need to probe in interview.
- 4.30 We will not always explore each competence in the same depth during the interview. For example, if a candidate applying for the position of chairperson at a life insurance company has clearly spent many years working in the relevant industry sector in various senior management positions, then exploring the candidate’s level of market knowledge during the interview is likely to assume a much lower priority than other important topics.

Non-technical skills and behaviours

- 4.31 We do not intend to assess matters in which we do not have a regulatory interest. We will, however, consider relevant non-technical skills and behaviours as part of our assessment, particularly in relation to the individual’s ability to play their role in delivering ‘effective governance’ and their willingness to work with us in an open

and cooperative manner. Appropriate behaviours are often critical to the delivery of effective performance in a key regulated role.

- 4.32 Other, non-technical skills may also be relevant. We would expect a NED candidate seeking approval for the additional role of audit committee chair to be a highly authoritative individual, capable of challenging the executive effectively and marshalling the diverse skills and contributions of the committee members. While these are not skills tied to financial services, they are pivotal in delivering effective governance and therefore relevant to the individual's capability as an approved person for that controlled function.
- 4.33 Where we identify any gaps in competence, behaviours or non-technical skills, we will look for evidence that the individual recognises such gaps, understands their importance and is capable and willing to address them.

What to expect during the interview

- 4.34 The key purpose of the interview is to help us assess the candidate's fitness and propriety, including their competence and capability, to perform the role in question.
- 4.35 When a decision has been made to interview, we will constitute a panel to plan and conduct the process. Interview panel members of appropriate seniority will be selected taking account of the firm, candidate and role being applied for. The panel will normally be made up of supervisors, technical specialists and other specialist support if required (for example from our Senior Advisors⁶). In selecting interview panel members, we are mindful to avoid any conflicts of interest that might arise.
- 4.36 The interview (which will take place at our London office and last about 90 minutes), will explore a range of issues that are relevant to our approval decision, including, but not limited to:
- the general responsibilities of an approved person;
 - the candidate's understanding of the role they have been asked to perform and, consequently, their responsibilities;
 - the knowledge, skills and experience that the candidate will bring to the role;
 - the candidate's view of the main risks facing the firm and the role they play in managing them; and
 - our expectations of the individual in performing the SIF role.
- 4.37 In addition to assessing candidates against the competences set out above, we may also explore the candidate's motivation for accepting the role, their capacity to perform the role in view of other commitments (see Chapter 5) and their own due diligence on the firm and the position before accepting the role.

6 We recently announced the appointment of five new senior advisors who will assist the FSA in its work on governance issues, including the panel interview process:
<http://www.fsa.gov.uk/pages/Library/Communication/PR/2009/162.shtml>

Interviewee support

- 4.38 We would not generally expect the candidate to be accompanied to the interview by another individual from the firm. Part of the purpose of the interview is to discuss the candidate's understanding of the firm and its business model, and their views on the risks the firm may face. We believe this discussion will take place more freely when the person is unaccompanied. However, we recognise that there may be exceptional circumstances (for example, if the candidate has a disability) where it may be appropriate for them to bring an assistant to help with practical matters. In such circumstances, however, we would expect the contribution of the supporting individual to be limited to the purpose for which they were invited.

Post-interview action

- 4.39 Based on the information provided by the firm/candidate in the application form and the answers provided to the questions during the interview, we will decide whether to grant approval of the application.
- 4.40 Where we decide to grant an application, we will provide written notice to the firm, who in turn should notify the individual concerned. In addition, we will normally write to the candidate setting out the key points of the discussion, which will include our understanding of the person's priorities during their first few months in post, and any action points agreed (see paragraph 4.28). A copy of this letter will also be sent to the firm.
- 4.41 There may be instances where we will decide to approve an individual although the interview highlighted areas of development for the candidate concerned. In these instances we may ask the individual and firm to put an action plan in place to complete appropriate training and development in those areas. As part of our normal supervisory activity, we will then follow up with the firm and the candidate to check that the action has been completed.

Refusals

- 4.42 In circumstances where we are minded to refuse an application, we will initially discuss our concerns with the firm and the individual concerned. In our experience, many firms and individuals decide to withdraw or modify their application at this stage in light of our feedback. However, should the firm decide to pursue the application despite hearing our concerns, the case will be referred for decision by our Regulatory Transactions Committee (RTC). This is one of our internal staff committees set up to make decisions about when and how to exercise some of our statutory powers.
- 4.43 If the RTC decides that the approval should not be granted, a warning notice will be issued privately to the firm. At this point, the candidate and firm have the option either to withdraw the application, or make written or oral representations to our Regulatory

Decisions Committee (RDC) and ultimately, the Financial Services and Markets Tribunal (FSMT). The decisions made by the RDC and the FSMT may be published.⁷

Supervising SIFs in post

- 4.44 Approval to perform a controlled function brings with it a number of important responsibilities, including a duty to be aware of and comply with our regulatory requirements and expectations. Once approved, the performance and competence of persons performing SIFs will be reviewed as part of ARROW assessments. These reviews will take account of our rules, in particular those contained in APER and FIT, which are relevant to both becoming and remaining an approved person. Non-compliance with our regulatory requirements may result in us taking action (which could include enforcement action) against the firm and/or the approved person concerned.
- 4.45 With this in mind, it is our intention to develop a standing programme of briefings on regulatory matters aimed particularly at NEDs to keep them up-to-date with our general regulatory priorities and concerns and the expectations that we have of them as approved persons. We will provide further information about this programme on our website.

⁷ An explanation of the RDC can be found at: <http://www.fsa.gov.uk/Pages/About/Who/board/committees/RDC/index.shtml>
Information about the FSMT can be found at: <http://www.tribunals.gov.uk/Finance/FinancialServicesMarkets.htm>

5 Non-executive directors (NEDs)

The commitment of NEDs and Chairpersons

- 5.1 The Walker Review recommended that the overall time commitment of NEDs as a group on a FTSE 100-listed bank or life assurance company board should be greater than has been normal in the past. Sir David Walker recognised that how this is achieved in particular board situations will depend on the composition of the NED group on the board. However, he recommended that for several NEDs, a minimum expected time commitment of 30 to 36 days in a major bank board should be clearly indicated in letters of appointment and will in some cases limit the capacity of an individual NED to retain or assume board responsibilities elsewhere. He also recommended that for any prospective director where so substantial a time commitment is not envisaged, the letter of appointment should specify the time commitment agreed between the individual and the board.
- 5.2 We agree that the level of commitment required for the chairmen and NEDs of major firms is substantial, and consider that the capacity to deliver it is relevant to an individual's capability to perform these controlled functions. We therefore propose to make clear in our guidance on the 'fit and proper' test for approved persons that in assessing an individual's capability, we may have regard to the extent to which they are capable of meeting the level of time commitment that the firm has specified in its contractual terms of appointment for the role. It will be for the firm and individual, as part of the application for approval, to demonstrate they have given due consideration to the amount of time required for the role, and that the individual has the capacity to deliver it. In relation to NEDs and chairpersons, we would expect a firm to have taken into account any time individuals have committed to other roles and activities, including other NED positions held at other companies, when considering whether the individual is capable of undertaking the proposed role.
- Q11: Do you agree with our proposed guidance on the time commitment required for chairmen and NEDs?
- 5.3 Our key message remains that NEDs have a pivotal role to play in the active governance of firms. Where it appears to us that executives have persistently made poor decisions, we will look closely at NEDs' performance if we feel they have not

intervened in a timely and sufficient way. Consistent with this message, we propose to delete current guidance⁸ in the Handbook that discusses the limits of NED liability. While it is not our intention to take disciplinary action against a NED (or any other approved person) for matters that clearly fall outside the scope of their responsibilities, we believe those responsibilities are broad. We are concerned that the existing guidance could be misinterpreted and taken to mean that we would not hold NEDs responsible for, for example, failing to intervene and challenge the executive. This is not the case, as we see such challenge and intervention as a key part of any NED's responsibilities.

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

Response and feedback from CP08/25

- 5.4 In our December 2008 CP (CP08/25), we included proposals to clarify our expectations of NEDs. When we published our July 2009 PS (PS09/14) we confirmed that we would not make a final decision on the proposals until we knew the outcome of Sir David Walker's final report and recommendations. We now outline the feedback we had to these proposals and set out our response in light of Sir David's final recommendations and the feedback we received.

We asked in CP08/25:

Q: Do you agree with our proposed guidance (as outlined in Appendix 1) that clarifies the role of non-executives?

- 5.5 We are grateful for the many responses we received from a broad range of banks and financial institutions, including from their respective trade associations. Many of the substantive issues raised by respondents centred on the scope of our proposed changes to clarify the role of NEDs (for example, querying whether or not it is appropriate for NEDs to be responsible for the appointment and performance of key staff) and certain issues surrounding the proposed drafting of the Handbook guidance. There was, however, an overarching concern, expressed by many, that our proposals will be too burdensome and prescriptive and they might deter individuals from taking on NED roles and thereby depriving firms of valuable knowledge and experience.
- 5.6 A number of organisations also wondered whether our proposals are necessary at all, bearing in mind that other guidance (for example, the Financial Reporting Council's Combined Code and that used by other, third party organisations, such as the Institute of Chartered Accountants) already covers many of the issues that we proposed including in our Handbook. There was a feeling too that our expectation that NEDs should challenge the executive and intervene where necessary was insufficiently clear – for example, about how this challenge and intervention should take place.

8 SYSC 2.1.2G & 4.4.4G

Our response: The original intention of the proposed guidance was to reinforce standards for NEDs and our view on this has not changed. However, there have been a number of developments since our proposal in CP08/25 and we need to make sure that our policy reflects these. We are aware that NED responsibilities will vary greatly depending on what they are actually doing and it was never our intention that the proposed guidance should imply that all NEDs have all the responsibilities suggested.

After considering Sir David Walker's final recommendations, our policy thinking has moved on and this is reflected in our proposals regarding our new controlled functions that specifically focus on the different roles performed by NEDs. We believe this approach better reflects the diversity of NED roles within the industry and that the proposed guidance in CP08/25 is no longer required.

6 The Walker Review

Introduction

- 6.1 In February 2009, Sir David Walker was asked by the Chancellor of the Exchequer to review corporate governance in UK banks in light of the experience of critical loss and failure throughout the banking system. His terms of reference, which are available on the Treasury's website⁹, initially referred only to banks but were subsequently extended to allow his review to identify where his recommendations were applicable to other financial institutions.
- 6.2 Sir David published his review in draft form for consultation on 16 July 2009. We wrote to him on 30 September, setting out our initial intentions regarding those of his recommendations that anticipated some action on our part. Following his consultative process, Sir David published his final report on 26 November 2009 and we have welcomed his thorough and insightful conclusions. His recommendations address a wide range of current governance issues and we are keen to support their delivery.
- 6.3 We consider that a number of Sir David's recommendations could be implemented at least in part through our regulatory actions, and have provided in Annex 4 a table showing our planned contribution to the implementation of each of Sir David's recommendations.
- 6.4 In some cases, changes to our rules and guidance will be needed. In others, we will ensure that our supervisory practice is designed to identify any deficiencies in the required quality and operation of firms' governance arrangements. Further detail on this latter point is provided in paragraphs 6.8 to 6.13.
- 6.5 Many of the recommendations relate to the roles and competence of key individuals in firms' governance structures. We are confident that our other proposals contained in this CP are well-aligned with Sir David's intentions and will contribute substantially to delivering improved governance outcomes.
- 6.6 This chapter deals with the other recommendations that Sir David has made, in respect of risk governance and shareholder engagement, and sets out our proposals in response to them.

⁹ http://www.hm-treasury.gov.uk/walker_review_information.htm

- 6.7 We have not, however, included in this CP any new policy proposals on remuneration. While we welcome Sir David's recommendations, we consider that our policy approach has been well explained in our earlier consultation and feedback statements, and we intend to fold any actions arising in response to Sir David's review into our ongoing work on that topic.

Our supervision of governance

- 6.8 Sir David notes in his review that 'ideally, corporate governance and regulation of a financial entity should be mutually reinforcing' and makes a number of references to the role ongoing regulation through our supervisory activities will play in supporting the changes arising from his recommendations.
- 6.9 We have mentioned, in paragraphs 1.7 to 1.9 of Chapter 1, the increased intensity of our supervisory approach. We believe this renewed emphasis on the standards and quality of governance in firms supports the overall thrust of Sir David's recommendations and will help to introduce the more effective practices needed to deliver a step-change in the way financial services firms are governed.
- 6.10 For our major banks, our evolving approach continues to focus on enhancements in stress-testing capital, monitoring liquidity and assessing business model sustainability. However, equally, it will include reviewing in greater depth the effectiveness of governance and risk management through our ongoing supervisory oversight activities. The quality of governance and risk management in individual firms has been a topic on which we have frequently asked 'skilled persons' to report to us over the past 18 months, using our powers under s.166 of FSMA. We expect this emphasis to continue.
- 6.11 Our in-depth review of governance will now involve more intensive work on a continuing basis through the ARROW supervisory period. In addition to holding meetings with board members and key senior executives below board level, we will increase our focus on the NEDs, particularly the senior independent director and the chairs of key board committees.
- 6.12 In evaluating the quality of governance, we will look closely at:
- the practical effectiveness of board, management and organisational structures including shareholder relationships, particularly looking for evidence of depth of understanding and effective discussion, challenge and risk-based decision-making in practice;
 - the formulation of strategy and determination of risk appetite and the subsequent monitoring of performance against strategy/appetite, including the role of the key control functions;
 - the quality of the reporting and analysis of management information and reporting to the board and evidence that it is understood and gives rise to feedback and actions; and
 - the key factors, such as incentives and culture, which support and enable robust governance, building on the work already taking place to verify compliance with our new code of remuneration practice.

- 6.13 This more intensive work on governance will be complemented by an in-depth review of the group-wide risk management function during the ARROW supervisory period, in turn supplemented by one or more in-depth reviews of particular risk areas (such as credit and market risk) each year.
- 6.14 Some aspects of this approach to governance and risk management for major banks will be more generally applicable to other firms, including insurance companies, although the level of intensity will vary according to the impact of the firm. We will also be reviewing the governance and risk management aspects of our ARROW risk framework in light of the evolving approach set out above. This may lead to some minor modifications to our published ARROW material in due course.

Our proposals

- 6.15 We propose to:
- amend existing references to the Combined Code (CC) in our Handbook to ensure that the current provisions will apply to the Corporate Governance Code (CGC) when it comes into effect; and
 - implement Sir David's recommendations 23 to 26 regarding Chief Risk Officers and board risk committees through guidance in our High-level Systems and Controls Sourcebook (SYSC).

We also indicate our intentions in relation to Sir David's recommendations 19 – 20B on Shareholder engagement.

Combined Code 'comply or explain' disclosures

- 6.16 The Combined Code (CC) – to be known in future as the UK Corporate Governance Code (CGC) – sets out standards of good practice for leadership, effectiveness, accountability and communication. The Financial Reporting Council (FRC) is responsible for the content and oversight of the code as part of its responsibilities to promote confidence in corporate governance and reporting.
- 6.17 The FRC initiated a review of the CC in March 2009. They later extended that process to allow for further changes reflecting Sir David's recommendations to be considered. On 1 December 2009, the FRC announced the outcome of its review of the CC and published its draft CGC for consultation. That consultation closes on 5 March 2010, and we expect the CGC to apply for accounting periods beginning on or after 29 June 2010.
- 6.18 The provisions of the CC are supported in our rules principally by a 'comply or explain' requirement in our Listing Rules, under which issuers with a primary ('premium' from 6 April 2010) listing are required to report on the extent to which they comply with the provisions of the code and, where they do not, to explain their reasons. The Listing Rules also require issuers to state how they have applied the principles of the code. It is our intention to continue this approach for the revised code when it comes into effect.

- 6.19 We therefore propose to amend our rules so as to refer to the updated code from the date it becomes effective and to make a number of other consequential changes to our rules.
- 6.20 Our proposal to remove the reference in the Listing Rules to Section 1 of the CC reflects the fact that the FRC intends to remove section 2 (Institutional Shareholders) from the new version of the code, subject to the development of a stewardship code for institutional investors. The need for the reference to Section 1 therefore becomes redundant. This change has no substantive effect on the meaning of the rules. We have also taken the opportunity to update cross references and replace references in our rules to the ‘Committee on Corporate Governance’ with references to the ‘Financial Reporting Council’. We have also updated the reference to ‘Guidance for Directors issued by the Institute of Chartered Accountants in England and Wales’ to a reference to ‘Internal Control: Revised Guidance for Directors on the Combined Code’ issued by the Financial Reporting Council.
- 6.21 As the FRC is consulting on its revised code following extensive earlier consultations on the detailed points for revision, our consultation assumes that the final code will not differ materially from the consultation draft. In the event there are material changes to the code it may be necessary for us to re-consult on our rules.
- 6.22 Our rules also contain transitional provisions in our Senior Management Systems and Controls Sourcebook (SYSC), Statements of Principle and Code of Practice for Approved Persons (APER), Listing Rules (LR) and Disclosure and Transparency Rules (DTR) to reflect the fact that the old version of the code will continue to apply to accounting periods beginning before 29 June 2010.
- 6.23 We also propose to amend the references to the CC in our Building Societies Regulatory Guide (BSOG) guidance, where it is recommended as a basis for appropriate standards of corporate governance in building societies.

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

Risk oversight

- 6.24 Sir David Walker has placed particular emphasis, as do we, on the central role of the governing body, or board of directors, of a firm in ensuring that risk is properly managed within a financial services firm. We fully agree with his view that boards must take appropriate steps to ensure that, in addition to the necessary review of the quality and effectiveness of internal controls in their firm, the overall risk appetite of the firm is clearly articulated and its future strategy appropriately aligned with that risk appetite.
- 6.25 Sir David has described how the scale of work required to deliver the necessary level of active oversight of risk in larger and more complex firms, means that some boards will need to delegate the detail of this work to a sub-committee established for that purpose. This committee would be charged with advising the board on high-level issues about current risk exposures and future risk strategy. We agree with Sir David’s analysis and propose to include guidance in SYSC on the need for firms – in particular, as he

recommends, FTSE 100-listed banks and insurers – to consider the value of establishing such a committee. As indicated elsewhere in this consultation, we consider the role of chair of this committee to be of such significance to the quality of risk governance in the firm that it merits identification as a specific controlled function.

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

6.26 Similarly, we have long stressed the importance to regulated firms of an effective and independent risk oversight function ('second line of defence'). We agree with Sir David that boards should, where possible, ensure that one individual is appointed within the executive to be accountable to them on risk issues. The board should be able to look to this person for advice on the subject of risk, so we are proposing to give guidance in SYSC on the need for some firms to appoint a chief risk officer (CRO). This senior executive will play a pivotal role in ensuring that the board receives balanced and accessible information and advice on high-level risk issues.

6.27 We have sought to reflect in our guidance the key elements of Sir David's recommendations in relation to the:

- the primacy of the CRO's accountability to the board, underpinned by adequate seniority in the executive hierarchy;
- the CRO's need for independence, access and resource;
- the CRO's responsibility for delivering advice to the board on enterprise-wide risk management issues; and
- the provision of independent challenge to the executive on matters relating to risk, particularly in relation to strategic proposals, and including the risks in the business' capital and liquidity strategies.

6.28 In addition, we have identified the need for the CRO to oversee the quality of risk data used within a firm, to ensure that it is reliable and sufficient in its depth and scope, and to validate the firm's external disclosures on risk.

6.29 We have noted that Sir David has directed his recommendation on the role of the CRO at banks and other financial institutions (BOFIs) and that the precise definition of this term raised many comments in response to the consultation on his draft. In his final version, Sir David has clarified that the scope of his recommendations was substantially influenced by the terms of reference provided to him, and that it will be for us to determine the appropriate scope of the measures we put in place to capture the intent of his recommendation. We consider that it will be appropriate for many firms, according to their nature, size and complexity, to appoint a CRO, but there will be others for whom it will be clearly unnecessary or disproportionate. We have therefore not sought to limit the scope of our guidance to specific firms. We expect that if firms are in any doubt about the appropriateness or desirability of appointing a CRO in line with this guidance, they should discuss the matter with their supervisor.

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

Shareholder engagement

- 6.30 In his review, Sir David highlights the importance of communication and engagement between companies and their shareholders. Sir David has identified the potential for long-term shareholders, as owners, to influence the quality of governance in the financial services firms they invest in, other than by simply divesting their holdings when dissatisfied. He has observed that such intervention could offer ‘a means of increasing absolute returns by addressing issues in the company in a timely and influential manner and thus improving long-run performance’.
- 6.31 Sir David has identified the Stewardship Code, developed by the Institutional Shareholder’s Committee, as providing a sound foundation for engagement policy for those who might reasonably be expected to engage.
- 6.32 We are pleased that the FRC has agreed to take responsibility for consulting on the content of the Stewardship Code with a view to ensuring that it can be operated effectively. The FRC published its consultation on 19 January and the consultation will close on 19 April.
- 6.33 We agree with the importance Sir David attaches to public disclosure of a firm’s shareholder engagement strategies and activities. We plan, therefore, to monitor and contribute to the FRC’s consultation on the Stewardship Code. In light of that process, we will consult on a disclosure rule as recommended by Sir David. This will require investment firms to disclose publicly the extent to which they comply with the Stewardship Code and explain, where relevant, their reasons for not doing so. For many firms, such a disclosure will entail no more than an indication that, because of the nature of their business model, they do not engage actively and do not consider that their customers expect such engagement. For others, a more detailed consideration of how the Code will apply to their business and how they observe or fail to observe it will be required. It will be for their customers to judge whether the level of engagement described is satisfactory for their needs.
- 6.34 However, we are also aware of planned European legislation that may have an impact on this work. The European Commission will shortly be bringing forward ‘level 2’ legislation, which will apply to the managers of UCITS schemes. This is expected to include some requirements about the exercise and disclosure of voting rights in investee companies. It will come into force in mid-2011. We will address the implementation issues arising from this in due course and will seek to ensure consistency as part of our implementation work.

‘Acting in concert’

- 6.35 We also realise the need to provide firms with more clarity about our interpretation of the expression ‘acting in concert’. We propose to provide guidance on this subject in a separate consultation in the second quarter of 2010.

Cost-benefit analysis and compatibility statement

Cost-benefit analysis

1. We have already taken steps to address the causes of the financial crisis through policy initiatives such as changes in the prudential regime. It is our view that the proposals in this CP could complement these existing initiatives.
2. The original CP¹⁰, in which we consulted on the establishment of an approved persons regime, outlined the benefits associated with a vetting and approval system. These include ensuring that individuals who exert a significant influence on a firm are assessed against appropriate standards of behaviour necessary to protect the interests of firms and their consumers. We observed in that CP that regulatory oversight could assist in delivering those benefits.
3. A more intrusive Significant Influence Function (SIF) approval process, the ability to hold individuals accountable for the carrying out of their responsibilities, along with a more granular approved persons regime, could assist prudent and sensible management. These, along with our initiatives in other areas (e.g. prudential and liquidity requirements) could contribute to a reduction in failure and a reduction in the wide costs associated with failure of financial firms.
4. However, the realisation of such benefits will depend on how effective our fit and proper assessment is in screening out ‘unsuitable’ candidates and how frequently our intervention – both actual and potential – will yield better or more suitable candidates.
5. For firms who otherwise would not have board risk committees and board-level CROs, our guidance on these issues could provide a useful structure within which firms could discuss, set and monitor their risk appetites.
6. We set out the cost benefit analysis for each proposal in the below sections, but this table provides an overview of the associated costs.

10 <http://www.fsa.gov.uk/pubs/cp/cp53.pdf>

A summary of the costs of each proposal

Proposal	Firms – initial implementation costs (£)	Firms – annual ongoing costs (£)	FSA – initial implementation costs (£)	FSA – annual ongoing costs (£)
Granularity of SIF regime				
- IS			1,000,000	
- Notifications	152,500		45,750	
- Applications (standard)		146,000		32,120
- SIF interviews		810,300		460,000
Sub-total	152,500	956,300	1,045,750	492,120
Extension of SIF regime to FSA-authorized parents				
- Notifications	9,000		2,700	
- Applications (standard)	8,000	40,000	1,760	8,800
- SIF interviews	44,400		25,200	
Sub-total	61,400	40,000	29,660	8,800
Extension of SIF regime to parents of LLPs and non-bodies corporate				
- Notifications				
- Applications (standard)	8,000	4,000	1,760	880
- SIF interviews	44,400	22,200	25,200	12,600
Sub-total	52,400	26,200	26,960	13,480
Extension of CF29 to EEA incoming deposit takers				
- Applications (standard)	18,000	9,000	3,960	1,980
- SIF interviews	9,250	9,250	5,250	5,250
Sub-total	27,250	18,250	9,210	7,230
Total	293,550	1,040,750	1,111,580	521,630

The increased granularity of the approved persons regime

7. We consider that the proposed increased granularity of the approved persons regime could increase our ability to vet and track individuals moving into and between key roles. To the extent that our approved persons regime could successfully stop unsuitable persons from taking up key roles, then some benefits associated with effective vetting and approval systems, such as improved quality of decision making and less reckless behaviour, may be realised.
8. Creating the new functions will have an impact on our systems, at an initial estimated cost of up to £1m.

9. There will also be implementation costs, both for firms, in notifying us about individuals who are already performing the newly defined controlled functions within their current approvals, and for us, in recording this information on our systems. We calculate that around 6,100 individuals will need to amend their controlled functions as a result of this proposal¹¹ at a cost of approximately £152,500 (£25 per notification¹²) to the industry and 45,750 (£7.50 per notification¹³) to us.
10. In addition, ongoing costs will arise because firms will now need to seek new approval for some individuals when they move between roles whereas those roles were previously comprised in one controlled function. For example, an existing NED of the firm will now need additional approval to become chair of its audit committee. We estimate approximately 730 additional applications arising as a result.¹⁴ According to the 'Real Assurance Estimation of FSA Administrative Burdens' (June 2006)¹⁵ it costs a firm on average £200 to prepare and submit an application form. Therefore, 730 applications will cost the industry an estimated minimum of £146,000. It is estimated that the cost to us of processing each application will be a minimum of £44 per application i.e. £32,120). However, we would expect to interview about 438 candidates¹⁶, at an additional cost to firms of £1850 each¹⁷ i.e. £810,300, and to us of £1050¹⁸ each i.e. £460,000.
11. With the introduction of increased granularity of the approved persons regime and our more intrusive approach, there is a risk that firms may place over-reliance on our approved persons process.

Further extending the SIF regime to individuals in FSA-authorized parent entities

12. We estimate that around 400¹⁹ new approvals will be generated by implementing the proposed further extension of the approved persons regime to SIFs based in FSA-authorized parent entities. We expect most of these individuals will already hold a SIF controlled function for a role they perform within the parent entity. We

11 We expect it to be likely that a significant number of the notification generated will come from those individuals who currently hold CF28 (approx 5000) and, within high impact firms specifically - CF2s (approx 1000) and CF1s (approx 2500). Assuming that all CF28s will be affected, 50% of CF2s and 10% of CF1s (adding an uplift of 20% for CF1 and CF2 for non-high impact firms that may be affected), plus approximately 200 individuals that applied for CF1 or CF2 specifically as a result of the extension to these controlled functions in PS09/14 (and who will need to transfer to the new Parent SIF or one of the other granular CFs if more appropriate), the estimated number of notifications likely to generated is 6,100.

12 We have estimated the notification cost to firms to be £25.

13 We have based our estimate of the FSA cost of administering a notification on 15 minutes for a full time employee.

14 Assuming an average 12% annual turnover in these roles from such internal moves (i.e. within the same firm and within what would have been the same function)

15 http://www.fsa.gov.uk/pubs/other/Admin_Burdens_Report_20060621.pdf

16 Based on interviewing 60%, assuming a majority of those in high impact firms are interviewed.

17 Assuming an hourly rate for a director's time of £365 (based on basic salary rate of 2 large banks) and approximately an average of 5 hours for the SIF interview process. We have assumed that comparable costs will apply for NED interviews. Some firms may wish to use the services of external agencies to help prepare candidates for an interview, but we have not included this discretionary cost in our estimates.

18 Assuming that the average cost to FSA of each SIF interview is between £500 and £1600 (based on the hourly rates for various panel combinations, based on 4 persons attending and spending approx. 2.5 hours each on the interview process.

19 We have taken the 200 estimated new applications from the CP08/25 proposals which looked at unregulated parent entities, and doubled this figure to take account of UK parent entities with multiple authorised subsidiaries in the UK.

do not intend to re-assess the fitness and propriety of these individuals in relation to the SIF role they perform for the authorised subsidiary firm. However, firms will still incur some costs from having to seek approval for individuals in relation to the Parent SIF role (or if more appropriate to the role – one of the other granular CFs). Assuming 90% will already be approved for a SIF role they perform for the parent entity, and therefore be subject to a streamlined process, the cost to the industry is estimated to be £25 each²⁰ (a total of £9,000). However, assuming 10% are not currently approved as a SIF within the parent entity the normal Form A application and approval process will apply, at a cost to the industry of approximately £52,400 (i.e. £200 minimum per application plus £1,850 each for a possible 60% subject to interview).

13. We estimate that 200 new applications will be generated each year on an ongoing basis, at a cost to firms of £40,000.
14. Costs to us will be around £29,660 (based on the same percentage of notifications, applications and interviews assumed above) to implement and £8,800 on an ongoing basis, assuming that most candidates will already be approved (as a SIF for their role in an authorised parent) and, therefore, no SIF interview will be undertaken.
15. For those who are already approved by us, albeit in different functions, while there will be negligible benefits associated with this exercise (as these individuals' fitness and propriety have already been assessed), the costs will also be negligible. For applicants who are not currently approved as a SIF within the parent entity, there will be some benefits associated with an effective vetting and approval systems.

Further extending the SIF regime to individuals in parent entities of LLPs and non-bodies corporate

16. This proposed extension will ensure a consistent application of the approved persons regime to SIFs based in parent entities. We estimate that around 40²¹ new applications will be generated by implementing the proposed further extension of the approved persons regime to SIFs based in parent entities of LLPs and non-bodies corporate. These will carry a minimum cost to the industry of approximately £200 each (a total of £8,000). For those selected for a SIF interview the cost will increase by approximately £1850. Assuming that 60% of these will be interviewed, the total cost to firms will be approximately £52,400.
17. We estimate that 20 new applications will be generated each year on an ongoing basis, at an estimated minimum cost to industry of approximately £4,000. Assuming 60% are subject to a SIF interview, the additional cost to industry will be £22,200.
18. Costs to us of processing the applications generated at implementation will be in the region of £1760 as a minimum, and £880 ongoing. Assuming 60% are interviewed the costs increase by £25,200 and £12,600 respectively.²²

20 As per the notification process (footnote 12).

21 We do not expect this proposal to result in substantial numbers of applications (given that LLPs and partnerships combined make up approximately 13% of the 21,000 population of FSA-authorised firms. In order to cost this proposal we have, therefore, added a 10% uplift to the 400 new applications expected to be generated from the proposal to extend the SIF regime to individuals in FSA-authorised parent entities.

22 See footnote 18.

Extending the SIF regime to EEA branches accepting retail deposits

19. We estimate that around 40 firms will be affected by this change. The number of individuals will vary with the size of the firm and we estimate around 90 new applications initially (at a minimum cost of £18,000 to industry and £3,960 to us), followed by 45 per year (costing industry a minimum of £9,000 and us £1,980 per year).²³ We estimate we may interview an additional five individuals initially as a result of this change, plus a further five per year on an ongoing basis. In each case, five interviews would cost firms £9,250 and us £5,250.
20. From an economic point of view, there is no particular reason why EEA branches should be treated any differently from UK-authorized firms when we are considering which measures should apply to the activities we (as opposed to the host regulator) are responsible for regulating. So if it is accepted that an approved person should be responsible in a UK-authorized firm for activities connected with accepting retail deposits, similar arguments/reasoning should apply to the EEA branches. However, it is worth noting that the collapse of EEA banks and their impact on the host country (UK) was not due to failures of the managers of their UK branches. Also, it is not clear that if CF29 had been in place at the time for these firms, their responses to our concerns about key risks would have been significantly different.

Clarification of our position on ‘compromise agreements’

21. We believe that this proposal will bring benefits to both firms and us, as it will clarify the existing position and to the extent that this results in firms providing us with relevant information about individuals, reducing the need for investigative efforts, and increasing the effectiveness of the approved persons regime. We do not believe there is any material cost associated with this proposal.

Requirements of establishing board risk committees and appointing CROs

22. For firms who already have board risk committees and CROs, these proposals will have limited costs and benefits implications. For firms who otherwise would not have board risk committees and CROs, these two proposals could provide a useful structure for the firms to discuss and evaluate their risk appetites. The compliance costs of establishing committees and appointing CROs are unlikely to be significant. However, whether these proposals lead to a reduction in excessive risk-taking will depend on their effectiveness in fostering better risk-management practices.

23 Based on estimates of £200 per application for firms and £44 per application for us.

Compatibility statement

Introduction

23. In this annex, we explain our reasons for concluding that our proposals outlined in this CP are compatible with our statutory objectives and the principles of good regulation.

Compatibility with our statutory objectives

Market confidence

24. We expect our proposals could have a positive impact on market confidence by reinforcing senior management responsibilities and emphasising the importance of good governance, increasing the scope of the approved persons regime and reiterating our aim of focusing more on the competence required to carry out SIF roles, both initially and on an ongoing basis. Tighter scrutiny of existing and future individuals within scope of the approved persons regime may reduce the risk that these individuals will damage market confidence.

Consumer protection

25. Broadly, these proposals are designed to ensure that the appropriate individuals within firms are included in the approved persons regime. Increased granularity of relevant significant influence controlled functions will also allow us to target more effectively the competences needed for each role. The approved persons regime is an effective tool in setting a consistent standard of fitness and propriety at approval stage, throughout the period of approved person status and ultimately for providing us with the means to take action against an individual when necessary.
26. While consumers may not be in a position to assess the competence of individuals within firms, our proposals will lead to greater focus on the competence and suitability of individuals by both us and the firms themselves. To the extent that these firms offer services to consumers, this focus will indirectly benefit those consumers, although they may bear some if not all of the costs associated with these proposals.

Financial crime

27. Our proposals are designed to help us assess the suitability of a candidate and their fitness and propriety to perform a controlled function, and increase the reach of those controlled functions to individuals both in and outside the UK, where they exercise a significant influence over UK-authorized firms. This may help reduce the risk of individuals using UK-authorized firms for the purposes of financial crime.

Public awareness

28. Our proposals will not contribute in any significant way to meeting this objective.

Compatibility with the need to have regard to the principles of good regulation

29. In pursuing our functions under FSMA, we are required to have regard to additional matters that we refer to as ‘principles of good regulation’. We set out below the principles and how our approach supports them.

The need to use our resources in the most efficient and economic way

30. We will process more applications as a result of these proposals, although we have confirmed that notifications will be sufficient in certain cases. Our expectation is that supervisors will be more confident about corporate governance arrangements in their firms and that increased focus on the competence required to carry out SIF roles, both initially and on an ongoing basis, will help to reduce the need for regulatory intervention at a later stage.

Role of management

31. We are required to take account of the responsibilities of those who manage the affairs of firms, and the proposed changes emphasise the importance of good governance. They will bring an increased understanding of the roles individuals are performing within firms and capture persons who are employed by or who have a significant influence on their firm’s affairs within the scope of our regulation. There is a risk that with our more intrusive approach, firms may place over-reliance on our approved persons process.

Proportionality

32. The extent of benefits from these proposals will depend on the effectiveness of the changes we are proposing to improve the quality of governance of authorised firms. Governance has a strong influence over the establishment of effective systems and controls in firms and we believe that our proposals and guidance will help increase the sophistication and intensity of our supervisory assessment of its quality. In particular, these are the proposals to identify key roles under existing SIFs, provide further clarity about the scope of the approved persons regime and guidance on our expectations for NEDs, board risk committees and CROs.

Innovation

33. We do not believe our proposals will restrict innovation.

International character

34. Some of our proposals extend to individuals based in third country firms. However, our intention is only to apply regulation where it arises in relation to UK-authorised firms. Therefore, an individual based in a third country firm who exercises a significant influence on a UK-authorised firm will be included in our proposals, but only to the extent of their significant influence on the UK-authorised firm.

35. Similarly, the proposal to extend CF29 (the significant management controlled function) to include managers of UK branches of EEA banks that accept retail deposits does not apply to individuals whose function relates to activities regulated in their home state.

Competition

36. We do not think that the consultation changes proposed in this paper on the scope and definition of controlled functions and further changes to the approved persons regime will have an adverse effect on competition, because they are designed to reflect the actual nature of existing governance structures rather than enforce a change in those structures.

List of questions in this consultation

- Q1: Do you agree with our proposal to separately identify certain key roles that are performed within the CF1 (director) CF2 (NED) or CF 28 (systems and controls) controlled functions?
- Q2: Are there any other key roles we should be identifying?
- 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?
- Q4: Do you agree that we should automatically grant the new controlled functions to individuals already performing the relevant role within their existing approvals?
- Q5: Do you agree that a phased approach of between 3 and 12 months is sufficient for the notification process, and that the Remuneration Code provides an appropriate basis for this phasing?
- Q6: Do you agree that we should extend the proposed CF00 (parent entity SIF) 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?
- Q8: Do you agree that these transitional periods are sufficient?
- Q9: Do you agree that it is appropriate for us to extend CF29 to UK branches of incoming EEA banks accepting retail deposits?
- Q10: Do you agree that our proposed guidance on compromise agreements is useful in clarifying the current position?

- Q11: Do you agree with our proposed guidance on the time commitment required for chairmen and NEDs?
- Q12: Do you agree that we should delete the guidance in SYSC 2 and 4 on NEDs' responsibilities?
- Q13: Do you agree that we should amend our rules to reflect the introduction of the new Corporate Governance Code?
- Q14: Do you agree with the content of our proposed guidance on board risk committees?
- Q15: Do you agree with the content of our proposed guidance on CROs?

Current and future scope of Parent SIF regime

Location of parent	Regulatory status of parent	Corporate status of the FSA-authorized firm being 'influenced'	Approve SIFs in parents? (i.e. those whose decisions or actions are regularly taken into account by the governing body of the authorised subsidiary firm)		
			Current		Proposal
			CF1	CF2	Parent SIFs?
EEA	Regulated	All	No	No	No
	Unregulated	Bodies corporate	Yes	Yes	Yes
		LLPs	No	Yes	
		Other partnerships/ non-corporates	No	No	
Overseas	Regulated	Bodies corporate	Yes	Yes	
		LLPs	No	Yes	
		Other partnerships/ non-corporates	No	No	
	Unregulated	Bodies corporate	Yes	Yes	
		LLPs	No	Yes	
		Other partnerships/ non-corporates	No	No	
UK	Regulated	All	No	No	
	Unregulated	Bodies corporate	Yes	Yes	
		LLPs	No	Yes	
		Other partnerships/ non-corporates	No	No	

Table showing FSA contribution to the implementation of the Walker recommendations

No	Revised recommendation	FSA implications
Board size, composition and qualification		
1	To ensure that NEDs have the knowledge and understanding of the business to enable them to contribute effectively, a BOFI board should provide thematic business awareness sessions on a regular basis and each NED should be provided with a substantive personalised approach to induction, training and development to be reviewed annually with the chairman. Appropriate provision should be made similarly for executive board members in business areas other than those for which they have direct responsibility.	<p>No new rules proposed</p> <p>However, we make clear in Chapter 4 our expectation that SIF applications, including those for NEDs, will address the need for induction and ongoing training and that they address any gaps in competence with clear development plans.</p> <p>Ongoing supervision will provide oversight of SIF competence and any business support required.</p>
2	A BOFI board should provide for dedicated support for NEDs on any matter relevant to the business on which they require advice separately from or additional to that available in the normal board process.	<p>No new rules proposed</p> <p>As per recommendation 1. Our ongoing supervisory oversight will consider the design and quality of board training.</p>
3	The overall time commitment of NEDs as a group on a FTSE 100-listed bank or life assurance company board should be greater than has been normal in the past. How this is achieved in particular board situations will depend on the composition of the NED group on the board. For several NEDs, a minimum expected time commitment of 30 to 36 days in a major bank board should be clearly indicated in letters of appointment and will in some cases limit the capacity of an individual NED to retain or assume board responsibilities elsewhere. For any prospective director where so substantial a time commitment is not envisaged or practicable, the letter of appointment should specify the time commitment agreed between the individual and the board. The terms of letters of appointment should be available to shareholders on request.	<p>New guidance proposed</p> <p>We already have the ability to consider all matters relevant to proposed appointments, including where we do not believe that the individual has the capacity to meet the commitment required of them.</p> <p>However, our proposed guidance will indicate explicitly that when considering an application for any approved person, we may have regard to whether the individual has adequate time to perform the controlled function, and we may take account of the process undertaken by the firm to determine the time required.</p> <p>See Chapter 5.</p>

No	Revised recommendation	FSA implications
4	The FSA's ongoing supervisory process should give closer attention to the overall balance of the board in relation to the risk strategy of the business, taking into account the experience, behavioural and other qualities of individual directors and their access to fully adequate induction and development programmes. Such programmes should be designed to assure a sufficient continuing level of financial industry awareness so that NEDs are equipped to engage proactively in BOFI board deliberation, above all on risk strategy.	<p>No new rules proposed</p> <p>We explain the evolution of our more in-depth and intensive supervisory approach to governance in Chapter 6.</p>
5	The FSA's interview process for NEDs proposed for FTSE 100-listed bank and life assurance company boards should involve questioning and assessment by one or more (retired or otherwise non-conflicted) senior advisers with relevant industry experience at or close to board level of a similarly large and complex entity who might be engaged by the FSA for the purpose, possibly on a part-time panel basis.	<p>Panel of senior advisers now recruited and announced.</p> <p>See Chapter 4 for further detail about the role that our senior advisers will play in planning and executing SIF interviews.</p>
Functioning of the board and evaluation of performance		
6	As part of their role as members of the unitary board of a BOFI, NEDs should be ready, able and encouraged to challenge and test proposals on strategy put forward by the executive. They should satisfy themselves that board discussion and decision-taking on risk matters is based on accurate and appropriately comprehensive information and draws, as far as they believe it to be relevant or necessary, on external analysis and input.	<p>No new rules proposed</p> <p>As per recommendation 1: we explore this issue as part of our competence and capability assessment of SIF applications.</p> <p>Ongoing oversight of NED performance is provided through our supervisory activity.</p> <p>See Chapter 4.</p>
7	The chairman of a major bank should be expected to commit a substantial proportion of his or her time, probably around two-thirds, to the business of the entity, with clear understanding from the outset that, in the event of need, the bank chairmanship role would have priority over any other business time commitment. Depending on the balance and nature of their business, the required time commitment should be proportionately less for the chairman of a less complex or smaller bank, insurance or fund management entity.	<p>New guidance proposed</p> <p>As recommendation 3. Our identification of 'Chairman' as a separate controlled function will allow us to assess applications by reference to the needs of that specific role.</p> <p>See Chapter 5.</p>
8	The chairman of a BOFI board should bring a combination of relevant financial industry experience and a track record of successful leadership capability in a significant board position. Where this desirable combination is only incompletely achievable at the selection phase, and provided that there is an adequate balance of relevant financial industry experience among other board members, the board should give particular weight to convincing leadership experience since financial industry experience without established leadership skills in a chairman is unlikely to suffice. An appropriately intensive induction and continuing business awareness programme should be provided for the chairman to ensure that he or she is kept well informed and abreast of significant new developments in the business.	<p>No new rules proposed</p> <p>As per recommendation 1: the balance of experience and skills required by an approved person performing a significant influence function are issues we may consider as part of our SIF approval processes. We may also consider the adequacy of a firm's induction and ongoing training arrangements.</p> <p>These issues may also fall to be considered in our ongoing supervision of governance within firms.</p> <p>See Chapters 4 and 6.</p>

No	Revised recommendation	FSA implications
9	The chairman is responsible for leadership of the board, ensuring its effectiveness in all aspects of its role and setting its agenda so that fully adequate time is available for substantive discussion on strategic issues. The chairman should facilitate, encourage and expect the informed and critical contribution of the directors in particular in discussion and decision-taking on matters of risk and strategy and should promote effective communication between executive and non-executive directors. The chairman is responsible for ensuring that the directors receive all information that is relevant to discharge of their obligations in accurate, timely and clear form.	No new rules proposed As per recommendation 1: we reflect this view in our SIF approval and ongoing supervisory processes. See Chapters 4 and 6.
10	The chairman of a BOFI board should be proposed for election on an annual basis. The board should keep under review the possibility of transitioning to annual election of all board members.	No action for FSA – although we will monitor outcomes within normal supervisory activity.
11	The role of the senior independent director (SID) should be to provide a sounding board for the chairman, for the evaluation of the chairman and to serve as a trusted intermediary for the NEDs, when necessary. The SID should be accessible to shareholders in the event that communication with the chairman becomes difficult or inappropriate.	New rule proposed SID will become a specific controlled function, leading to inclusion in SIF approval process and ongoing supervisory activity. See Chapter 2.
12	The board should undertake a formal and rigorous evaluation of its performance, and that of committees of the board, with external facilitation of the process every second or third year. The evaluation statement should either be included as a dedicated section of the chairman's statement or as a separate section of the annual report, signed by the chairman. Where an external facilitator is used, this should be indicated in the statement, together with their name and a clear indication of any other business relationships with the company and that the board is satisfied that any potential conflict given such other business relationship has been appropriately managed.	No action for FSA Board evaluations, whether or not they are formally published, will provide useful intelligence for our supervisory processes. See Chapter 6 for a description of our supervision of governance.
13	The evaluation statement on board performance and governance should confirm that a rigorous evaluation process has been undertaken and describe the process for identifying the skills and experience required to address and challenge adequately key risks and decisions that confront, or may confront, the board. The statement should provide such meaningful, high-level information as the board considers necessary to assist shareholders' understanding of the main features of the process, including an indication of the extent to which issues raised in the course of the evaluation have been addressed. It should also provide an indication of the nature and extent of communication with major shareholders and confirmation that the board were fully apprised of views indicated by shareholders in the course of such dialogue.	As per recommendation 12 – no action for FSA.
The role of institutional shareholders: communication and engagement		
14	Boards should ensure that they are made aware of any material cumulative changes in the share register as soon as possible, understand as far as possible the reasons for such changes and satisfy themselves that they have taken steps, if any are required, to respond. Where material cumulative changes take place over a short period, the FSA should be promptly informed.	No new rules proposed Principle 11 already requires firms to disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice.
15	Deleted	

No	Revised recommendation	FSA implications
16	The remit of the FRC should be explicitly extended to cover the development and encouragement of adherence to principles of best practice in stewardship by institutional investors and fund managers. This new role should be clarified by separating the content of the present Combined Code, which might be described as the Corporate Governance Code, from what might most appropriately be described as the Stewardship Code.	No action for the FSA.
17	The Code on the Responsibilities of Institutional Investors, prepared by the Institutional Shareholders' Committee, should be ratified by the FRC and become the Stewardship Code. By virtue of the independence and authority of the FRC, this transition to sponsorship by the FRC should give materially greater weight to the Stewardship Code. Its status should be akin to that of the Combined Code as a statement of best practice, with observance on a similar 'comply or explain' basis.	No action for the FSA.
18	The FRC should oversee a review of the Stewardship Code on a regular basis, in close consultation with institutional shareholders, fund managers and other interested parties, to ensure its continuing fitness for purpose in the light of experience and make proposals for any appropriate adaptation.	No action for the FSA.
18B	All fund managers that indicate commitment to engagement should participate in a survey to monitor adherence to the Stewardship Code. Arrangements should be put in place under the guidance of the FRC for appropriately independent oversight of this monitoring process which should publish an engagement survey on an annual basis.	No action for the FSA, although the outcomes may be of supervisory interest.
19	Fund managers and other institutions authorised by the FSA to undertake investment business should signify on their websites or in other accessible form whether they commit to the Stewardship Code. Disclosure of such commitment should be accompanied by an indication whether their mandates from life assurance, pension fund and other major clients normally include provisions in support of engagement activity and of their engagement policies on discharge of the responsibilities set out in the Code of Stewardship. Where a fund manager or institutional investor is not ready to commit and to report in this sense, it should provide, similarly on the website, a clear explanation of its alternative business model and the reasons for the position it is taking.	As per recommendation 20.
20	The FSA should require institutions that are authorised to manage assets for others to disclose clearly on their websites or in other accessible form the nature of their commitment to the Stewardship Code or their alternative business model.	See Chapter 6 on our intention to implement through COB disclosure rule, following the FRC's consultative process.
20B	In view of the importance of facilitating enhanced engagement between shareholders and investee companies, the FSA, in consultation with the FRC and Takeover Panel, should keep under review the adequacy of what is in effect 'safe harbour' interpretation and guidance that has been provided as a means of minimising regulatory impediments to such engagement.	We will consult on guidance in Q2 2010 (see Chapter 6).

No	Revised recommendation	FSA implications
21	Institutional investors and fund managers should actively seek opportunities for collective engagement where this has the potential to enhance their ownership influence in promoting sustainable improvement in the performance of their investee companies. Initiative should be taken by the FRC and major UK fund managers and institutional investors to invite potentially interested major foreign institutional investors, such as sovereign wealth funds, public sector pension funds and endowments, to commit to the Stewardship Code and its provisions on collective engagement.	No action for FSA.
22	Voting powers should be exercised, fund managers and other institutional investors should disclose their voting record, and their policies in respect of voting should be described in statements on their websites or in other publicly accessible form.	No action for FSA.
Governance of risk		
23	The board of a FTSE 100-listed bank or life insurance company should establish a board risk committee separately from the audit committee. The board risk committee should have responsibility for oversight and advice to the board on the current risk exposures of the entity and future risk strategy, including strategy for capital and liquidity management, and the embedding and maintenance throughout the entity of a supportive culture in relation to the management of risk alongside established prescriptive rules and procedures. In preparing advice to the board on its overall risk appetite, tolerance and strategy, the board risk committee should ensure that account has been taken of the current and prospective macro-economic and financial environment drawing on financial stability assessments such as those published by the Bank of England, the FSA and other authoritative sources that may be relevant for the risk policies of the firm.	New SYSC guidance proposed. See Chapter 6.
24	In support of board-level risk governance, a BOFI board should be served by a CRO who should participate in the risk management and oversight process at the highest level on an enterprise-wide basis and have a status of total independence from individual business units. Alongside an internal reporting line to the CEO or CFO, the CRO should report to the board risk committee, with direct access to the chairman of the committee in the event of need. The tenure and independence of the CRO should be underpinned by a provision that removal from office would require the prior agreement of the board. The remuneration of the CRO should be subject to approval by the chairman or chairman of the board remuneration committee.	New SYSC guidance proposed. See Chapter 6.
25	The board risk committee should be attentive to the potential added value from seeking external input to its work as a means of taking full account of relevant experience elsewhere and in challenging its analysis and assessment.	See recommendation 23 – captured in proposed SYSC guidance
26	In respect of a proposed strategic transaction involving acquisition or disposal, it should as a matter of good practice be for the board risk committee in advising the board to ensure that a due diligence appraisal of the proposition is undertaken, focussing in particular on risk aspects and implications for the risk appetite and tolerance of the entity, drawing on independent external advice where appropriate and available, before the board takes a decision whether to proceed.	See recommendation 23 – captured in proposed SYSC guidance

No	Revised recommendation	FSA implications
27	The board risk committee (or board) risk report should be included as a separate report within the annual report and accounts. The report should describe thematically the strategy of the entity in a risk management context, including information on the key risk exposures inherent in the strategy, the associated risk appetite and tolerance and how the actual risk appetite is assessed over time covering both banking and trading book exposures and the effectiveness of the risk management process over such exposures. The report should also provide at least high level information on the scope and outcome of the stress-testing programme. An indication should be given of the membership of the committee, of the frequency of its meetings, whether external advice was taken and, if so, its source.	No action for the FSA
Remuneration		
28	The remuneration committee should have a sufficient understanding of the company's approach to pay and employment conditions to ensure that it is adopting a coherent approach to remuneration in respect of all employees. The terms of reference of the remuneration committee should accordingly include responsibility for setting the over-arching principles and parameters of remuneration policy on a firm-wide basis.	Where there are actions for the FSA to consider in respect of Sir David Walker's recommendations on remuneration, we will address these in our 2010 review of the Remuneration Code.
29	The terms of reference of the remuneration committee should be extended to oversight of remuneration policy and outcomes in respect of all 'high end' employees.	See recommendation 28
30	In relation to 'high end' employees, the remuneration committee report should confirm that the committee is satisfied with the way in which performance objectives and risk adjustments are reflected in the compensation structures for this group and explain the principles underlying the performance objectives, risk adjustments and the related compensation structure if these differ from those for executive board members.	See recommendation 28
31	For FTSE 100-listed banks and comparable unlisted entities such as the largest building societies, the remuneration committee report for the 2010 year of account and thereafter should disclose in bands the number of 'high end' employees, including executive board members, whose total expected remuneration is in a range of £1 million to £2.5 million, in a range of £2.5 million to £5 million and in £5 million bands thereafter and, within each band, the main elements of salary, cash bonus, deferred shares, performance-related long-term awards and pension contribution. Such disclosures should be accompanied by an indication to the extent possible of the areas of business activity to which these higher bands of remuneration relate.	See recommendation 28
32	FSA-authorized banks that are UK-domiciled subsidiaries of non-resident entities should disclose for the 2010 year of account and thereafter details of total remuneration bands (including remuneration received outside the UK) and the principal elements within such remuneration for their 'high end' employees on a comparable basis and timescale to that required for UK-listed banks.	See recommendation 28

No	Revised recommendation	FSA implications
33	<p>Deferral of incentive payments should provide the primary risk adjustment mechanism to align rewards with sustainable performance for executive board members and 'high end' employees in a BOFI included within the scope of the FSA Remuneration Code. Incentives should be balanced so that at least one-half of variable remuneration offered in respect of a financial year is in the form of a long-term incentive scheme with vesting subject to a performance condition with half of the award vesting after not less than three years and of the remainder after five years. Short-term bonus awards should be paid over a three-year period with not more than one-third in the first year. Clawback should be used as the means to reclaim amounts in circumstances of misstatement and misconduct. This recommended structure should be incorporated in the FSA Remuneration Code review process next year and the remuneration committee report for 2010 and thereafter should indicate on a 'comply or explain' basis the conformity of an entity's 'high end' remuneration arrangements with this recommended structure.</p>	See recommendation 28
34	<p>Executive board members and 'high end' employees should be expected to maintain a shareholding or retain a portion of vested awards in an amount in line with their total compensation on a historic or expected basis, to be built up over a period at the discretion of the remuneration committee. Vesting of stock for this group should not normally be accelerated on cessation of employment other than on compassionate grounds.</p>	See recommendation 28
35	<p>The remuneration committee should seek advice from the board risk committee on specific risk adjustments to be applied to performance objectives set in the context of incentive packages; in the event of any difference of view, appropriate risk adjustments should be decided by the chairman and NEDs on the board.</p>	See recommendation 28
36	<p>If the non-binding resolution on a remuneration committee report attracts less than 75 per cent of the total votes cast, the chairman of the committee should stand for re-election in the following year irrespective of his or her normal appointment term.</p>	See recommendation 28
37	<p>The remuneration committee report should state whether any executive board member or 'high end' employee has the right or opportunity to receive enhanced benefits, whether while in continued employment or on termination, resignation, retirement or in the wake of any other event such as a change of control, beyond those already disclosed in the directors' remuneration report and whether the committee has exercised its discretion during the year to enhance such benefits either generally or for any member of this group.</p>	See recommendation 28
38	<p>[38 merged with 39] Remuneration consultants should put in place a formal constitution for the professional group that has now been formed, with provision: for independent oversight and review of the remuneration consultants code; that this code and an indication of those committed to it should be lodged on the FRC website; and that</p>	See recommendation 28
39	<p>all remuneration committees should use the code as the basis for determining the contractual terms of engagement of their advisers; and that the remuneration committee report should indicate the source of consultancy advice and whether the consultant has any other advisory engagement with the company.</p>	

Draft handbook text

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 73A (Part 6 Rules);
 - (5) section 80 (General duty of disclosure in listing particulars);
 - (6) section 81 (Supplementary listing particulars);
 - (7) section 96 (Obligations of issuers of listed securities);
 - (8) section 138 (General rule-making power);
 - (9) section 156 (General supplementary powers);
 - (10) section 157(1) (Guidance); and
 - (11) schedule 7 (The Authority as a competent authority for Part VI).
- 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 [*date*].

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
Listing Rules sourcebook (LR)	Annex G
Disclosure Rules and Transparency Rules sourcebook (DTR)	Annex H

Amendments to material outside the Handbook

- E. The Building Societies Regulatory Guide (BSOG) is amended in accordance with Annex I to this instrument.

Citation

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

By order of the Board
[*date*]

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.

<i>chairman of the audit committee function</i>	<i>controlled function</i> CF2B 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> CF2C 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> CF2D in the <i>table of controlled functions</i> , described more fully in SUP 10.6.9DR.
<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>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 and SYSC 3.2.10AR.
<i>senior independent director function</i>	<i>controlled function</i> CF2E in the <i>table of controlled functions</i> , described more fully in SUP 10.6.9ER.
<i>UK Corporate Governance Code</i>	(in LR and DTR) the UK Corporate Governance Code published in [April] 2010 by the Financial Reporting Council.

Amend the following as shown.

<i>Combined Code</i>	(in LR and DTR) in relation to an <i>issuer</i> : (1) in respect of a reporting period commencing on or after 29 June 2008, the Combined Code on Corporate Governance published
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in June 2008 by the Financial Reporting Council; or

- (2) ~~in respect of a reporting period commencing before 29 June 2008, the Combined Code on Corporate Governance published in June 2006 by the Financial Reporting Council.~~

governing function any of *controlled functions* 1 ~~00~~ to 6 in the *table of controlled functions* (*SUP 10.4.5R*).

systems and controls function functions ~~any of~~ *controlled functions* CF~~28~~ 13 to 15 in the *table of controlled functions* (*SUP 10.4.5R*), and 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. [deleted]~~

...

Allocation Table of allocation of functions

...

2.1.6 G Frequently asked questions about allocation of functions in SYSC 2.1.3R
This table belongs to SYSC 2.1.5G

	Question	Answer
...		
14	What if generally accepted principles of good corporate governance recommend that the <i>chief executive</i> should not be involved in an aspect of corporate governance?	The Note to SYSC 2.1.4R provides that the <i>chief executive</i> or other executive director or <i>senior manager</i> need not be involved in such circumstances. For example, the Combined Code developed by the Committee on Corporate Governance <u>UK Corporate Governance Code published by the Financial Reporting Council</u> recommends that the board of a listed company should establish an audit committee of non-executive directors to be responsible for oversight of the audit. That aspect of the oversight function may therefore be allocated to the members of such a committee without involving the <i>chief executive</i> . Such individuals may require approval by the <i>FSA</i> in relation to that function (see Question 1).
...		

...

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.

3.1.3 G Where the ~~Combined Code developed by the Committee on Corporate Governance~~ UK Corporate Governance Code published by the Financial Reporting Council is relevant to a *firm*, the *FSA*, in considering whether the *firm's* obligations under SYSC 3.1.1R have been met, will give it due credit for following corresponding provisions in the Code and related guidance.

...

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.

...

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.

...

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.

...

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.

...

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.

...

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.

...

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.

...

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 a material 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;

- (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.

...

After SYSC TP 3 insert the following new transitional provision. The text is not underlined.

TP 4 Combined Code

(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
1.	SYSC 2.1.6G	R	References to provisions in the <i>UK Corporate Governance</i>	From [] to 28 December	[]

	SYSC 3.1.3G		<i>Code</i> are to be read as references to the equivalent provisions in the <i>Combined Code</i> for accounting periods beginning before 29 June 2010.	2011	
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Annex C

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.

3.1 Introduction

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- 3.1.9 G *UK domestic firms listed on the London Stock Exchange are subject to the ~~Combined Code developed by the Committee on Corporate Governance~~ UK Corporate Governance Code, whose *internal control* provisions are amplified in the ~~Guidance for Directors~~ publication entitled "Internal Control: Revised Guidance for Directors on the Combined Code (October 2005)" issued by the ~~Institute of Chartered Accountants in England and Wales~~ Financial Reporting Council. *FSA-regulated firms* in this category will thus be subject to that code as well as to the requirements and standards of the *regulatory system*. In forming an opinion whether *approved persons* have complied with its requirements, the *FSA* will give due credit for their following corresponding provisions in the ~~Combined Code~~ UK Corporate Governance Code and related *guidance*.*

...

TP 1 Transitional Provisions

TP 1.1

~~There are no transitional provisions in APER. However,~~ In addition to the transitional provision below, GEN contains some technical transitional provisions that apply throughout the Handbook and which are designed to ensure a smooth transition at commencement.

(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
<u>1.</u>	<u>APER</u> <u>3.1.9G</u>	<u>R</u>	<u>References to provisions in the UK Corporate Governance Code are to be read as references to the equivalent provisions in the</u>	<u>From [] to 28 December 2011</u>	<u>[]</u>

			<u>Combined Code for accounting periods beginning before 29 June 2010.</u>		
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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 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.

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.~~
- (3) ~~the chief executive function;~~
- (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
- (7) the customer function.

...

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).

...

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*.

...

10.4 Specification of functions

...

Controlled Table of controlled functions

10.4.5 R

Type	CF	Description of controlled function
Governing functions*	<u>00</u>	<i><u>Parent entity significant influence function</u></i>
	1	<i>Director function</i>
	2	<i>Non-executive director function</i>
	<u>2A</u>	<i><u>Chairman function</u></i>
	<u>2B</u>	<i><u>Chairman of the audit committee function</u></i>
	<u>2C</u>	<i><u>Chairman of the remuneration committee function</u></i>
	<u>2D</u>	<i><u>Chairman of the risk committee function</u></i>
	<u>2E</u>	<i><u>Senior independent director function</u></i>
	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>
Required functions*	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>	<u>28</u>	<i><u>Systems and controls function</u></i>
	<u>13</u>	<i><u>Finance function</u></i>
	<u>14</u>	<i><u>Risk function</u></i>
	<u>15</u>	<i><u>Internal audit function</u></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*.

...

10.6 Governing functions

...

- 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 4.4.3 R:
- (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*.

...

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]~~

...

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*.

Chairman of the audit committee function (CF2B)

10.6.9B 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 (CF2C)

- 10.6.9C 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).

Chairman of the risk committee function (CF2D)

- 10.6.9D 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.

Senior independent director function (CF2E)

- 10.6.9E 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.

Guidance on 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 *chairman of the audit committee function*, the *chairman of the remuneration committee function*, the *chairman of the risk committee function* and the *senior independent director function* are not subsumed within *controlled functions* 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. [deleted]~~
- (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*. [deleted]~~
- 10.6.10 A R The effect of SUP 10.6.10R is that a *person* who is approved for the *chairman function*, the *chairman of the audit committee function*, the *chairman of the remuneration committee function*, the *chairman of the risk*

committee function and the senior independent director function will also require approval for whichever of controlled functions 1, 2, 3, 4, 5 or 6 are applicable. 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.

...

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 (except where that parent undertaking or holding company is an EEA firm) of that firm; and
 - (2) whose decisions, or actions are regularly taken into account by the governing body of the firm.
- 10.6.31 G ~~[deleted]~~ Examples of where SUP 10.6.30R would apply include (but are not limited to):
- (1) an individual who is a 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 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 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 director of the UK firm would act; or
 - (5) an individual who is a 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; or

- (6) a 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 who is accustomed to influencing the operations of 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
- (7) the 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
- (8) 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.

- 10.6.32 G (1) ~~{deleted}~~ This paragraph explains the basis on which the parent entity significant influence function has been included as a controlled function.
- (2) The basic position is set out in SUP 10.3.4G. As is the case with all controlled functions, SUP 10.6.30R 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 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 parent entity significant influence 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.

10.6.33 R Each of the governing functions includes, with respect to a firm, the parent entity significant influence function where performed in relation to that firm.

10.6.34 G The effect of SUP 10.6.33R is that where a person is approved to perform a governing function 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.

...

10.8 Systems and control functions

Systems and control 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).~~

The risk function (CF14)

- 10.8.2 G ~~[deleted]~~ The risk function is the function of acting in the capacity of an
 R 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 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.

...

10.9 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:
- ...
- ...
- 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.

(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* if that other controlled function applies to the firm.

...

10.12 Application for approval and withdrawing an application for approval

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How to apply for approval

...

10.12.2 A 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 [an abbreviated Form A] available on the FSA's website:

[insert hyperlink]

...

10.13 Changes to an approved person's details

...

Ceasing to perform a controlled function

...

10.13.7A G The obligations to supply information to the FSA under SUP 10.13.7 R apply notwithstanding any agreement 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. Failing to disclose relevant information to the FSA may be a criminal offence under section 398 of the Act.

...

Changes to an approved person's personal details

...

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

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
...					
8R	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 on the first date in column (5):</p> <p>(a) he was approved to carry on one of the existing <i>governing functions</i> for a <i>firm</i>; and</p> <p>(b) he would otherwise have been performing one of the granular <i>governing functions</i>.</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 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 8ZR contains various supplemental provisions applicable to this <i>rule</i>.</p>	[Date instrument comes into force] – [3 months later]	[3 months later]
8S	SUP 10.6.30AR	R	(1) This <i>rule</i> applies to a <i>person</i> who on the [date rules come into force].	Not applicable	Not applicable

	and SUP 10.13.6AR		<p>(a) was approved to carry on a <i>governing function</i> for a subsidiary <i>firm</i>; and</p> <p>(b) was performing the <i>parent entity significant influence function</i> with respect to that subsidiary <i>firm</i>.</p> <p>(2) 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 <i>FSA</i> 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 Governance 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 8ZR contains various supplemental provisions applicable to this <i>rule</i>.</p>		
8T	SUP 10.6.30R	R	<p>(1) This <i>rule</i> applies to a person who meets the following conditions on the first date in column (5):</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>;</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 Governance Instrument 2010); and</p> <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</p>	[Date instrument comes into force] – [6 months later]	[6 months later]

			<p>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</i> TP 8ZR contains various supplemental provisions applicable to this <i>rule</i>.</p>		
8U	<i>SUP</i> 10.6.30R	R	<p>(1) This <i>rule</i> applies to a person who meets the following conditions on the first date in column (5):</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>;</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 Governance Instrument 2010); and</p> <p>(e) he was approved to carry on a <i>governing function</i> for the parent.</p> <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)(d) covers the</p>	[Date instrument comes into force] – [3 months later]	[3 months later]

			<p><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 8ZR contains various supplemental provisions applicable to this <i>rule</i>.</p>		
8V	<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 on the first date in column (5):</p> <p>(a) he was approved to carry on what prior to the Governance Instrument 2010 was <i>controlled function</i> 28 (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>.</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</i> 28, 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 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> <p>(5) <i>SUP</i> TP 8ZR contains various supplemental provisions applicable to this <i>rule</i>.</p>	[Date instrument comes into force] – [3 months later]	[3 months later]
8W	<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 on the first date in column (5):</p> <p>(a) he was approved to perform a <i>governing function</i> for a <i>firm</i>; and</p> <p>(b) as a result of the extension of the <i>systems and controls functions</i> through the deletion of <i>SUP</i> 10.6.2R(1) by the Governance Instrument 2010 he is performing one of the <i>systems and controls functions</i> for that <i>firm</i>.</p>	[Date instrument comes into force] – [3 months later]	

- (2) The *firm* must notify the *FSA* of each *approved person* falling into (1).
- (3) The *firm* must give the notification in (2) within the period specified in (4) or (5). The period begins from the date in (1).
- (4) (a) The notification period is three months for a *firm* that meets at least one of the conditions in this *rule*.
- (b) The first condition is that the *firm* is a *UK bank* or *building society* that had *capital resources* exceeding £1 billion on its last *accounting reference date*.
- (c) The second condition is that the *firm* is a *BIPRU 730K firm* that had *capital resources* exceeding £750 million on its last *accounting reference date*.
- (d) The third condition is that:
- (i) the *firm* is a *full credit institution*, a *BIPRU 730K firm* or a *third country BIPRU 730K firm*;
- (ii) the *firm* is part of a *group*; and
- (iii) on the *firm's* last *accounting reference date* total *capital resources* held within the *group*:
- (A) by *UK banks* or *building societies* exceeded £1 billion; or
- (B) by *BIPRU 730K firms* exceeded £750 million.
- (5) The notification period is twelve months for all other *firms*.
- (6) The deletion of what was *controlled function* 28, the deletion referred to in paragraph (1) and the introduction of the *controlled functions* referred to in paragraph (1)(b), as respects that *person* and that *firm*, do not take effect until the earlier to occur of the date on which the *firm* gives the notification under (2) and the date in column (5).
- (7) If the notification in (2) is given in accordance with that paragraph, the approval referred to in paragraph (1)(a) covers the *systems and controls functions* referred to in (1)(b) as respects that *person* and that *firm*.

			(8) <i>SUP</i> TP 8ZR contains various supplemental provisions applicable to this <i>rule</i> .		
8X	<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 Governance 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> because of the extension described in (1) on the first date in column (5).</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> <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</i> TP 8ZR contains various supplemental provisions applicable to this <i>rule</i>.</p>	[Date instrument comes into force] – [6 months later]	[6 months later]
8Y		G	(1) <i>SUP</i> TP 8RR deals with the introduction of the granular <i>governing functions</i> by the Governance 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		

			<p>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 8SR</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>. The policy in <i>SUP 10.6.33R</i> is that approval for a <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 Governance Instrument 2010.</p> <p>(3) Before the Governance 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 8SR</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 Governance Instrument 2010 falls under the <i>parent entity significant influence function</i>. As a result of the Governance 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> <p>(4) <i>SUP TP 8VR</i> deals with the splitting into the three <i>systems and controls functions</i> of what was a single <i>controlled function</i> by the Governance Instrument 2010. A <i>firm</i> must notify the <i>FSA</i> of its <i>approved person</i> who are covered by this change. If it does, the <i>approved person</i> will be approved to carry out the <i>systems and controls function</i> that he has been performing 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>(5) <i>SUP TP 8WR</i> deals with the same issue in the case of those also affected by the removal of the <i>rule</i> that said that a <i>person</i> performing certain of the <i>governing functions</i> did not need separate approval for the <i>controlled function</i> that was split to form the <i>systems and controls functions</i>. The</p>	
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			<p>same procedures apply.</p> <p>(6) <i>SUP TP 8TR</i> and <i>SUP TP 8UR</i> deal with the <i>parent entity significant influence function</i> in relation to those who are not approved to carry out a <i>governing function</i> for the subsidiary <i>firm</i>. A <i>person</i> carrying on that function for a subsidiary <i>firm</i> whose parent is a <i>UK firm</i> will not need a new approval to perform that <i>controlled function</i> as long as notice is given in accordance with <i>SUP TP 8UR</i> and he is already approved to carry on a <i>governing function</i> for the parent. In other cases <i>SUP TP 8TR</i> sets out a period within which the <i>person</i> may get approval without having to cease to carry on that function in the mean time. An example of a <i>firm</i> to which <i>SUP TP 8TR</i> applies is a <i>UK firm</i> that is a limited liability partnership.</p> <p>(7) <i>SUP TP 8TR</i> and <i>SUP TP 8XR</i> provide a six month period in which applications can be made. Both say that if an application for approval is still being processed at the end of the transitional period, the <i>person</i> 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 in the first part of the transitional 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 <i>person</i> will have to stop carrying out the function.</p>	
8Z	<i>SUP TP 8QR - SUP TP 8XG</i>	R	<p>(1) This <i>rule</i> defines various terms used in <i>SUP TP 8RR</i> to <i>SUP TP 8YG</i> 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 8RR, <i>SUP</i> TP 8SR, <i>SUP</i> TP 8UR, <i>SUP</i> TP 8VR and <i>SUP</i> TP 8WR 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 Governance Instrument 2010 means the Controlled Functions (Amendment) Instrument 2010.</p> <p>(5) 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>(6) 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>(7) 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 <i>SUP</i> 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>		
...					

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 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*.

Annex G

Amendments to the Listing Rules sourcebook (LR)

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

9.8 Annual financial report

...

Additional information

9.8.6 R In the case of a *listed company* incorporated in the *United Kingdom*, the following additional items must be included in its annual financial report:

...

(5) a statement of how the *listed company* has applied the Main Principles set out in ~~Section 1~~ of the ~~Combined Code~~ UK Corporate Governance Code, in a manner that would enable shareholders to evaluate how the principles have been applied.

(6) a statement as to whether the listed company has:

(a) complied throughout the accounting period with all relevant provisions set out in ~~Section 1~~ of the ~~Combined Code~~ UK Corporate Governance Code; or

(b) not complied throughout the accounting period with all relevant provisions set out in ~~Section 1~~ of the ~~Combined Code~~ UK Corporate Governance Code and if so, setting out:

...

...

Auditors report

9.8.10 R A *listed company* must ensure that the auditors review each of the following before the annual report is published:

...

(2) the parts of the statement required by LR 9.8.6R(6) (corporate governance) that relate to the following provisions of the ~~Combined Code~~ UK Corporate Governance Code:

(a) C.1.1;

(b) C.2.12; and

(c) C_{3.1} to C_{3.7}.

...

15.6 Notifications and periodic financial information

...

Statement regarding compliance with Combined Code

- 15.6.6 R (1) This *rule* applies to a *closed-ended investment fund* that has no executive *directors*.
- (2) A *closed-ended investment fund's* statement required by LR 9.8.6R(6) need not include details about the following principles and provisions of the *Combined Code* except to the extent that those principles or provisions relate specifically to non-executive *directors*:
- (a) Principle BD.1 (including Code Provisions BD.1.1 to B.1.6 D.1.5); and
- (b) Principle BD.2 (including Code Provisions BD.2.1 to BD.2.4).

...

Appendix 1

1.1 Relevant definitions

...

Combined Code in relation to an *issuer*:

- (1) ~~in respect of a reporting period commencing on or after 29 June 2008, the Combined Code on Corporate Governance published in June 2008 by the Financial Reporting Council; or~~
- (2) ~~in respect of a reporting period commencing before 29 June 2008, the Combined Code on Corporate Governance published in June 2006 by the Financial Reporting Council.~~

...

UK Corporate Governance Code in relation to an *issuer*, the UK Corporate Governance Code published in [April] 2010 by the Financial Reporting Council.

Transitional Provisions

Insert the following new Transitional Provisions after LR TP 4. The text is not underlined.

TR 5 Transitional Provisions for the Combined Code

(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
1.	<i>LR 9.8.6R(5) and (6)</i> <i>LR 9.8.10R(2)</i> <i>LR 15.6.6R(2)</i>	R	References to provisions in the <i>UK Corporate Governance Code</i> are to be read as references to the equivalent provisions in the <i>Combined Code</i> for accounting periods beginning before 29 June 2010. For the avoidance of doubt, in <i>LR 9.8.10R(2)(b) Combined Code</i> provision C.2.1 became <i>UK Corporate Governance Code</i> provision C.2.2; <i>Combined Code</i> Principles B.1 and B.2 became <i>UK Corporate Governance Code</i> Principles D.1 and D.2 respectively; and <i>Combined Code</i> provisions B.1.1 to B.1.5 and B.2.1 to B.2.4 became <i>UK Corporate Governance Code</i> provisions D.1.1 to D.1.5 and D.2.1 to D.2.4 respectively.	From [] to 28 December 2011	[]

Annex H

Amendments to the Disclosure Rules and Transparency Rules sourcebook (DTR)

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

7.1 Audit committees

...

- 7.1.7 G In the *FSA's* view, compliance with provisions A.1.2, C.3.1, C.3.2 and C.3.3 of the ~~Combined Code~~ UK Corporate Governance Code will result in compliance with *DTR* 7.1.1R to *DTR* 7.1.5R.

...

7.2 Corporate governance statements

...

- 7.2.4 G A *listed company* which complies with LR 9.8.6R(6) (the comply or explain rule in relation to the ~~Combined Code~~) UK Corporate Governance Code will satisfy the requirements of *DTR* 7.2.2R and *DTR* 7.2.3R.

...

- 7.2.8 G In the *FSA's* view, the information specified in provisions A.1.1, A.1.2, ~~A.4.6, B.2.1 and, B.2.4~~, C.3.3 and D.2.1 of the ~~Combined Code~~ UK Corporate Governance Code will satisfy the requirements of *DTR* 7.2.7 R.

Transitional Provisions

TP 1.1

(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
...					
<u>18</u>	<u><i>DTR</i> 7.1.7G</u> <u><i>DTR</i> 7.2.4G</u> <u><i>DTR</i> 7.2.8G</u>		<u>References to provisions in the <i>UK Corporate Governance Code</i> are to be read as references to the equivalent provisions in the</u>	<u>From [] to 28 December 2011</u>	<u>[]</u>

			<p><u>Combined Code</u> for accounting periods beginning before 29 June 2010. For the avoidance of doubt, in <u>DTR 7.2.8G</u>, <u>Combined Code</u> provision A.4.6 and B2.1 became <u>UK Corporate Governance Code</u> provisions B.2.4 and D.2.1 respectively.</p>		
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Annex I

Building Societies Regulatory Guide (BSOG)

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

1.1 Application, purpose and definitions

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Frequently used terms

- 1.1.3 G The following terms are used in this Guide and have the meaning described here:

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“the Combined Code” the Combined Code on Corporate Governance, developed by the Corporate Governance Committee of the Financial Reporting Council for accounting periods beginning before 29 June 2010

...

“the UK Corporate Governance Code” the UK Corporate Governance Code, published by the Financial Reporting Council

...

...

1.3 Constitutional matters

Constitutional form

...

- 1.3.2 G Although societies are not publicly quoted, they should have regard to the UK Corporate Governance Code or the Combined Code as appropriate when they establish and review their corporate governance arrangements.

...

1.4 Accounting records and reporting requirements

...

Reporting requirements

...

- 1.4.4 G The Accounts Regulations and the 1986 Act require a building society to disclose to its members, by its annual report and accounts:
- (1) the interests of the society's directors;
 - (2) the interests of its chief executive (on the matter of service contracts) and other officers (on the matter of options to subscribe for shares or debentures);
 - (3) individual directors' remuneration;
 - (4) particulars of service contracts for the directors and chief executive;
 - (5) current and past directors' additional retirement benefits; and
 - (6) directors' interests in the shares or debentures of a connected undertaking.

In the interests of transparency, a building society should also explain whether it adheres to some or all of the UK Corporate Governance Code or the Combined Code as appropriate and, if so, in what respects.

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The Financial Services Authority
25 The North Colonnade Canary Wharf London E14 5HS
Telephone: +44 (0)20 7066 1000 Fax: +44 (0)20 7066 1099
Website: <http://www.fsa.gov.uk>

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