

CP12/34**

Financial Services Authority

Regulatory Reform:

FCA Handbook updates relating to supervision and threshold conditions and statement on the FCA's new power of direction over qualifying parent undertakings

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The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by 29 January 2013.

Comments may be sent by electronic submission using the form on the FSA's website at: www.fsa.gov.uk/Pages/Library/Policy/CP/2012/cp12-34-response.shtml.

Alternatively, if you wish to respond by letter, please send your comments to the person named at the end of each chapter and set out below:

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If you are responding in writing to several chapters, please send your comments to Conor Rafferty who will pass your response on as appropriate.

All responses to the above people should be sent to them at:
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It is the FSA's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise. A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure.

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.

Abbreviations used in this paper

CAD	EU Capital Adequacy Directive
CBA	Cost Benefit Analysis
CF	Controlled function
COLL	Collective Investment Schemes sourcebook
COND	Threshold Conditions sourcebook
CP	Consultation Paper
CRD	EU Capital Requirements Directive
DEPP	The Decision Procedure and Penalties Manual
EU	European Union
FCA	Financial Conduct Authority
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act 2000
GABRIEL	The FSA's online regulatory reporting system (GATHERing Better Regulatory Information ELECTRONically)
LCO	Legal cutover
MIFID	EU Markets in Financial Instruments Directive
ONA	Online Notifications and Applications system
PRA	Prudential Regulation Authority
RIE	Recognised Investment Exchange

SIF	Significant influence function
SUP	The Supervision Manual
TC(s)	Threshold condition(s)
The Bill	Financial Services Bill
Treasury	Her Majesty's Treasury
XML	eXtensible Markup Language

1

Overview

- 1.1** This Consultation Paper (CP) is part of a series of papers setting out proposed changes to the regulatory requirements needed to create the new rulebooks and policies for the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). These proposals are intended to be in place for when the new regulators acquire their legal powers in 2013.

Regulatory reform and changes to existing requirements

- 1.2** The background to the proposed changes is set out in the following CPs and a number of other papers recently published by the government, the FSA and the Bank of England¹:
- CP12/24², PRA and FCA regimes relating to aspects of authorisation and supervision;
 - CP12/26³, PRA and FCA regimes for Approved Persons; and
 - CP12/28⁴, Regulatory fees and levies: policy proposals for 2013/14.
- 1.3** The Financial Services Bill (the Bill) that is being considered by Parliament, and the necessary secondary legislation that will support it, will establish the new UK regulatory architecture. This includes creating the PRA and the FCA.
- 1.4** The PRA, a subsidiary of the Bank of England, will prudentially supervise deposit takers, insurers and a small number of significant investment firms. The FCA will regulate conduct in retail and wholesale markets; supervise the trading infrastructure that supports those markets; and prudentially regulate firms not regulated by the PRA.
- 1.5** The Bill proposes changes to a number of existing Acts of Parliament, most notably the Financial Services and Market Act 2000 (FSMA), the Bank of England Act 1998 and the Banking Act 2009.

¹ Please see the FSA's webpages on Regulatory Reform at www.fsa.gov.uk/about/what/reg_reform

² www.fsa.gov.uk/library/policy/cp/2012/12-26.shtml

³ www.fsa.gov.uk/library/policy/cp/2012/12-24.shtml

⁴ www.fsa.gov.uk/library/policy/cp/2012/12-28.shtml

- 1.6 The FSA is helping the FCA and PRA create their new rulebooks, which will come into effect when the new regulators acquire their legal powers – a point we refer to as ‘legal cutover’. In October 2012, the Treasury announced its intention that the new regime be fully established and operational on 1 April 2013. The overall approach to amending the rulebook ready for legal cutover is based on only making the changes that are required properly to implement the Bill and support the creation of the new regulatory structure. This approach aims to control the degree of change for the regulators and firms at legal cutover.
- 1.7 As we have explained in the previous Regulatory Reform CPs, a key element of this approach is that when the FCA and PRA acquire their new powers, provisions in the existing FSA Handbook will be adopted, or ‘designated’ by the FCA, the PRA or by both regulators, to form the basis of the new FCA and PRA rulebooks. More information can be found in a ‘One Minute Guide’ to designation, which was first published in June 2012.⁵
- 1.8 In addition to designation, some more substantive changes to the existing FSA Handbook are required to align the new rulebooks with the future objectives and functions of the FCA and PRA, as set out in the Bill, and the resulting adjustments to the regulatory procedures of the new regulators. It is this category of substantive changes that this paper primarily consults on.
- 1.9 Unlike the previous Regulatory Reform CPs, this paper covers only changes to certain parts of the FCA’s new Handbook (not the PRA’s). It also consults on a draft statement on how the FCA proposes to approach its new power of direction over qualifying parent undertakings.

Structure of this Consultation Paper

- 1.10 This paper is structured as follows:
- Chapter 2 sets out our proposed revision of Chapter 1 of the Supervision Manual (SUP 1), which currently sets out the FSA’s approach to supervision. The revised SUP 1 (‘SUP 1A’) provides an overview of the FCA’s new supervisory model in the context of an introduction to the FCA’s Supervision Manual section of its new Handbook.
 - Chapter 3 sets out our proposed amendments to Chapter 7 of the Supervision Manual (SUP 7). SUP 7 currently provides guidance to firms about when the FSA will exercise its ‘own initiative’ powers to vary and/or impose a requirement or limitation on a firm’s Part IV permission. The amended SUP 7 will cover the FCA’s variation powers, revised as necessary to reflect the relevant new terminology and provisions in the Bill. SUP 7 will be carried forward as Handbook material only by the FCA. The PRA will explain its approach to exercising its similar powers in material it will maintain *outside* its Handbook.

⁵ www.fsa.gov.uk/smallfirms/resources/one_minute_guides/about_fsa/handbook-pra-fca.shtml

- Chapter 4 explains our proposed amendments to the Threshold Conditions Sourcebook of the existing FSA Handbook (COND). Amendments to COND are necessary to align the FCA Handbook with the FCA Threshold Conditions (contained in the Treasury's Threshold Conditions Order) while, having regard to the future objectives and functions of the new regulator. After legal cutover, COND will only apply to the Threshold Conditions for which the FCA is responsible. The PRA has set out its approach in its approach documents.
- Chapter 5 consults on a non-Handbook element of the FCA's new regulatory toolkit. The Bill will give the FCA (and the PRA) some specific new powers in relation to certain 'qualifying parent undertakings', (also called 'unregulated holding companies') that are the parent entities of regulated firms. These consist of three sets of powers that can be applied directly to a qualifying parent undertaking: a power of direction; a rule-making power for information gathering; and a supporting enforcement power to fine or censure for breaches of a direction or information rule. The FCA powers are available in relation to all FCA-authorised investment firms and recognised investment exchanges (RIEs), other than overseas investment exchanges. This CP explains the context for these new powers and consults on a draft statement of policy on the use of the Power of Direction. This statement is required by the Bill, and the FSA, on behalf of the FCA, is hereby complying with the Bill's requirement for the regulator to publish a draft of the proposed statement.

- 1.11** Aside from the changes to SUP 7 (which simply aligns SUP 7 with the Bill), each set of proposals has involved a degree of policy judgement and discretion, so readers may want to consider the proposals covered by Chapters 2, 4 and 5 in particular.
- 1.12** The proposed FCA Handbook text in the Appendices to the main paper includes the revised SUP 1, SUP 7 and COND (except COND 2.6) in full, given the extent of the changes proposed. In addition, for clarity, the intended designation of the provisions is also included in the Appendices We are not formally consulting on the proposed designation of the individual provisions, but only on the substantive content of the changes.
- 1.13** We have indicated in this CP the areas where we expect there to be transitional arrangements (to be confirmed by the legislation). We will make details of the expected transitional arrangements available over the coming months (before legal cutover).

Minor amendments

- 1.14** As with the previous regulatory reform policy proposals we will need to make a number of associated minor amendments. These include (but are not limited to):
- replacing references to the 'FSA' with references to the FCA or the appropriate regulator as relevant;

- updating references to the FSA's website, address, departments, teams or contact details to give the website, address or contact details of the FCA, as appropriate;
- updating cross-references to other parts of the FCA's Handbook, to FSMA or to other legislation, where changes to numbering or headings have occurred; and
- restructuring some specific provisions to make the text carried forward from the existing FSA Handbook work in the FCA's (and PRA's) new rulebooks (but where no change to the policy behind the provision has been made).

1.15 For Handbook provisions included in this CP, we have already applied as many of these minor changes as we can, to allow respondents to understand all the proposed changes to each section.

Submission of notifications and returns – update

1.16 In CP12/24, we explained our proposed changes to Chapter 16 of the Supervision Manual (SUP 16), which sets out reporting requirements for firms. In the CP, we noted that SUP 16.3 sets out the current system, email and postal submission requirements for notifications and returns covered by SUP 16. We explained that after legal cutover it is envisaged that information submitted via an online system, for example GABRIEL and ONA, will continue to be submitted through the relevant current system, whether the submissions are destined for the FCA or the PRA.

1.17 However, we also said that we proposed to review whether other submission methods should be accommodated after legal cutover, or whether all submissions to the new regulators should be made via online systems (where relevant) or email, and no longer by post. After further consideration, we have decided not to require all submissions to be made electronically, at this time. Where paper-based submissions are currently acceptable, they will continue to be, at legal cutover.

1.18 We will confirm the relevant provisions in SUP 16 and future submission addresses before legal cutover, to take effect at legal cutover. We will also communicate any other updates that may be required following our review of current FSA reporting forms and XML specifications.

Timetable and next steps

1.19 Comments on this CP should reach us by 29 January 2013. Contacts are listed in each Chapter. We will review all responses, and final rule instruments and Policy Statements will be issued by the FCA once it acquires its legal powers.⁶

⁶ Where other FSA consultations also cover changes to these Handbook provisions or sections, unrelated to Regulatory Reform, the various changes will be reconciled at the appropriate point.

- 1.20** Because the legislation is still going through the parliamentary process, final rules and guidance may be subject to changes to the Bill (or associated secondary legislation). If any changes have a significant policy effect on proposed FCA Handbook text (or other material) on which we have already consulted, it is possible that we may need to re-consult.
- 1.21** Some references in the revised FCA Handbook text have not yet been finalised; for example online addresses, and the names of some functions within the new regulators. These have been left in square brackets and will be completed before the final provisions are made. Such practical information will also be made available to firms in good time before the new regime is operational.
- 1.22** There will also be further FCA and PRA Handbook consultations driven by regulatory reform over the next two months or so.
- 1.23** We intend to publish a designated version of the existing Handbook before legal cutover, to indicate the way in which the Handbook contents are being transitioned to the PRA and FCA.

Impact on Mutual Societies

- 1.24** Section 138K of FSMA (as amended) requires the FCA and PRA to consider whether the impact of proposed rules on mutual societies is significantly different to the impact on other authorised persons and if so to provide details of the difference. Because the rules consulted on in this paper are expected to be made by the new regulatory bodies in 2013, this section gives our opinion on the impact of the rules on mutuals on behalf of the FCA.
- 1.25** To the extent that firms, mutual societies or otherwise, will be dual-regulated and not FCA-only regulated, the cost of complying with the new regime and interacting with two regulators will be marginally higher than they will be for FCA-only regulated firms (mutual or otherwise). However, such costs will not result directly from our proposed changes, but from the creation of the new UK regulatory structure, and the impact of the proposed changes covered by this CP on mutual societies should not be significantly different to the impact on other authorised persons.

Equality and diversity

- 1.26** We have considered whether equality and diversity issues arise from the proposals in this CP. We have concluded that the proposals do not give rise to discrimination and are of low relevance to the equality agenda.
- 1.27** We would welcome any comments you may have on any equality and diversity issues you believe arise from our proposals.

Who should read this Consultation Paper?

Firms

- 1.28 This paper should be read by all firms.

CONSUMERS

The proposals are likely to be of general interest to consumers, as they concern various obligations on firms and amended regulatory processes that relate to these obligations.

2

Changes to the Supervision Manual (SUP 1): The FCA approach to supervision

Introduction

- 2.1 In this chapter, we explain our proposed revision of Chapter 1 of the Supervision Manual (SUP 1), which sets out the FSA's approach to supervision. The revision arises from the FCA's new supervisory model, which has most recently been explained in the *Journey to the FCA*, which was published in October 2012.⁷
- 2.2 The text of the proposed new SUP 1 (SUP 1A) is in Appendix 1, the draft designation for SUP 1A is in Appendix 2.

Summary of key Handbook changes

- 2.3 As the first chapter of the Supervision Manual section of the Handbook, SUP 1 gives a summary and overview of the regulator's supervisory approach to regulated firms. This overview is then supplemented in the subsequent chapters of the Supervision Manual by further detail on particular elements of our approach and processes, and on our exercise of particular supervisory powers and duties.
- 2.4 Inevitably, the FCA's approach to supervision will be different from that of the FSA and SUP 1 has been revised to reflect this. The FCA will have a new set of statutory objectives. It will have a different focus, which will be particularly reflected in the way it supervises dual-regulated firms (i.e. those authorised and prudentially regulated by the PRA but

⁷ www.fsa.gov.uk/about/what/reg_reform/fca

regulated for conduct purposes by the FCA). In addition, the FCA will have some new powers to add to its supervisory toolkit; including new powers in relation to product development and marketing.

2.5 We have set out the rationale underlying the FCA's new supervisory approach in more detail in the *Journey to the FCA*. All stakeholders should read this document in conjunction with the changes we are now proposing in SUP 1A. SUP 1A has a particular function and style intended to sit alongside the rest of the Handbook. It therefore provides only a high-level context to the rest of the Supervision Manual. In addition, SUP 1A is currently a 'living document', which will be developed further as certain elements of the FCA's supervisory model and approach are finalised over the coming months. It is likely that we will wish to add to SUP 1A over the coming months, consulting appropriately. We highlight below a number of areas where further material can be expected.

2.6 Specific proposed changes to SUP 1 (to form the new SUP 1A) include the following:

- All references to the FSA's regulatory objectives have been amended (see 1.1.3) to refer to the FCA's new statutory objectives.⁸ This includes specific reference to the FCA's new competition objective. The way in which the FCA supervises must satisfy this objective, so far as this is compatible with acting in a way that advances its other objectives.
- We have added the following sections of SUP 1A to reflect the FCA supervisory approach:
 - SUP 1.3.1 – 1.3.4 – summarising the key aspects of the new approach and the principles on which the new model is based;
 - SUP 1.3.7 and 1.3.8, detailing:
 - the supervisory approach in relation to the relationship with the firm and the addition of the contact centre as first line of contact for many firms; and
 - the new supervisory relationship required between the FCA and the PRA (particularly important in the case of dual-regulated firms);
 - SUP 1.4.5 and 1.4.6 – some additions to the list of supervisory tools available to the FCA as a result of the Bill.

2.7 The following sections of the existing SUP 1 have been deleted to ensure that the information in the updated SUP 1 is current and relevant:

- SUP 1.3.1: the purpose of the approach to supervision. This section has been replaced to reflect the new pre-emptive approach to supervision;
- SUP 1.3.2-1.3.6: this section references the Impact and Probability Assessment under the current FSA risk-assessment supervisory model. The section has been deleted as it will not fully reflect the new supervisory model;

⁸ As set out in the Bill and discussed further in the FCA approach document (Chapter 1: The Creation of the FCA: Spotlight on some of our new powers).

- SUP 1.3.11-1.3.12 references to the nature of our relationship with firms. This section has been replaced with 1.3.7 to reflect the new approach to the FCA's relationship with firms; and
- SUP 1.5: lead supervision and the arrangements applied for the supervision of Groups. This section has been deleted as it will not necessarily fully reflect the new supervisory model.

2.8 As indicated earlier, we envisage that: (i) updated material on the replacement for the current Impact and Probability model; and (ii) an updated explanation of the FCA's supervision of groups and lead supervision arrangements, will be published over the coming months. We will consider how these aspects of the FCA supervisory approach can also best be incorporated in the Handbook.

2.9 Other references to the FSA and FSMA have been updated as far as possible at this stage. References to other parts of the FSA Handbook (e.g. DEPP and COLL) remain, since the FCA Handbook will retain these modules, updated as required. Necessary changes to the Decision Procedure and Penalties manual (DEPP) and the Enforcement Guide will be consulted on separately before legal cutover.

Cost benefit analysis

2.10 SUP 1A sets out guidance on the regulator's supervisory approach, rather than providing guidance on our rules as such. Therefore, a cost benefit analysis is not required under FSMA.

Q1: Do you have any comments on how we propose to cover the FCA's new supervisory approach in the revised SUP 1?

Contact

Comments should reach us by 29 January 2013. Please send them to:

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3

Changes to the Supervision Manual (SUP 7): Individual requirements

Introduction

- 3.1 In this chapter we explain our proposed amendments to Chapter 7 of the Supervision Manual in the FSA Handbook (SUP 7), ready for legal cutover.
- 3.2 The text of the proposed amendments to SUP 7 is set out in Appendix 3 and the draft designation for SUP 7 set out in Appendix 4.
- 3.3 SUP 7 currently provides guidance to firms about when we will exercise our ‘own initiative’ powers to vary a firm’s Part IV permission and/or impose a requirement or limitation on a Part IV permission. It indicates to firms when we might consider using these powers and the criteria we will apply.
- 3.4 SUP 7 will be carried forward as Handbook material only by the FCA. The PRA approach to exercising its similar powers will be set out in other material, where appropriate, to be published ahead of legal cutover.
- 3.5 The changes we are proposing reflect this, as well as aligning SUP 7 with the relevant changes in the Bill. This means that, for the purposes of the designation of the revised SUP 7, all provisions will be designated ‘FCA only’ and references to the FSA in the updated SUP 7 have been amended to ‘the FCA’ (though with certain additional references to the PRA).
- 3.6 In CP12/24⁹, we consulted on our proposed changes to Chapter 6 of the Supervision Manual (SUP 6), which covers variations of a firm’s permission or requirements imposed

⁹ CP12/24: ‘Regulatory Reform: PRA and FCA regimes relating to aspects of authorisation and supervision’, September 2012 (www.fsa.gov.uk/library/policy/cp/2012/12-24.shtml)

on a firm at the firm's request, as opposed to at the initiative of the regulator. So SUP 6 and SUP 7 are complementary in covering the range of circumstances where such variations or requirements might be imposed.

Overview of changes from the Bill

3.7 The relevant sections in the Bill are sections 55J, 55K, 55L, 55N, 55O, 55P, 55Q, 55R, 55S, 55T and 55Y, which replace the current FSMA sections.

- 55J sets out the amended powers of the FCA (and PRA) to vary or cancel a permission on its own initiative and what precisely it may do. It also sets out when the FCA may exercise its power in relation to a dual-regulated firm, when it must consult the PRA and when the PRA must consult the FCA;
- 55K sets out more detail on when the cancellation power may be exercised by either regulator in relation to investment firms;
- 55L sets out the amended powers of the FCA to impose, vary or cancel requirements on a firm, when it must consult the PRA (and when the PRA must consult the FCA);
- 55N contains further provisions on when requirements may be imposed and their scope;
- 55O covers the imposition of prohibitions or requirements on changes of control;
- 55P covers powers to impose restrictions on assets;
- 55Q covers the exercise of own-initiative powers to assist an overseas regulator;
- 55R, 55S and 55T cover additional considerations relevant to the exercise of these powers – relevant connected persons and other permissions; and
- 55Y covers the procedure for the exercise of FCA (or PRA) own-initiative powers.

Changes required to SUP 7

3.8 SUP 7 will continue to be relevant to all FCA-regulated firms, (whether FCA or PRA authorised) and also to non-UK firms. The FCA's powers extend to dual-regulated firms as well as FCA-only firms, to the extent that the FCA is acting within its remit and statutory objectives. This is reflected in the updated SUP 7. We have also introduced new paragraphs to remind firms when the FCA may need to consult the PRA before exercising its powers and when PRA consent to a FCA action is required.

3.9 The Bill does not fundamentally alter the variation powers available to the FCA compared to those available to the FSA. So we do not envisage any fundamental change in the FCA's approach to exercising these variation powers; although it will need to do so consistently

with its range of other powers (including, for example, its new product intervention powers) and having regard to its new objectives (including its new competition objective).

3.10 Other changes include the following:

- Some changes to the headings and structure of SUP 7 to:
 - reflect the fact that the Bill now makes a clearer distinction between powers concerning variations to a firm's permission, and the imposition, variation or cancellation of requirements on a firm or limitations on its activities; and
 - to underline the distinction between the powers described in SUP 6 and those covered in SUP 7.
- Introducing a proposed new Handbook Glossary definition of 'own-initiative variation powers' to describe the relevant new FCA powers to vary or cancel a firm's part 4A permission, and to impose, vary or cancel a requirement on a firm.
- Changing all references to Part IV permission to 'Part 4A permission', since Part 4A is the new part of FSMA covering permissions to carry on regulated activities.
- Updating to all references in SUP 7 to FSMA powers to reflect the amendments made by the Bill.
- Adding a new example in SUP 7.3.2G of when the FCA powers may be used, to reflect section 55Q in the Bill – at the request of an overseas regulator or to assist an overseas regulator.

3.11 Details of the associated changes to FCA enforcement procedures will be covered by our review of our Enforcement Guide and our Decision Procedure and Penalties Manual (DEPP), and changes will be consulted on at a later date (but ahead of legal cutover).

Transitional arrangements

3.12 We expect that transitional arrangements will cover the treatment of existing Part IV permissions, and variations, limitations and requirements imposed by the regulator. We will provide more information on these arrangements ahead of legal cutover. But in its October 2012 consultation on draft secondary legislation to be made under the Bill¹⁰, the Treasury stated:

'More details on the transitional arrangements to the new regulatory system will be published in the coming months. As a general principle, the Government intends to minimise the disruption that could be caused by the transition by grandfathering existing Part IV permissions, controlled functions, rule waivers and modifications, passports, limitations and requirements. Firms do not need to take any action to enable this to happen.'

¹⁰ www.hm-treasury.gov.uk/d/condoc_fin_regulation_draft_secondary_leg.pdf (Paragraph 1.7.)

Cost benefit analysis

- 3.13** We expect the proposals to be made by the Board of the FCA, rather than by the FSA. As a result, the relevant cost benefit analysis (CBA) requirements are those set out in sections 138I and 138J of the revised version of FSMA rather than those in section 155 of the original version of FSMA. Sections 138I and 138J of the revised version of FSMA are currently before Parliament and we will review the CBA in the event that those requirements change.
- 3.14** The proposed changes to SUP 7 are driven by legal considerations relating to the requirements of the Bill, and the creation of the new UK regulatory structure. They do not address particular market failures, so we do not expect any particular economic benefits to arise. The proposals seek to minimise the risk of regulatory failure in future by helping to ensure that there is legal certainty and clarity for firms in relation to their responsibilities as FCA and/or PRA authorised entities.
- 3.15** As firms adjust to the new UK regulatory structure, it is likely they will incur some extra compliance costs while understanding and adjusting to the new FCA (and PRA) processes – particularly where firms are dual-regulated. We do not, however, expect firms to incur any incremental costs as a result of the proposals explained in this chapter, as the updated explanations of our approach reflect changes in the Bill and do not involve significant alterations to the actual powers of the FCA compared to the FSA.
- 3.16** There will be some additional costs for the FCA to implement this aspect of the new regime under the Bill (including the required interaction with the PRA). For example, there will be some additional personnel and resources to update existing documentation, systems and processes. However, we do not envisage these costs will be material.

Q2: Do you have any comments on our proposals to amend SUP 7?

Contact

Comments should reach us by 29 January 2013. Please send them to:

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London E14 5HS
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4

Changes to the Threshold Conditions sourcebook (COND)

Introduction

- 4.1 In this chapter we explain our proposed amendments to the Threshold Conditions sourcebook of the FSA Handbook (COND). COND copies out the threshold conditions (TCs'), as stated in Schedule 6 of FSMA, providing our guidance on them.
- 4.2 We are not consulting on the TCs themselves in this CP. We are consulting on our proposed changes to the guidance.
- 4.3 These changes will form part of the FCA Handbook and will be relevant for both dual-regulated firms and firms regulated only by the FCA at legal cutover.¹¹ The text of the proposed amendments is set out at Appendix 5.

Review of the threshold conditions

- 4.4 As a part of the creation of the new UK regulatory regime, the government committed to undertake a comprehensive review of the existing TCs. Having completed this review, it is proposing amendments to the TCs which are set out in the Treasury's draft Threshold Conditions Consultation Order, published on 15 October 2012.¹² The draft TCs may be subject to further amendment, before they are made, as a result of the outcome of the

¹¹ There are a few limited exceptions relating to incoming EEA firms and incoming Treaty firms.

¹² A description can be found at www.hm-treasury.gov.uk/consult_fin_regulation_draft_secondary_leg.htm

Treasury consultation. If that were so, we would need to consider whether any consequential changes were needed to what we have proposed for COND.

Impact on the COND sourcebook

- 4.5 Amendments to COND will be necessary to align the FCA Handbook with the FCA TCs contained in the Threshold Conditions Order, having regard to the future objectives and functions of the new regulator.

Relevance of the COND sourcebook to dual-regulated firms

- 4.6 From legal cutover, the application of COND to dual-regulated firms will be limited in two ways.
- Firstly, COND will only provide guidance on the TCs for which the FCA is responsible. It will have no application to the TCs for which the PRA is responsible. The PRA will not retain formal guidance on its TCs; instead it has set out its approach to the PRA's TCs in its October 2012 Approach Documents.
 - Secondly, the guidance will only apply to dual-regulated firms to the extent that it is relevant to the discharge of the FCA's functions in relation to them. Where guidance in COND relates to an assessment of a firm's financial position or its compliance with prudential regulatory requirements, it will not apply to PRA-authorised persons. These aspects relate to the discharge of the PRA's functions and will be considered by the PRA when assessing whether a PRA-authorised person meets its threshold conditions. Furthermore, any guidance on the FCA's assessment of appropriate financial resources should be read as applying only to the TCs that apply to firms solely authorised and regulated by the FCA.
- 4.7 When assessing whether a dual-regulated firm meets any particular TC, if this is done by both the FCA and PRA, the FCA will only assess the firm's compliance with that TC having regard to its own statutory objectives, duties and functions. We have drawn attention to the limitation (described in this section) on the application of COND in the draft Instrument at Appendix 5.

The relevance of threshold conditions

- 4.8 The TCs are important because they are the basic requirements that all firms must meet to become authorised, and which they must continue to meet to remain authorised.

- 4.9 In addition, in granting a firm's application to vary its permission, to impose or vary requirements on a firm, or to consent to a variation, the PRA and the FCA will have to ensure that the firm concerned will satisfy, and continue to satisfy, the TCs for which that regulator is responsible.

Summary of key changes to the threshold conditions arising from the Treasury's review

- 4.10 To ensure clarity following the split of regulatory responsibilities between the FCA and the PRA, the government has proposed separate TCs for each regulator as follows:
- conditions for firms authorised and regulated by the FCA only;
 - FCA-specific conditions for firms authorised by the PRA and subject to dual-regulation;
 - PRA-specific conditions for insurance firms; and
 - PRA-specific conditions for deposit-takers and dual-regulated investment firms.
- 4.11 The proposed FCA TCs differ from the existing FSA TCs in the following key ways:
- the 'close links' TC has been replaced by a broader 'effective supervision' TC;
 - the 'adequate resources' TC has been replaced by an 'appropriate resources' TC for FCA-only firms and an 'adequate non-financial resources' TC for dual-regulated firms, which, among other things, makes it clear that appropriate resources encompasses 'systems, controls, plans or policies' and 'human resources';
 - the 'suitability' TC sets out additional circumstances, which the FCA may have regard to when assessing whether a firm is 'fit and proper' – e.g. assessing whether those who manage the firm's affairs have the adequate skills and experience and act with probity; and
 - there is a new 'business model' TC which means that the FCA will assess whether a firm's strategy for doing business is suitable for its regulated activities.
- 4.12 Further details on the draft TCs can be found in the Treasury's consultation paper.

The Threshold Condition Code

- 4.13 The Bill includes a provision giving the FCA (and the PRA) a new power to issue a 'Threshold Condition Code'. The code would effectively be a set of supplementary requirements with particular characteristics made by the FCA. A key characteristic of the code is that such requirements would apply to all FCA firms and could not be waived, under any circumstances.

- 4.14 We have not identified a need for the FCA to issue a Threshold Condition Code at this stage. The revised TCs are more detailed than what currently exists, and in our view a code offering further detail is not necessary at this time. We believe that the key areas the FCA will have regard to when considering whether a firm should be authorised (and granted a Part 4A permission) are adequately covered in the revised TCs and the COND sourcebook (including our proposed changes).

Retaining the COND sourcebook

- 4.15 We believe that the COND sourcebook will continue to be useful for new applicants and authorised firms alike following legal cutover. We believe that COND:
- is a useful and convenient single point of reference for firms, as it copies out the Treasury's TCs and includes FCA guidance in the same location; and
 - provides valuable guidance, which helps firms by explaining what is expected of them when they apply for authorisation and throughout their regulatory life, bearing in mind that the TCs are the minimum standards that we expect firms to satisfy to become and remain authorised.

Q3: Do you agree the COND sourcebook should be retained in the FCA Handbook?

Amendments to existing guidance in the COND sourcebook

- 4.16 Our experience of using the existing COND has been that firms find the guidance in it useful for explaining what they might need to do to comply with the TCs.
- 4.17 Although we propose keeping much of the existing guidance in COND, we do not intend to transition it into the FCA Handbook in its entirety. We propose to update the guidance to have regard to the Treasury's revised and more detailed TCs. We also propose taking this opportunity to consolidate COND by:
- removing guidance where the substance is to be contained in one or more of the FCA TCs, to avoid duplication;
 - including new text arising out of consequential changes (e.g. COND 1.1A explaining which threshold conditions COND applies to); and
 - removing some guidance where we believe the material is of limited value to both firms and the FCA.¹³

¹³ It is important to note that although some references to specific provisions of the Handbook will be removed as part of this review, the FCA will still expect firms to be ready, willing and able to comply with all of the applicable FCA Handbook requirements in detail.

Q4: Do you agree with the amendments to COND as set out in the Instrument at Appendix 5?

Q5: Do you agree that the guidance in the Instrument sufficiently draws the distinction between the Threshold Conditions that apply to dual-regulated firms and those which apply to FCA-only regulated firms?

New business model guidance

- 4.18** The introduction of the new business model TC demonstrates the importance the FCA will place on a firm's ability to put forward an appropriate, viable and sustainable business model, reflecting the nature, scale and complexity of the business the firm intends to carry out.
- 4.19** A firm's business model and any changes to it after a firm has been authorised (including for product strategies) is key to both the viability of the business and the fair treatment of consumers.
- 4.20** The draft business model TC says that a firm's business model must be 'suitable' but does not expand on what the firm might be expected to do to make it so. Therefore we believe introducing guidance in relation to this TC will assist firms in understanding what they need to do to comply with this new TC. This is the only significant new guidance we propose to add to the FCA's COND sourcebook.
- 4.21** Although a specific business model TC does not currently exist, when assessing a firm against the TCs as a whole, the FSA does ask for information about a firm's business model. Therefore the revised TCs, which now include a specific business model TC, make explicit what is already implicit and as a result we believe our new business model guidance reflects existing practice.

What the business model guidance covers

- 4.22** The guidance is not specific or exhaustive but lists the issues that firms should take into account to be able to demonstrate to the FCA that their business model is appropriate to the regulated activities they undertake. It covers:
- the assumptions the firm has relied on, the rationale behind the business model, the pricing and product strategy and the needs of and risks to consumers;
 - how the firm intends to implement its business model, including such areas as the procurement and outsourcing arrangements;

- sustainability – for example, the identification and mitigation of potential risks and any contingency plans; and
- the areas a firm may wish to consider when its business model changes – for example, the governance of changes to the business model and any risks to and impact of such changes on the consumer.

Q6: Do you have any comments on the proposed guidance to the new business model TC?

Implications of the revised TCs for firms currently authorised

- 4.23** The Treasury's aim will be to publish the final version of the TC's before legal cutover. Our guidance will be brought into force at the same time as the new TC's. We expect this to happen at legal cutover. Firms will be expected to take the necessary steps to ensure they become familiar with the guidance so that they will comply with the revised TC's.

Implications of the Treasury's timetable

- 4.24** Our proposed guidance is based on the Treasury's draft TCs, which are currently being consulted on. The Treasury's consultation will close on 24 December 2012 and we expect the Treasury to publish the final set of TCs in early 2013. It is also likely that amendments will be made to the Bill and the relevant secondary legislation to clarify the treatment of the additional conditions addressed in COND 2.6 (and for this reason COND 2.6 is not addressed in this consultation). So our proposals may be subject to change, and we may need to re-consult on some points.

Cost benefit analysis

- 4.25** We believe the provisions resulting from the proposals set out in this Consultation Paper will be made by the Board of the FCA, rather than by the FSA. As a result, the relevant cost benefit analysis (CBA) requirements are those set out in sections 138I and 138J of the revised version of FSMA rather than that in section 55 of the original version of FSMA. This states that no CBA is required if there will be no increase in costs or a minimal increase. As we expect any increase in costs from the proposals in this chapter to be minimal, we have not carried out a CBA.
- 4.26** The proposals to retain the COND sourcebook in the FCA Handbook and to update the TCs, as required by the Treasury, should not have cost implications as they maintain the

status quo for legal cutover. The additional guidance for the business model TC aims to reflect current FSA practice, so firms will not need to carry out additional activities that would impose significant costs on them.

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5

FCA powers over qualifying parent undertakings

Introduction

- 5.1 The Financial Services and Markets Act, as amended by the Bill (sections 192A – 192N), will grant the FCA (and PRA) some specific powers in relation to ‘qualifying parent undertakings’ (also called ‘unregulated holding companies’) that are the parent entities of regulated firms.
- 5.2 These consist of three sets of powers that can be applied directly to a qualifying parent undertaking: a power of direction; a rule-making power for information gathering; and a supporting enforcement power to fine or censure for breaches of a direction or information rule. The FCA powers are available in relation to all FCA-authorized investment firms and recognised UK investment exchanges (RIEs), other than overseas investment exchanges.
- 5.3 This chapter sets out the FCA’s proposals for implementing the powers provided for in the Bill. The PRA is publishing a separate consultation on its proposed implementation of its powers of direction in sections 192A to 192N of the Act, to reflect the differing objectives of the two regulators.
- 5.4 This chapter sets out the context of these new powers and consults on a draft FCA statement of policy on using the power of direction (set out at Appendix 7). This statement is required by section 192H of the Act¹⁴ as amended by the Bill.¹⁵
- 5.5 The FSA, on behalf of the FCA, is hereby formally complying with the requirement to publish a draft of the proposed statement as required under section 192I of the Act.

14 The draft FCA statement of approach reflects the current government proposals as at 26 November 2012.

15 The Bank of England will also publish separately a statement setting out its policy on the use of its power to direct a qualifying parent undertakings of recognised clearing houses under section 192C of FSMA (as applied to the Bank of England and recognised clearing houses by paragraph 17 of Schedule 17A of FSMA).

What does the statement include?

- 5.6 The statement sets out the FCA's policy on using its power to direct a qualifying parent undertaking under section 192C of the Act.
- 5.7 The FCA is only able to exercise the power of direction in relation to a qualifying parent undertaking and where either the general or consolidated supervision condition in the Act is satisfied.

Definition of a 'qualifying parent undertaking'

- 5.8 The Act (section 192B) defines a 'qualifying parent undertaking' as a parent undertaking of a qualifying authorised person¹⁶ (section 192A) or recognised UK investment exchange. A qualified parent undertaking is:
- A) a body corporate incorporated in any part of the UK or which has a place of business in the UK;
 - B) not itself an authorised person, a recognised investment exchange or a recognised clearing house; and
 - C) a financial institution of a kind prescribed by the Treasury by order.
- 5.9 At the time of publication, the Treasury has not yet set out what kind of financial institutions should meet condition C of the definition (section 192B (4)). However, the Treasury is currently consulting on a draft Order¹⁷ that covers this. The Order provides that the following are prescribed as 'qualifying parent undertakings':
- a) Insurance holding companies – broadly, companies whose main business is to acquire and hold subsidiary companies that are exclusively or mainly insurance or reinsurance companies.
 - b) Financial holding companies – broadly, companies whose principal activities are to acquire subsidiary companies that are either exclusively or mainly credit institutions or investment firms.
 - c) Mixed financial holding companies – companies that have at least one subsidiary which is a credit institution, an insurance undertaking or an investment firm and, together with their subsidiaries, constitute a financial conglomerate for the purposes of the Financial Conglomerates Directive.
 - d) The Order also states that all kinds of financial institution are set out for the purposes of Condition C of section 192B(4), insofar as the parent undertakings

¹⁶ A body corporate incorporated in any part of the United Kingdom.

¹⁷ The Financial Services and Markets Act 2000 (Prescribed Financial Institutions) Order 201*, as published in the HM Treasury Consultation Paper.

of RIEs are concerned. In this context, ‘financial institution’ is not defined. It will include an entity that provides financial services or operates financial market infrastructure or whose business involves the ownership of, or management of, such entities.

- 5.10 For the purposes of this definition, a qualifying authorised person is a PRA-authorised person or an investment firm. We are working on the assumption that the definition of a qualifying authorised person will include any FCA-regulated firms that is classified as an investment firm; and this may included personal investment firms.

The general and consolidated supervision conditions

- 5.11 The **general condition** is that the FCA considers that it is desirable to give the direction in order to advance one or more of its operational objectives.

- 5.12 The **consolidated supervision condition** is that:

- a) the FCA is the competent authority for the consolidated supervision that is required, for some or all of the members of the group of a qualifying authorised person, to follow the relevant EU directives; and
- b) the FCA considers that the giving of the direction is desirable for the purposes of the effective consolidated supervision of the group. Our draft statement of policy sets out a non-exhaustive list of possible scenarios in which the FCA may consider exercising the power of direction. (See Appendix 7, Annex 1.)

How we will use the powers in relation to FCA-regulated entities

Power of direction

- 5.13 The power of direction is a power the Act gives the FCA to use against the parent company of an FCA-regulated entity. In addition, the FCA may need to exercise the powers in relation to a dual-regulated firm to resolve a conduct issue.

- 5.14 In deciding whether to give a direction, section 192C(5) of the Act states that the FCA must have regard to:

- a) the desirability where practicable of exercising its powers in relation to authorised persons or RIEs rather than its powers under this section; and
- b) the principle that a burden or restriction that is imposed on a person should be proportionate to the benefits, considered in general terms, which are expected to result from its imposition.

The content of direction

- 5.15** A direction, specified in section 192D(1) in the Act, may require the parent undertaking:
- a) to take specified action; or
 - b) to refrain from taking specified action.
- 5.16** We envisage that the FCA would issue a direction designed to bring the FCA-regulated entity and the group back into compliance with its regulatory requirements, or to prevent the parent undertaking from taking action that may lead to a disorderly failure of an FCA-regulated entity or the FCA regulated entity's group. The direction may be time limited.
- 5.17** A requirement may be imposed by reference to the parent undertaking's relationship with:
- a) its group; or
 - b) other members of its group.
- 5.18** The draft statement of policy sets out a non-exhaustive list of possible directions which the FCA may consider making. (See Appendix 7, Annex 2.)

Background to new powers

- 5.19** A large proportion of FCA-regulated investment firms are part of group structures where the ultimate parent undertaking is not an authorised firm. It is also common for RIEs to be part of groups headed by parent companies that are not themselves authorised firms or RIEs.
- 5.20** The boards of FCA-authorized investment firms and RIEs (referred to collectively as 'FCA-regulated entities') are responsible for ensuring the FCA-regulated entity complies with the UK regulatory structure, but the ultimate direction and control of aspects key to that compliance often lie with a parent undertaking.
- 5.21** In most cases, it is the board of the ultimate parent undertaking that decides overall group strategy and organisation, risk management procedures and intra-group flows of capital and liquidity. The ultimate parent undertaking is often the primary-listed entity in the group (if the group has a listing) and may have the core capital-raising ability for the group. The ultimate parent undertaking is also usually the only entity that can alter the group structure above and around an FCA-regulated entity.
- 5.22** Actions by a parent undertaking of an FCA-regulated entity can therefore affect that entity's ability to comply with both its own solo regulatory requirements, as well as any consolidated or group requirements for which it may also be responsible. The ability of a parent undertaking to influence or control decisions affecting whether an FCA-regulated entity complies with its regulatory obligations, could pose risks to the FCA's operational objectives of securing an appropriate degree of protection for consumers, protecting and enhancing the integrity of the UK financial system and/or promoting effective competition in the interests of consumers in the markets, where the interests of the parent and

subsidiary undertakings are not sufficiently aligned. Therefore, there are circumstances in which the FCA may wish to direct a parent undertaking of an FCA-authorized group to act, or to refrain from acting, in a certain manner, notwithstanding that the parent undertaking is itself unauthorised and unregulated.

- 5.23** In consultation with the PRA, the FCA may need to exercise the power, in relation to FCA-authorized firms that are part of a PRA-consolidated group, on the common unregulated financial holding company. In consultation with the Bank of England¹⁸, the FCA may also need to exercise the power for a qualifying parent undertaking whose group consists of recognised investment exchanges and recognised clearing houses.
- 5.24** In terms of numbers, the majority of FCA investment firms are subject to only a limited range of international standards or EU legislation. However, they conduct financial services activities that pose similar risks to other investment firms that are subject to EU legislation. And at a national level, we apply similar, but proportionate, conduct and prudential supervision to these ‘non-directive’ firms.

International standards

- 5.25** Some FCA-regulated entities are subject to MiFID, and MiFID, together with the Capital Adequacy Directive¹⁹ (CAD) that forms part of the Capital Requirements Directive (CRD²⁰), sets standards for the prudential supervision of those entities. The CRD rules are derived from principles established by The Basel Committee on Banking Supervision (‘the Basel Committee’) that stated in its Concordat²¹ that ‘the existence of holding companies either at the head, or in the middle, of groups may constitute an impediment to adequate supervision’. To mitigate these risks, the Basel Committee recommended that all international banking groups should be supervised by a supervisor that capably performs consolidated supervision²² to monitor the risks to which a banking group is exposed, as well as the adequacy of its capital.
- 5.26** The Basel Core Principles²³ on prudential and consolidated supervision set out by the Basel Committee, while not legally binding, are relevant to all FCA-regulated firms in a consolidated group, regardless of whether or not they are subject to EU legislation.

18 The Bank will be the appropriate regulator of recognised clearing houses.

19 Directive 2006/49/EC.

20 This will be replaced by CRD IV in the future.

21 Basel Committee on Banking Supervision – Principles for the Supervision of Banks’ Foreign Establishments (May 1983) – www.bis.org/publ/bcbssc312.pdf

22 Basel Committee – Minimum Standards for the Supervision of International Banking Groups and their Cross-border Establishments (July 1992) – www.bis.org/publ/bcbssc314.pdf

23 Basel Committee – Core Principles for Effective Banking Supervision (September 2012) – www.bis.org/publ/bcbs230.pdf

EU financial services laws

- 5.27** EU financial services laws reflect this international concern that firms should be supervised on a group basis. For example:
- For banking groups, the current Banking Consolidation Directive provides that consolidated supervision should be applied to all banking groups, and that supervisors should hold the necessary legal powers to be able to exercise such supervision.²⁴
 - For investment firm groups, the Capital Adequacy Directive²⁵ (CAD) applies consolidated supervision to investment firm groups. Though the directive allows the regulator, on a case-by-case basis, to waive²⁶ the need to comply with the consolidated capital requirement for investment firm groups if certain conditions are met (see paragraph 5.30 for more information).
 - For insurance groups, Title III of the Solvency II Directive²⁷ requires member states to provide for supervision, at group level, of all insurance and reinsurance undertakings that are part of a group.
 - For financial conglomerates (i.e. groups including both banks/investment firms and insurers), the Financial Conglomerates Directive²⁸ (FCD) provides that supervisors should be able to assess at a group-wide level the financial situation of banks, insurers and investment firms that are part of a financial conglomerate. While FCA-regulated entities are unlikely to trigger a financial conglomerate group, they may be included within the scope of another group.
- 5.28** In addition, the ‘Post-BCCP’ Directive²⁹ imposes an additional requirement for authorisation on banks, insurers and investment firms, so that where a firm is part of a group, the group structure must be sufficiently transparent to enable the firm to be supervised effectively. This requirement is reflected in the threshold conditions made under FSMA.
- 5.29** Regulators and resolution authorities also require powers over parent companies to implement the EU’s new Recovery and Resolution Framework. In its legislative proposal for a new Recovery and Resolution Directive³⁰, the European Commission stated that:

‘The powers of resolution authorities should also apply to holding companies where one or more subsidiary credit institutions or investment firms meet the conditions for resolution’.³¹

24 Directive 2006/48/EC, Recital (58)

25 Directive 2006/49/EC, Recital (27)

26 Directive 2006/49/EC, Article 22

27 Directive 2009/138/EC

28 Directive 2002/87/EC, Recital (7)

29 Directive 95/26/EC

30 Directive 95/26/EC

31 Ibid. p9, para 4.4.1

- 5.30** The CAD allows some investment management firms³² the option to dis-apply consolidated supervision requirements through the investment firm consolidation waiver. (These groups are sometimes referred to as CAD article 22 groups.)
- 5.31** One of the conditions of the exemption from consolidated supervision is that the financial holding company at the head of the consolidated group needs to meet the test for such a holding company. This test requires the financial holding company to have capital resources sufficient to cover the sum of the capital requirements of certain group members.³³ This test could apply to unregulated financial holding companies.
- 5.32** Dual-regulated firms³⁴ may be subject to the ‘ring-fencing’³⁵ arrangement under the Banking Reform Bill³⁶ and proposals by the EU on reforming the structure of the EU banking sector.³⁷ Power of direction over unregulated holding companies could help effectively monitor and supervise any such ring-fence of functions supervised by the FCA.

FCA powers to support supervision

Powers under the threshold conditions

- 5.33** The board of an FCA-authorised investment firm is responsible for ensuring that an authorised firm conducts its business in a way that complies with the threshold conditions. PRA-regulated entities will also be regulated by the FCA for the purposes of complying with conduct rules.
- 5.34** The proposed draft threshold conditions for FCA-authorised investment firms, which the Treasury is currently consulting on³⁸, recognise that the acts or omissions of an authorised firm’s parent company can affect its ability to comply with its own regulatory requirements for conduct issues and the requirements of consolidated supervision, and make provision for such matters to be considered as part of the FCA’s assessment of whether the firm satisfies the threshold conditions.

32 As a pre-condition all investment firms in the group must be limited licence and limited activity firms.

33 The group members to be included in this sum are set out in BIPRU 8.4.11 and include CAD investment firms, financial institutions (excluding insurers), asset management companies and ancillary services undertakings.

34 Firms regulated by the FCA for conduct purposes and by the PRA for prudential purposes.

35 Critical banking functions will be ring-fenced from other banking services to help to ensure the continuity of these functions, while reducing the risk that the government will be forced to bail out universal banks in their entirety in the future.

36 www.hm-treasury.gov.uk/d/icb_banking_reform_bill.pdf

37 Consultation by the High-level Expert Group on reforming the structure of the EU banking sector. http://ec.europa.eu/internal_market/consultations/docs/2012/banking_sector/consultation_paper_en.pdf

38 See the draft Financial Services and Markets Act 2000 (Threshold Conditions) Order [201*], as published in the Treasury Consultation Paper. See also Chapter 4 of this CP.

Powers under the recognition requirements

- 5.35 A recognised UK investment exchange (RIE) must continue to meet responsibilities set out in the recognition requirements in accordance with FSMA and secondary legislation.³⁹ When considering whether an exchange satisfies those requirements, we (and in future the FCA) may take into account all relevant circumstances. When assessing whether an exchange is fit and proper to perform the functions of an RIE, we may take into account its connection with any person. We must, in particular, be satisfied that persons in a position to exercise significant influence over the management of the exchange are suitable. In addition, when assessing the adequacy of an RIE's financial resources, we will take into account the risks posed to the RIE as a result of its membership of a group. Also, under FSMA, a proposal by a person to acquire (or increase) control of an RIE requires our approval.

Information-gathering powers

- 5.36 The Act gives the FCA the power to make ad hoc information requests. Section 165 of the Act provides that the FCA may, by written notice, require an RIE (or a person connected with an RIE) to provide specified information or documents, or information or documents of a specified description. In addition to the ad hoc power, the Bill adds a new section 192J, which gives the FCA the power to make rules requiring a qualifying parent undertaking to provide to the FCA information or documents of a specified description that are relevant to the exercise by the FCA of its functions. At legal cutover, the FCA plans to use the ad hoc data collection powers as set out in section 165 of the Act, where appropriate, but is not proposing to introduce new information gathering rules under its powers with respect to qualifying parent undertakings.

Q7: Do you have any comments on our draft statement of policy on using the power of direction?

Enforcement powers

- 5.37 Section 192N of the Act, as amended by the Bill, requires the FCA to produce a statement of policy on how it will use the enforcement powers associated with its new holding company powers, to fine or censure. This Statement will form part of DEPP and will be consulted on as part of our DEPP consultation to be published at a later date (but before legal cutover).

³⁹ SI 2001/995

Contact

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Annex 1

Compatibility statement

Compatibility with the FSA's General Duties

1. We believe the final changes in this CP will be made by the Board of the FCA, rather than by the FSA. So we comment here on the compatibility of our proposals with the draft duties and objectives of the FCA as set out in the Financial Services Bill.

FCA general duties and principles of good regulation

2. According to Section 138I(2)(d) of FSMA, a consultation by the FCA should include an explanation of how the proposed rules are compatible with its duties and regulatory objectives. We comment on these below.

In discharging its general functions, the FCA must, so far as is reasonably possible, act in a way which (a) is compatible with its strategic objective, and (b) advances one or more of its operational objectives (section 1B(1) FSMA, as proposed to be amended by the Financial Services Bill).

3. Our approach is to preserve the benefits of the original requirements, standards and processes being amended, while making the necessary adjustments required by the Bill and the creation of the new UK regulatory structure, and making any legal updates that we believe are necessary as part of the review we have undertaken.
4. We believe that the proposed changes covered by this CP are also compatible with the draft FCA operational objectives – the consumer protection objective, the integrity objective and the competition objective. Further comment is provided below about how we have discharged the competition duty (see paragraph 9).
5. The Bill also requires (section 1K) the FCA's general guidance to include guidance about how it intends to advance its operational objectives in discharging its general functions in relation to different categories of authorised person or regulated activity.

6. The draft SUP 1A already references this duty and we envisage that further relevant detail will be provided when we publish material on the replacement for the FSA's Impact and Probability model and an updated explanation of the FCA's supervision of groups and lead supervision arrangements. SUP 1A will also contribute to the FCA explanation of how it satisfies the FSMA requirement (section 1L in the Bill) to maintain arrangements for supervising authorised persons.
7. In exercising its supervisory powers, its variation powers, its power of direction over qualifying parent undertakings, and in applying the FCA threshold conditions, the FCA will also look to act in a way that is compatible with, and advances, its objectives. This will include recognition of the distinction between firms which are regulated by the FCA only and those which are dual regulated, as well as the different regulated activities performed by firms.

In discharging its general functions the FCA must have regard to the regulatory principles set out in the Act (section 1B(5)(a) FSMA (as proposed to be amended by the Financial Services Bill)).
8. We believe that all proposed changes covered by this CP are compatible with the draft principles of good regulation. In particular, we have endeavoured to minimise additional costs while preserving benefits and believe that an appropriate balance has been struck between the need to ensure the FCA's regulatory objectives are fulfilled, the need to keep regulatory burdens to a minimum, and the need to provide transparency in how the FCA proposes to exercise its functions.

Competition objective and duty

9. The FCA must, so far as is compatible with its objectives, discharge its general functions (including rule-making, guidance and general policies) in a way which promotes competition.
10. In updating the guidance in SUP1A (see chapter 2), SUP 7(see chapter 3) and changes to the COND sourcebook (see chapter 4), we have had regard to competition.
11. It is expected the additional guidance outlining our supervisory approach will improve the quality of firms operating in regulated markets. If firms' behaviour falls short of our expected regulatory standards, supervisory interventions may be necessary to meet our consumer protection and market integrity objectives. This may constrain competition in the short-run (for example, in the extreme case by reducing the number of firms operating in particular regulated markets). However, in the long run it is expected that supervisory interventions will result in more effective competition than would otherwise be the case; for example, by ensuring that firms operating in regulated markets have good quality and sustainable business models that result in products and services that meet consumer needs and provide value for consumers, at prices that reflect the cost of production. The FCA will seek to ensure supervisory action does not unduly raise barriers to entry or impose

unjustifiable costs on firms that operate in regulated markets to the extent that they constrain competition in the long-run or weaken firm incentives to compete.

12. In respect of the additional business model guidance on the FCA's Threshold Conditions, the Threshold Conditions are the minimum standards that firms must meet and continue to meet to operate in regulated markets. They seek to promote an appropriate degree of protection for consumers, and to protect and enhance the integrity of the UK financial system and will not unduly raise barriers to entry to firms. It is expected that the changes to the COND sourcebook will:
- not adversely impact market behaviour; and
 - clarify the expectations the FCA will have of new entrants, and help them develop appropriate business models to become authorised, making market entry easier and the process more straightforward.
13. It has always been the case that firms seeking to enter the market must have a clear and coherent business model. What is proposed therefore is not a new requirement, but by setting out more clearly how firms can meet our expectations we should make it easier for firms to enter markets where authorised firms operate. As noted in the recently published *Journey to the FCA*¹, when carrying out analyses of business models and strategy, we will take account of a firm's competitive position in various markets when assessing the potential conduct risks that may arise from their strategies.

1 www.fsa.gov.uk/about/what/reg_reform/fca

Annex 2

List of questions

Chapter 2: Changes to the Supervision Manual (SUP 1): The FCA approach to supervision

- Q1:** Do you have any comments on how we propose to cover the FCA's new supervisory approach in the revised SUP 1?

Chapter 3: Changes to the Supervision Manual (SUP 7): Individual requirements

- Q2:** Do you have any comments on our proposals to amend SUP 7?

Chapter 4: Changes to the Threshold Conditions sourcebook (COND)

- Q3:** Do you agree the COND Sourcebook should be retained in the FCA Handbook?
- Q4:** Do you agree with the amendments to COND as set out in the Instrument at Appendix 5?
- Q5:** Do you agree that the Instrument sufficiently draws the distinction between the guidance that applies to dual-regulated firms and that which applies to FCA-only regulated firms?

Q6: Do you have any comments on the proposed guidance to the new Business Model TC?

Chapter 5: FCA powers over qualifying parent undertakings

Q7: Do you have any comments on our draft statement of policy on using the power of direction?

Appendix 1

Revised Chapter 1 of the Supervision Manual (SUP 1A)

SUPERVISION OF AUTHORISED FIRMS LEGAL CUTOVER INSTRUMENT 2012

Powers exercised

- A. The Financial Conduct Authority makes this instrument in the exercise of section 139A (Power of the FCA to give guidance) and related provisions in the Financial Services and Markets Act 2000 (“the Act”).

Commencement

- B. This instrument comes into force on 1 April 2013.

Amendments to the Handbook

- C. The Supervision manual (SUP) is amended in accordance with the Annex to this instrument.

Citation

- D. This instrument may be cited as the Supervision of Authorised Firms Legal Cutover Instrument 2012.

By order of the Board
[date]

Annex

Amendments to the Supervision manual (SUP)

In this Annex, SUP 1 is deleted in its entirety and replaced with SUP 1A as set out below. This text is all new and is not underlined.

1A The FCA's approach to supervision

1A.1 Application and purpose

Application

- 1A.1.1 G This chapter applies to every *firm*, except that its relevance for an *ICVC* is limited as the *FCA* does not intend to carry out an assessment of an *ICVC* that is specific to that *ICVC*.

Purpose

- 1A.1.2 G The *Act* (section 1L) requires the *FCA* to "maintain arrangements for supervising authorised persons". Section 1K of the *Act* also requires the *FCA* to provide general *guidance* about how it intends to advance its operational objectives in discharging its general functions in relation to different categories of *authorised person* or *regulated activity*. One purpose of this *guidance* is to discharge the duties of the *FCA* set out in sections 1L and 1K of the *Act*. The *FCA's* approach to supervision is also designed to enable it to meet its supervisory obligations in accordance with *EU* legislation, where applicable, including in relation to requirements arising otherwise than under the *Act* (for example, directly applicable *EU* regulations).
- 1A.1.3 G The design of these arrangements is shaped by the *FCA's statutory objectives* in relation to the conduct supervision of financial services *firms* as well as the prudential supervision of *firms* not supervised by the *PRA*. These objectives are set out in Chapter 1 of the *Act*. The *FCA* has one *strategic objective*: ensuring that the relevant markets function well. In discharging its general functions, the *FCA* must, so far as is reasonably possible, act in a way which is compatible with its *strategic objective* and which advances one or more of its three operational objectives:
- (1) securing an appropriate degree of protection for consumers;
 - (2) protecting and enhancing the integrity of the UK financial system; and
 - (3) promoting effective competition in the interests of consumers in the markets for regulated financial services (or services provided by a recognised exchange in carrying on regulated activities in respect of which it is exempt from the general prohibition by virtue of section 285(2) of the *Act*).

1A.1.4 G In designing its approach to supervision, the *FCA* has regard to the regulatory principles set out in section 3B of the *Act*. In particular, the *FCA's* regulatory approach aims to focus and reinforce the responsibility of the senior management of each *firm* (section 3B(1)(d) of the *Act*) to ensure that it takes reasonable care to organise and control the affairs of the *firm* responsibly and effectively and develops and maintains adequate risk management systems. It is the responsibility of management to ensure that the *firm* acts in compliance with its regulatory requirements. The *FCA* will have regard to the principle that a burden or restriction which is imposed on a *firm* should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction (section 3B(1)(b) of the *Act*). The *FCA* will, so far as is compatible with acting in a way which advances the consumer protection or the integrity objective, discharge its supervisory functions in a way which promotes effective competition in the interests of consumers.

1A.2 Introduction

- 1A.2.1 G (1) The Supervision manual (*SUP*) and Decision Procedure and Penalties manual (*DEPP*) form the regulatory processes part of the *Handbook*.
- (2) *SUP* sets out the relationship between the *FCA* and *authorised persons* (referred to in the *Handbook* as *firms*). As a general rule, *SUP* contains material that is of continuing relevance after *authorisation*.
- (3) *DEPP* is principally concerned with and sets out the *FCA's* decision making procedures that involve the giving of *statutory notices*, the *FCA's* policy in respect to the imposition and amount of penalties, and the conduct of interviews to which a direction under section 169(7) of the *Act* has been given or the *FCA* is considering giving.
- 1A.2.2 G For a *firm* which undertakes business internationally (or is part of a *group* which does), the *FCA* will have regard to the context in which it operates, including the nature and scope of the regulation to which it is subject in jurisdictions other than the *United Kingdom*. For a *firm* with its head office outside the *United Kingdom*, the regulation in the jurisdiction where the head office is located will be particularly relevant. As part of its supervision of such a *firm*, the *FCA* will usually seek to cooperate with relevant *overseas regulators*, including exchanging information on the *firm*. Different arrangements apply for an *incoming EEA firm*, an *incoming Treaty firm* and a *UCITS qualifier*. The arrangements applying for an *incoming EEA firm* and an *incoming Treaty firm* are addressed in *SYSC* Appendix 1. For *UCITS qualifiers* see also *COLLG*.

1A.3 The FCA's approach to supervision

Purpose

1A.3.1 G The *FCA* will adopt a pre-emptive approach which will be based on making

forward-looking judgements about *firms*' business models, product strategy and how they run their businesses, to enable the *FCA* to identify and intervene earlier to prevent problems crystallising. The *FCA*'s approach to supervising *firms* will contribute to its delivery against its objective to protect and enhance the integrity of the *UK financial system* (as set out in the *Act*). Where the *FCA* has responsibilities for prudential supervision, its focus will be on reducing the impact on customers and the integrity of the financial system of *firms* failing or being under financial strain. In addition, when consumer detriment does actually occur, the *FCA* will robustly seek redress for consumers. This approach will be delivered through a risk-based and proportionate supervisory approach.

1A.3.2 G The overall approach in the *FCA* supervision model is based on the following principles:

- (1) forward looking and more interventionist;
- (2) focused on judgement, not process;
- (3) consumer-centric;
- (4) focused on the big issues and causes of problems;
- (5) interfaces with executive management/Boards;
- (6) robust when things go wrong;
- (7) focused on business model and culture as well as product supervision;
- (8) viewing poor behaviour in all markets through the lens of the impact on consumers;
- (9) orientated towards *firms* doing the right thing; and
- (10) externally focused, engaged and listening to all sources of information.

The scope of the supervision model for firms

1A.3.3 G The *FCA* supervision model risk assessment process applies to all *firms*, although the detail required may vary from *firm* to *firm*. For example, some *firms* may experience a highly intensive level of contact although others may only be contacted once every four years. *Firms* judged as high impact are likely to require a more detailed assessment. A peer review process within the *FSA* assists consistency and will be focused on *firms* and sectors of the industry that could cause, or are causing, consumers harm or threaten market integrity.

1A.3.4 G The supervision model is based on three pillars:

- (1) the Firm Systematic Framework (FSF) – preventative work through structured conduct assessment of *firms*;
- (2) event-driven work – dealing with problems that are emerging or have crystallised, and securing customer redress or other remedial work (eg to

secure the integrity of the market) where necessary; and

- (3) issues and products – thematic work on sectors of the market or products within a sector that are putting or may put consumers at risk

- 1A.3.5 G In order to create incentives for *firms* to raise standards and to maximise the success of the *FCA's* supervisory arrangements, it is important that a *firm* understands the *FCA's* evaluation of its risk so that it can take appropriate action.
- 1A.3.6 G The *FCA* intends to communicate the outcomes of its pillars of supervision to each *firm*. In the case of *firms* in which risks have been identified which could have a material bearing on the *FCA* meeting its statutory *objectives*, the *FCA* will also outline a remedial programme intended to address these. The *FCA* considers that it would generally be inappropriate for a *firm* to disclose its *FCA* risk assessment to third parties, except to those who have a need or right to be aware of it, for example external auditors. *FCA* risk assessments are directed towards a specific purpose – namely illustration of the risks posed by a *firm* to the *FCA's* statutory *objectives* and to enable the *FCA* to allocate its resources accordingly. Using a risk assessment for any other purpose has the potential to be misleading. The *FCA* therefore discourages *firms* from disclosing their assessments, unless they are required to make them public under relevant disclosure obligations.

The nature of the *FCA's* relationship with firms

- 1A.3.7 G As many *firms* will not have dedicated, fixed portfolio resource, the first point of contact for many issues for such *firms* will be handled by the *FCA's* Contact Centre, with the aim being that fewer issues and queries will need to be referred to the supervisors. To support all *firms* the *FCA* will also provide regional workshops and road shows to clarify its expectations on these risks and issues that are particularly important to the *FCA*.

The nature of the *FCA's* relationship with the *PRA*

- 1A.3.8 G While respecting each regulators different *statutory objectives and mandates*, in undertaking its supervisory activity the *FCA* will co-ordinate and co-operate with the *PRA* as required and necessary in the interests of the effective and efficient supervision of regulated firms and individuals. Both regulators will coordinate with each other as required under the *Act*, including on the exchange of information relevant to each regulator's individual objectives. However, the *FCA* and *PRA* will act independently from one another when engaging with *firms*, reflecting an independent but coordinated regulatory approach.

1A.4 Tools of supervision

- 1A.4.1 G In order to meet the statutory *objectives* and address identified risks to those objectives, the *FCA* has a range of supervisory tools available to it, including the power to impose financial penalties.

- 1A.4.2 G These tools may be usefully grouped under four headings:
- (1) diagnostic: designed to identify, assess and measure risks;
 - (2) monitoring: to track the development of identified risks, wherever these arise;
 - (3) preventative: to limit or reduce identified risks and so prevent them crystallising or increasing; and
 - (4) remedial: to respond to risks when they have crystallised.
- 1A.4.3 G Tools may serve more than one purpose. For example, supervisory powers can be used to address risks which have materialised or to assist in preventing risks from escalating. In the first instance they are remedial; in the second, preventative.
- 1A.4.4 G Some of these tools, for example the use of public statements to deliver messages to *firms* or *consumers* of financial services, do not involve the *FCA* in direct oversight of the business of *firms*. In contrast, other tools do involve a direct relationship with *firms*. The *FCA* also has powers to act on its own initiative to impose or vary individual *requirements* on a *firm* (see *SUP 7*) and to ban or impose requirements in relation to specific financial promotions. The *FCA* may also use its general rule-making powers to ban or impose requirements in relation to specific products, types of products or practices associated with a particular product or type of product. The use of the *FCA*'s tools in its oversight of market practices, in ensuring the protection of client assets and for prudential supervision of *FCA-only firms*, will also contribute to the integrity and orderly operation of the financial markets.
- 1A.4.5 G The *FCA* uses a variety of tools to monitor whether a *firm*, once *authorised*, remains in compliance with regulatory requirements. These tools include (but are not limited to):
- (1) desk-based reviews;
 - (2) liaison with other agencies or regulators;
 - (3) meetings with management and other representatives of a *firm*;
 - (4) on-site inspections;
 - (5) reviews and analysis of periodic returns and notifications;
 - (6) reviews of past business;
 - (7) transaction monitoring;
 - (8) use of auditors; and
 - (9) use of *skilled persons*.

1A.4.6 G The *FCA* also uses a variety of tools to address specific risks identified in *firms*. These tools include:

- (1) making recommendations for preventative or remedial action;
- (2) giving other individual *guidance* to a *firm*;
- (3) imposing individual *requirements*; and
- (4) varying a *firm's permission* in another way.

1A.4.7 G For further discussion of the *FCA's* regulatory approach, see publications on the *FCA's* website.

Appendix 2

Designation of Chapter 1 of the Supervision Manual (SUP 1A)

1. FSA Handbook provisions will be ‘designated’ to create a FCA Handbook and a PRA Handbook on the date that the regulators exercise their legal powers to do so. Please visit our website¹ for further details about this process.
2. We plan to designate the Handbook Provisions which we are proposing to create and/or amend within this Consultation Paper as follows:

Handbook Provision	Designation
SUP 1.1	FCA
SUP 1.1.1	FCA
SUP 1.1.2	FCA
SUP 1.1.3	FCA
SUP 1.1.4	FCA
SUP 1.2	FCA
SUP 1.2.1	FCA
SUP 1.2.2	FCA
SUP 1.3	FCA
SUP 1.3.1	FCA
SUP 1.3.2	FCA
SUP 1.3.3	FCA
SUP 1.3.4	FCA
SUP 1.3.5	FCA
SUP 1.3.6	FCA
SUP 1.3.7	FCA
SUP 1.3.8	FCA
SUP 1.4	FCA
SUP 1.4.1	FCA

¹ One-minute guide <http://media.fsahandbook.info/latestNews/One-minute%20guide.pdf>

SUP 1.4.2	FCA
SUP 1.4.3	FCA
SUP 1.4.4	FCA
SUP 1.4.5	FCA
SUP 1.4.6	FCA
SUP 1.4.7	FCA

Appendix 3

Changes to Chapter 7 of the Supervision Manual (SUP 7)

VARIATION OF PERMISSION (AMENDMENT NO 2) LEGAL CUTOVER INSTRUMENT 2012

Powers exercised

- A. The Financial Conduct Authority makes this instrument in the exercise of the powers under section 139A (Power of the FCA to give guidance) of the Financial Services and Markets Act 2000 (“the Act”).

Commencement

- B. This instrument comes into force on 1 April 2013.

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Supervision manual is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the as the Variation of Permission (Amendment No 2) Legal Cutover Instrument 2012.

By order of the Board
[*date*]

Annex A**Amendments to the Glossary of definitions**

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

- own-initiative variation powers*
- (1) the power set out in section 55J of the *Act* allowing the *FCA* to vary or cancel a *firm's Part 4A permission*; and
 - (2) the power set out in section 55L of the *Act* allowing the *FCA* to impose, vary or cancel a requirement on a *firm*

Annex B

Amendments to the Supervision manual (SUP)

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

7.1 Application and purpose

Application

- 7.1.1 G This chapter applies to every *firm* which has a ~~Part IV permission~~ Part 4A permission.
- 7.1.2 G The application of this chapter to an *incoming EEA firm, incoming Treaty firm* or *UCITS qualifier* with a ~~Part IV permission~~ Part 4A permission (a "top-up permission") is limited as explained in SUP 7.2.4G.

Purpose

...

- 7.1.4 G The ~~FSA FCA~~, in the course of its supervision of a *firm*, may sometimes judge it necessary or desirable to impose additional *requirements* on a *firm* or in some way amend or restrict the activities which the *firm* has *permission* to undertake. The *guidance* in this chapter describes when and how the ~~FSA FCA~~ will seek to do this.
- 7.1.5 G By waiving or modifying the requirements of a *rule* or imposing an additional *requirement* or *limitation*, the ~~FSA FCA~~ can ensure that the *rules*, and any other *requirements* or *limitations* imposed on a *firm*, take full account of the *firm's* individual circumstances, and so assist the ~~FSA FCA~~ in meeting ~~the its regulatory objectives (for example, to protect consumers, maintain market confidence and contribute to financial stability)~~ statutory objectives under the Act.

7.2 The ~~FSA's FCA's~~ powers to set individual requirements and limitations on its own initiative

- 7.2.1 G The ~~FSA FCA~~ has the power under ~~section 45~~ sections 55J and 55L of the *Act* (~~Variation on the Authority's own initiative~~) to vary a *firm's* ~~Part IV permission~~ Part 4A Permission and/or impose a requirement on a firm. This Varying a firm's Part 4A permission includes imposing a statutory requirement or limitation on that ~~Part IV permission~~ Part 4A Permission.
- 7.2.2 G The circumstances in which the ~~FSA FCA~~ may vary a *firm's* ~~Part IV permission~~ Part 4A permission on its own initiative or impose a requirement on a firm under ~~section 45~~ 55J or 55L of the *Act* include where it appears to the ~~FSA FCA~~

that:

- (1) one or more of the threshold conditions for which the FCA is responsible is or is likely to be no longer satisfied; or
- (2) it is desirable to vary a *firm's permission* in order to meet any of the ~~FSA's~~ FCA's regulatory objectives statutory objectives under the Act; or
- (3) a firm has not carried out a regulated activity to which its Part 4A permission applies for a period of at least 12 months.

7.2.3 G The ~~FSA~~ FCA may also use its ~~powers under section 45~~ own-initiative variation powers for enforcement purposes. *EG 8* sets out in detail the ~~FSA's~~ FCA's powers under ~~section 45~~ sections 55J and 55L of the Act and the circumstances under which the ~~FSA~~ FCA may ~~vary a firm's permission~~ use its own-initiative variation powers in this way, whether for enforcement purposes or as part of its day to day supervision of *firms*. This chapter provides additional guidance on when the ~~FSA~~ FCA will use these powers for supervision purposes.

7.2.4 G The ~~FSA~~ FCA may use its ~~powers under section 45~~ own-initiative variation powers only in respect of a *firm's* ~~Part IV permission~~ Part 4A permission; that is, a *permission* granted to a *firm* under section ~~42~~ 55E of the *Act* (Giving permission: the FCA) or having effect as if so given. In respect of an *incoming EEA firm*, an *incoming Treaty firm*, or a *UCITS qualifier*, this power applies only in relation to any *top-up permission* that it has. There are similar but more limited powers under Part XIII of the *Act* in relation to the *permission* of an *incoming EEA firm* or *incoming Treaty firm* under Schedules 3 or 4 to the *Act* (see *EG 8.26* to *EG 8.27*).

7.2.4A G The FCA will consult the PRA before using its own-initiative variation powers in relation to a PRA-authorised person, or a member of a group which includes a PRA-authorised person.

7.2.4B G In the case of a dual-regulated PRA-authorised person, the FCA may exercise its power to add a new regulated activity other than a PRA-regulated activity to those activities already included in the firm's Part 4A permission, or to widen the description of a regulated activity, only after consulting with the PRA.

7.2.5 G If the ~~FSA~~ FCA exercises its ~~powers under section 45 of the Act~~ own-initiative variation powers, it will do so by issuing a *supervisory notice*. The procedure that will be followed is set out in *DEPP 2*.

7.2.6 G A *firm* has a right of referral to the *Tribunal* in respect of the ~~exercise by the FSA of its powers to vary, on its own initiative,~~ FCA exercising its own-initiative variation powers on the firm's Part IV permission Part 4A permission.

7.3 **Criteria for varying a firm's permission or imposing, varying or cancelling requirements on the FCA's own initiative**

- 7.3.1 G The *FSA FCA* expects to maintain a close working relationship with certain types of *firm* and expects that routine supervisory matters arising can be resolved during the normal course of this relationship by, for example, issuing individual *guidance* where appropriate (see *SUP* 9.3). However, ~~the *FSA* may seek to vary a *firm's Part IV permission* where the *FCA* deems it appropriate, it will exercise its *own-initiative variation powers*:~~
- (1) in circumstances where it considers it appropriate for the *firm* to be subject to a formal *requirement*, breach of which could attract enforcement action; or
 - (2) if a variation is needed to enable the *firm* to comply with the *requirement*, due to agreements the *firm* may have with third parties. (For example a *firm* may be under a contractual obligation to do something, but only if it can do so lawfully. In this case, if the *FSA FCA* considers the *firm* must not do it, then the *FSA FCA* would need to prevent it doing so through a variation in its *Part IV permission Part 4A* permission to enable the *firm* to avoid breaching the contractual obligation.)
- 7.3.2 G The *FSA FCA* may also seek to ~~vary a *firm's Part IV permission* on its own initiative in certain situations~~ exercise its *own-initiative variation powers* in certain situations, including the following:
- (1) If the *FSA FCA* determines that a *firm's* management, business or *internal controls* give rise to material risks that are not fully addressed by ~~its *rules* existing requirements~~, the *FSA FCA* may seek to ~~vary the *firm's Part IV permission* and impose an additional *requirement* or *limitation* on the *firm*~~ use its *own-initiative variation powers*.
 - (2) If a *firm* becomes or is to become involved with new products or selling practices which present risks not adequately addressed by existing requirements, the *FSA FCA* may seek to vary the *firm's Part IV permission Part 4A permission* in respect of those risks.
 - (3) If there has been a change in a *firm's* structure, *controllers*, activities or strategy which generate material uncertainty or create unusual or exceptional risks, then the *FSA FCA* may seek to ~~vary the *firm's Part IV permission*~~ use its *own-initiative variation powers*. (See also *SUP* 11.7.14G to *SUP* 11.7.18G 11.7 for a description of the *FSA's FCA's* ability to ~~vary a *firm's Part IV permission* impose a *requirement* on a change in the acquisition of *control* of a *firm*~~ under section 46 55Q of the *Act*.)
 - (4) If a *firm* is a member of a *financial conglomerate* and the *FSA* is implementing supplementary supervision under the *Financial Groups Directive* with respect to that *financial conglomerate* by imposing obligations on the *firm*. Further material on this can be found in *GENPRU* 3.1 (Cross sector groups) and *SUP* 16.7.82R to *SUP* 16.7.83R (reporting requirements with respect to *financial conglomerates*).
- At the request of, or to assist an overseas regulator as set out in section 55Q

of the Act.

- 7.3.3 G ~~The FSA~~ Pursuant to sections 55L, 55N, 55O, 55P and 55Q of the *Act*, within the scope of its functions and powers, the FCA may seek to impose requirements ~~or limitations~~ which include but are not restricted to:
- (1) requiring a *firm* to submit regular reports covering, for example, trading results, management accounts, *customer* complaints, connected party transactions;
 - (2) where appropriate, requiring a *firm* to maintain prudential limits, for example on large *exposures*, foreign currency *exposures* or liquidity gaps;
 - (3) requiring a *firm* to submit a business plan (~~or for an insurer, a scheme of operations (see SUP App 2)~~);
 - (4) limiting the *firm's* activities;
 - (5) requiring a ~~firm~~ FCA-*authorised person* to maintain a particular amount or type of financial resources.
- 7.3.4 G The ~~FSA~~ FCA will seek to give a *firm* reasonable notice of an intent to vary its permission or impose a requirement and to agree with the *firm* an appropriate timescale. However, if the ~~FSA~~ FCA considers that a delay may create a risk to any of the ~~FSA's regulatory objectives~~ FCA's statutory objectives, the ~~FSA~~ FCA may need to act immediately using its powers under section ~~45~~ 55J and/or 55L of the *Act* to vary a ~~firm's Part IV permission~~ with immediate effect.

Appendix 4

Designation of changes to Chapter 7 of the Supervision Manual (SUP 7)

1. FSA Handbook provisions will be ‘designated’ to create a FCA Handbook and a PRA Handbook on the date that the regulators exercise their legal powers to do so. Please visit our website¹ for further details about this process.
2. We plan to designate the Handbook Provisions which we are proposing to create and/or amend within this Consultation Paper as follows:

Handbook Provision	Designation
SUP 7.1.1	FCA
SUP 7.1.2	FCA
SUP 7.1.3	FCA
SUP 7.1.4	FCA
SUP 7.1.5	FCA
SUP 7.2.1	FCA
SUP 7.2.2	FCA
SUP 7.2.3	FCA
SUP 7.2.4	FCA
SUP 7.2.4A	FCA
SUP 7.2.5	FCA
SUP 7.2.6	FCA
SUP 7.3.1	FCA
SUP 7.3.2	FCA
SUP 7.3.3	FCA
SUP 7.3.4	FCA

¹ One-minute guide <http://media.fsahandbook.info/latestNews/One-minute%20guide.pdf>

Appendix 5

Changes to the Threshold Conditions sourcebook (COND)

THRESHOLD CONDITIONS LEGAL CUTOVER INSTRUMENT 2013

- A. The Financial Conduct Authority makes this instrument in the exercise of its powers under section 139A (Power of the FCA to give guidance) of the Financial Services and Markets Act 2000 (“the Act”).

Commencement

- B. This instrument comes into force on 1 April 2013.

Amendments to the Handbook

- C. The Threshold Conditions sourcebook (COND) is amended in accordance with the Annex to this instrument.

Citation

- D. This instrument may be cited as the Threshold Conditions Legal Cutover Instrument 2013.

By order of the Board of the Financial Conduct Authority
[*date*]

Annex A

Amendments to the Threshold Conditions sourcebook (COND)

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

COND 1.1 is deleted in its entirety. The deleted text is not shown.

Insert the following new section after the deleted text of COND 1.1. This text is all new and is not underlined.

1.1A Application

To which threshold conditions does COND apply?

- 1.1A.1 G (1) The *guidance* in *COND* is only applicable to the *threshold conditions* for which the *FCA* is responsible (ie the *threshold conditions* stated in paragraphs 2A and 3A of Schedule 6 to the *Act* as being relevant to the discharge by the *FCA* of its functions under the *Act*).
- [FCA]
- (2) In respect of a *person* which does not carry on, or seek to carry on, any *PRA-regulated activities*, the *threshold conditions* that are relevant to the discharge by the *FCA* of its functions under the *Act* are those set out in paragraphs 2B to 2F of Schedule 6 to the *Act*, subject to *COND* 1.1A.4G(1) to (2), below.
- (3) In respect of a *firm* which does carry on, or seeks to carry on, a *PRA-regulated activity*, the *threshold conditions* that are relevant to the discharge by the *FCA* of its functions under the *Act* are those set out in paragraphs 3B to 3F of Schedule 6 to the *Act*, subject to *COND* 1.1A.4G(3) to (5), below.
- (4) A reference to “*FCA threshold conditions*” in *COND* means a reference to the *threshold conditions* referred to in (2) and (3) that apply to a particular *firm*.

To whom does COND apply?

- 1.1A.2 G (1) *COND* applies to all *firms*, except where stated otherwise in this *guidance*.
- [FCA]
- (2) In *COND*, '*firm*' includes an applicant for *Part 4A permission* unless the context otherwise requires.

To what extent does COND apply to PRA-authorised persons?

- 1.1A.3 G The *guidance* in *COND* applies to *PRA-authorised persons* only to the extent that it is relevant to the discharge of the *FCA*'s functions in relation to them. For example, where *guidance* in *COND* relates to an assessment of a *firm*'s financial position or its compliance with prudential regulatory requirements,
- [FCA]

this *guidance* will not apply to *PRA-authorised persons*. These are matters that fall to be considered by the *PRA* when assessing whether a *PRA-authorised person* meets the *threshold conditions* for which the *PRA* is responsible.

To what extent does COND apply to incoming EEA firms and incoming Treaty firms?

- 1.1A.4 [FCA] G Only certain *FCA threshold conditions* apply to *incoming EEA firms* and *incoming Treaty firms* and, in each case, they apply only in as far as relevant to the discharge by the *FCA* of its relevant functions. The application of *COND* is limited accordingly:
- (1) for an *incoming EEA firm* which does not carry on any *PRA-regulated activities* only, only *FCA threshold conditions* 2C to 2F apply;
 - (2) for an *incoming Treaty firm* which does not carry on any *PRA-regulated activities*, only *FCA threshold conditions* 2C to 2F apply;
 - (3) for an *incoming EEA firm* which carries on a *PRA-regulated activity*, only *FCA threshold conditions* 3B to 3E apply;
 - (4) for an *incoming Treaty firm* which carries on a *PRA-regulated activity* and which is an *insurer*, only *FCA threshold conditions* 3B to 3E apply; and
 - (5) for an *incoming Treaty firm* which carries on a *PRA-regulated activity* and which is not an *insurer*, only *FCA threshold conditions* 3B to 3E apply.

The term “as far as relevant to the discharge by the *FCA* of its relevant functions” above is a reference to the *FCA* discharging its functions in relation to an application for, or the exercise of its *own-initiative powers* in relation to, a *top-up permission* or the functions relating to the *FCA*’s consent or consultation rights relating to the exercise by the *PRA* of its powers in relation to an application for, or use of its *own-initiative powers* relating to, a *top-up permission*.

To what extent does COND apply to Swiss general insurance companies?

- 1.1A.5 [FCA] G [Placeholder for application of threshold conditions to Swiss general companies, subject to finalisation of relevant secondary legislation.]

To which regulated activities does COND apply?

- 1.1A.6 [FCA] G Subject to the limitations referred to above, *COND* applies in relation to all of the *regulated activities* for which a *firm* has, or will have, *permission*.

Where does COND apply?

- 1.1A.7 G *COND* applies in relation to all of the *regulated activities* wherever they are

[FCA] carried on, except as stated in *COND 1.1A.4G*.

1.2 Purpose

1.2.1 G *COND* gives guidance on the *FCA* threshold conditions ~~set out in or under~~
[FCA] ~~Schedule 6 to the Act (Threshold conditions)~~. The *FCA* threshold conditions represent the minimum conditions for which the *FCA* is responsible which a firm is required to satisfy, and continue to satisfy, in order to be given and to retain *Part IV Part 4A* permission. A *PRA*-authorised person or, as appropriate, a firm seeking to become a *PRA*-authorised person must also satisfy, and continue to satisfy, the threshold conditions for which the *PRA* is responsible in order to be given and to retain a *Part 4A* permission (these threshold conditions are not the subject of the guidance in *COND*).

Applications for ~~Part IV~~ 4A permission or variation of ~~Part IV~~ 4A permission

1.2.2 G (1) Under section ~~41(2) of the Act (The threshold conditions)~~ 55B(3) of the
[FCA] Act, in giving or varying a *Part IV Part 4A* permission or imposing, ~~or~~
varying any requirement or giving consent, the ~~FSA~~ FCA must ensure that the firm concerned will satisfy, and continue to satisfy, the *FCA* threshold conditions in relation to all of the regulated activities for which it has or will have permission.

(2) If, however, the applicant for permission is an incoming firm seeking top-up permission, or variation of top-up permission, under ~~Part IV~~ 4A of the Act (Permission to carry on regulated activities), then under paragraphs ~~6A and 7A~~ of Schedule 6 to the Act (~~Threshold conditions~~), the ~~FSA~~ FCA will have regard only to satisfaction of the *FCA* threshold conditions 1, 3, 4 and 5 specified as applicable in *COND 1.1A.4G*, as relevant to the regulated activities for which the applicant has, or will have, ~~Part IV permission~~ Part 4A permission.

Exercise of the ~~FSA~~ FCA's own-initiative powers

1.2.3 G (1) If, among other things, a firm is failing to satisfy any of the *FCA*
[FCA] threshold conditions, or is likely to fail to do so, ~~section 45 of the Act~~
(~~Variation etc. on the FSA's own initiative~~) ~~states that the FSA~~ the *FCA*
may exercise its own-initiative power under either section 55J
(Variation or cancellation on initiative of regulator) or section 55L
(Imposition of requirements by *FCA*) of the Act. Use of the ~~FSA~~ FCA's
own-initiative powers is explained in *SUP 7* (Individual requirements),
and *EG 8* (Variation and cancellation of permission on the ~~FSA~~ FCA's
own initiative and intervention against incoming firms).

(2) If, when exercising its own-initiative power under section ~~45(1)~~ 55J or
section 55L of the Act, the ~~FSA~~ FCA varies a firm's permission, or
imposes or varies a requirement, then, under section ~~41(2)~~ 55B(3) of the
Act the ~~FSA~~ FCA must ensure that the firm concerned will satisfy, and
continue to satisfy, the *FCA* threshold conditions in relation to all of the

relevant *regulated activities* for which it has or will have *permission*. However, section 41(3) 55B(4) of the *Act* states that the duty imposed by section 41(2) 55B(3) of the *Act* does not prevent the *FSA FCA* taking such steps as it considers necessary in relation to a particular *firm* in order to ~~secure its regulatory objective of consumer protection~~ advance any of its operational objectives.

- (3) The *FSA FCA* can also exercise its *own-initiative power* under section 45(1) 55J or section 55L of the *Act*, in relation to the *top-up permission* of an *incoming firm*. But this is only on the grounds that the *incoming firm* is failing, or likely to fail, to satisfy the *FCA threshold conditions* 1, 3, 4 or 5 in relation to that *permission* specified as applying to *incoming firms* under COND 1.1A.4G.

Approval of acquisitions or increases of control

- 1.2.4 G (1) ~~Under section 186(3) of the *Act* (Objection to acquisition of control), in deciding whether the approval requirements for a proposed acquisition or increase of *control* are satisfied, the *FSA* must have regard, in relation to the *control* that the acquirer: [deleted]~~
- (a) ~~has over the *firm*; or~~
- (b) ~~will have over the *firm* if the proposal which has been notified to the *FSA* is carried out; to its general duty to ensure that the *firm* will continue to satisfy the threshold conditions.~~
- (2) ~~The *FSA* must also have regard to the *threshold conditions* in imposing any conditions on its approval of an acquisition or increase of *control* (section 185(2) of the *Act* (Conditions attached to approval). See SUP 11.7.3 G (Acquisition or increase of control: procedures). [deleted]~~

Approval of acquisitions or increases of control

- 1.2.5 [FCA] G (1) Under section 185 of the *Act* (Assessment: general) the *FCA* may, subject to consultation with the *PRA* where the conditions in section 187B of the *Act* are satisfied, object to an acquisition of an *FCA-authorised person* if there are reasonable grounds to do so on the basis of the matters set out in section 186 of the *Act* (Assessment: criteria) or if the information provided by the section 178 notice giver is incomplete. Section 186(d) (Assessment: criteria) specifies one such criteria as whether an *FCA-authorised person* will be able to comply with its prudential requirements (including the *threshold conditions* in relation to all of the *regulated activities* for which it has or will have *permission*.)
- (2) Under section 191A of the *Act* (Objection to control), subject to consultation with the *PRA* in the circumstances specified in that provision, the *FCA* may object to a *person's* existing control of an *FCA-authorised person* on the grounds specified under section 186 of the *Act*.

1.3 General

An overview of the *threshold conditions* is given in COND 1 Annex 1G.

- 1.3.1 [FCA] G The *guidance* in COND 2 explains each *FCA threshold condition* in Part I of Schedule 6 (threshold conditions) to the *Act* and indicates how the *FSA FCA* will interpret it in practice. ~~An overview of the *threshold conditions* is given in COND 1 Annex 1G.~~ This *guidance* is not, however, exhaustive and is written in very general terms. A *firm* will need to have regard to the obligation placed upon the *FSA FCA* under section 41 ~~(the *threshold conditions*)~~ 55B (The *threshold conditions*) of the *Act*; that is, the *FSA FCA* must ensure that the *firm* will satisfy, and continue to satisfy, the *FCA threshold conditions* in relation to each *regulated activity* for which it has or will have *permission*.
- 1.3.2 [FCA] (1) The *FSA FCA* will consider whether a *firm* satisfies, and will continue to satisfy, the *FCA threshold conditions* in the context of the size, nature, scale and complexity of the business which the *firm* carries on or will carry on if the relevant application is granted.
- (2) In relation to the *threshold conditions* ~~4 and 5~~ contained in paragraphs 2D to 2F of Schedule 6 to the *Act* in respect of *firms* which are not *PRA-authorised persons* and paragraphs 3C to 3E of Schedule 6 to the *Act* in respect of *firms* which are *PRA-authorised persons*, the *FSA FCA* will consider whether a *firm* is ready, willing and organised to comply, on a continuing basis, with the requirements and standards under the *regulatory system* which apply to the *firm*, or will apply to the *firm*, and for which the *FCA* is responsible, if it is granted a *Part IV 4A permission*, or a variation of its *permission*. These matters will also be considered if the *FSA FCA* is exercising its *own-initiative powers* (see COND 1.2.3G). *Guidance* to *firms* on the implications of this is given under each of those *threshold conditions*.
- 1.3.3 [FCA] G Although the *FSA FCA* may consider that a matter is relevant to its assessment of a *firm*, the fact that a matter is disclosed to the *FSA FCA*, for example in an application, does not necessarily mean that the *firm* will fail to satisfy the *FCA threshold conditions*. The *FSA FCA* will consider each matter in relation to the *regulated activities* for which the *firm* has, or will have, *permission*, having regard to ~~the *regulatory objectives* set out in section 2 of the *Act* (The *FSA's* general duties)~~ its *statutory objectives*. A *firm* should disclose each relevant matter but, if it is appropriate to do so, it is encouraged to discuss it with the *FSA FCA*. This will enable the *FSA FCA* to consider fully how material or significant the matter is and how it affects the ability of the *firm* to satisfy, and continue to satisfy, the *FCA threshold conditions* (see also ~~COND 2.3.5G, COND 2.4.4G(3) and COND 2.5.4G(3)~~).
- 1.3.3A [FCA] G In determining the weight to be given to any relevant matter, the *FCA* will consider its significance in relation to the *regulated activities* for which the *firm* has, or will have, *permission*, in the context of its ability to supervise the

firm adequately, having regard to the FCA's statutory objectives. In this context, a series of matters may be significant when taken together, even though each of them in isolation might not give serious cause for concern.

- 1.3.3B G In determining whether the firm will satisfy, and continue to satisfy, the FCA
[FCA] threshold conditions, the FCA will have regard to all relevant matters, whether arising in the United Kingdom or elsewhere.
- 1.3.3C G When assessing the FCA threshold conditions, the FCA may have regard to
[FCA] any person appearing to be, or likely to be, in a relevant relationship with the firm, in accordance with section 55R of the Act (Persons connected with an applicant). For example, a firm's controllers, its directors or partners, other persons with close links to the firm (see COND 2.3), and other persons that exert influence on the firm which might pose a risk to the firm's satisfaction of the FCA threshold conditions would be in a relevant relationship with the firm.
- 1.3.3D In making its assessment, the FCA will consider the individual circumstances
[FCA] of each firm on a case-by-case basis.
- 1.1.3E G Notes on the contents of a business plan are given in the business plan section
of the application pack for Part 4A permission.

Statutory quotations

- 1.3.4 G (1) For ease of reference, the FCA threshold conditions in or under
[FCA] Schedule 6 to the Act have been quoted in full in COND 2.
- (1A) Paragraphs 2A and 3A of Schedule 6 of the Act have not been quoted. These set out the application of the FCA threshold conditions to FCA-
authorised persons and PRA-
authorised persons (and firms seeking to become an FCA-
authorised person or a PRA-
authorised person), respectively. This application is summarised in COND 1.1AG.
- (2) As these provisions the threshold conditions impose obligations, they are printed in bold type. The use of bold type is not intended to indicate that these quotations are rules made by the FSA FCA.
- (3) Where words have been substituted for the text of these provisions the substitutions are enclosed in square brackets ([]). However, none of the changes made by the FSA FCA in these quotations for the purpose of the text in COND can supersede or alter the meaning of the statutory provision concerned. [deleted]
- (4) Paragraph 1A of Schedule 6 of the Act sets out interpretative provisions that apply to the threshold conditions. These are repeated in COND 1.3.5G below for ease of reference.
- 1.3.5 UK **Paragraph 1A of Schedule 6 to the Act**

- (1) “assets” includes contingent assets;**
“consolidated supervision” has the same meaning as in section 3L;
consumer” has the meaning given by section 425A;
“functions” in relation to either the FCA or the PRA means the functions conferred on that regulator by or under the Act;
“liabilities” includes contingent liabilities;
“relevant directives” has the same meaning as in section 3L;
“Society” means the society incorporated by Lloyd’s Act 1871(a) by the name of Lloyd’s;
“subsidiary undertaking” includes all the instances mentioned in Article 1(1) and (2) of the Seventh Company Law Directive in which an entity may be a subsidiary of an undertaking.
- (2) For the purposes of this Schedule, the “non-financial resources” of a person include any systems, controls, plans, information or policies that the person maintains and the human resources that the person has available.**
- (3) References to “integrity of the UK financial system” are to be read with section 1D(2).**
- (4) The reference to the failure of a person is to be read in accordance with section 2I(3) and (4).**

COND 1 Annex 1G and COND 1 Annex 2G are deleted in their entirety. The deleted text is not shown.

2 The threshold conditions

COND 2.1 is deleted in its entirety. The deleted text is not shown.

2.2 ~~Threshold condition 2:~~ Location of offices

2.2.1 UK ~~Paragraph 2, Schedule 6 to the Act.~~

- | | |
|------------|---|
| (1) | Subject to sub-paragraphs 1(A) and (3), if the person concerned is a body corporate constituted under the law of any part of the United |
|------------|---|

	Kingdom
-	(a) its head office, and
-	(b) if it has a registered office, that office, must be in the United Kingdom.
(1A)	If
-	(a) the regulated activity concerned is any of the investment services and activities, and
-	(b) the person concerned is a body corporate with no registered office,
sub-paragraph (1B) applies in place of sub-paragraph (1).	
(1B)	If the person concerned has its head office in the United Kingdom, it must carry on business in the United Kingdom.
(2)	If the person concerned has its head office in the United Kingdom but is not a body corporate, it must carry on business in the United Kingdom.
(3)	If the regulated activity concerned is an insurance mediation activity, sub-paragraph (1) does not apply.
(4)	If the regulated activity concerned is an insurance mediation activity, the person concerned
-	(a) if he is a body corporate constituted under the law of any part of the United Kingdom, must have its registered office, or if it has no registered office, its head office, in the United Kingdom;
-	(b) if he is a natural person, is to be treated for the purposes of subparagraph (2), as having his head office in the United Kingdom if his residence is situated there.
(5)	"Insurance mediation activity" means any of the following activities
-	(a) dealing in rights under a contract of insurance as agent;
-	(b) arranging deals in rights under a contract of insurance;
-	(c) assisting in the administration and performance of a contract of insurance;
-	(d) advising on buying or selling rights under a contract of

		insurance;
-	(e)	agreeing to do any of the activities specified in sub-paragraph (a) to (d).
(6)		Paragraph (5) must be read with—
-	(a)	section 22;
-	(b)	any relevant order under that section; and
-	(c)	Schedule 2.
[Note: article 5(4) of MiFID]		

[deleted]

2.2.1A UK **Paragraph 1A of Schedule 6 to the Act**

[FCA]

- (1) Unless sub-paragraph (3) or (4)(a) applies, if A is a body corporate constituted under the law of any part of the United Kingdom-**
- (a) A's head office, and**
- (b) if A has a registered office, that office,**
- must be in the United Kingdom.**
- (2) If A is not a body corporate but A's head office is in the United Kingdom, A must carry on business in the United Kingdom.**
- (3) If-**
- (a) A is seeking to carry on, or is carrying on, a regulated activity which is any of the investment services and activities,**
- (b) A is a body corporate with no registered office, and**
- (c) A's head office is in the United Kingdom,**
- A must carry on business in the United Kingdom.**
- (4) If A is seeking to carry on, or is carrying on, an insurance mediation activity-**
- (a) where A is a body corporate constituted under the law of any part of the United Kingdom, A's registered office, or if**

A has no registered office, A's head office, must be in the United Kingdom;

(b) where A is an individual, A is to be treated for the purposes of sub-paragraph (2), as having a head office in the United Kingdom if A's residence is situated there.

(5) Insurance mediation activity” means any of the following activities-

(a) dealing in rights under a contract of insurance as agent;

(b) arranging deals in rights under a contract of insurance;

(c) assisting in the administration and performance of a contract of insurance;

(d) advising on buying or selling rights under a contract of insurance;

(e) agreeing to do any of the activities specified in sub-paragraph (a) to (d).

(6) Sub-paragraph (5) must be read with-

(a) section 22

(b) any relevant order under that section; and

(c) Schedule 2.

- 2.2.1B G Paragraph 2B of Schedule 6 to the Act sets out the location of offices
[FCA] threshold condition for firms carrying on, or seeking to carry on, regulated activities which do not include a PRA-regulated activity.
- 2.2.1C G The FCA is not responsible for the location of offices threshold condition for
[FCA] firms carrying on, or seeking to carry on, regulated activities which include a PRA-regulated activity.
- 2.2.2 G Threshold condition 2(1) and (2) Location of offices Paragraphs 2B(1) and
[FCA] 2B(2) (Location of offices) of Schedule 6 to the Act, implement the requirements of article 6 of the Post BCCI Directive and article 5(4) of MiFID and the threshold condition 2(3) and (4) contained in paragraph 2B(4) of Schedule 6 to the Act implements article 2.9 of the Insurance Mediation Directive, although the Act extends the threshold condition 2 contained in paragraph 2B of Schedule 6 to the Act to firms which are outside the scope of the Single Market Directives and the UCITS Directive.
- 2.2.3 G Neither the *Post BCCI Directive*, *MiFID*, the *Insurance Mediation Directive*
[FCA] nor the *Act* define what is meant by a firm's "head office". This is not necessarily the firm's place of incorporation or the place where its business is wholly or mainly carried on. Although the *FSA FCA* will judge each application on a case-by-case basis, the key issue in identifying the head

office of a *firm* is the location of its central management and control, that is, the location of:

- (1) the *directors* and other senior management, who make decisions relating to the *firm's* central direction, and the material management decisions of the *firm* on a day-to-day basis; and
- (2) the central administrative functions of the *firm* (for example, central compliance, internal audit).

COND 2.2A is deleted in its entirety. The deleted text is not shown.

2.3 ~~Threshold conditions~~ 3: Close links Effective supervision

2.3.1 UK ~~Paragraph 3, Schedule 6 to the Act.~~

(1) If the person concerned ("A") has close links with another person ("CL"), the [FSA] must be satisfied-
(a) that those links are not likely to prevent the [FSA's] effective supervision of A; and
(b) if it appears to the [FSA] that CL is subject to the laws, regulations or administrative provisions of a territory which is not an EEA State ("the foreign provisions"), that neither the foreign provisions, nor any deficiency in their enforcement, would prevent the [FSA's] effective supervision of A.
(2) A has close links with CL if:
(a) CL is a parent undertaking of A;
(b) CL is a subsidiary undertaking of A;
(c) CL is a parent undertaking of a subsidiary undertaking of A;
(d) CL is a subsidiary undertaking of a parent undertaking of A;
(e) CL owns or controls 20% or more of the voting rights or capital of A; or
(f) A owns or controls 20% or more of the voting rights or capital of CL.
(3) "Subsidiary undertaking" includes all the instances mentioned in Article 1(1) and (2) of the Seventh Company Law Directive in

	which an entity may be a subsidiary of an undertaking.
--	---

[deleted]

2.3.1A UK Paragraph 2C of Schedule 6 to the Act

[FCA]

- (1) A must be capable of being effectively supervised by the FCA having regard to all the circumstances including—**
- (a) the nature (including the complexity) of the regulated activities that A carries on or seeks to carry on;**
 - (b) the complexity of any products that A provides or will provide in carrying on those activities;**
 - (c) the way in which A’s business is organised;**
 - (d) if A is a member of a group, whether membership of the group is likely to prevent the FCA’s effective supervision of A;**
 - (e) whether A is subject to consolidated supervision required under any of the relevant directives;**
 - (f) if A has close links with another person (“CL”)-**
 - (i) the nature of the relationship between A and CL;**
 - (ii) whether those links are or that relationship is likely to prevent the FCA’s effective supervision of A; and**
 - (iii) if CL is subject to the laws, regulations or administrative provisions of a territory which is not an EEA State (“the foreign provisions”), whether those foreign provisions, or any deficiency in their enforcement, would prevent the FCA’s effective supervision of A.**
- (2) A has close links with CL if-**
- (a) CL is a parent undertaking of A;**
 - (b) CL is a subsidiary undertaking of A;**
 - (c) CL is a parent undertaking of a subsidiary undertaking of A;**
 - (d) CL is a parent undertaking of a subsidiary undertaking of A;**

(e) CL owns or controls 20% or more of the voting rights or capital of A; or

(f) A owns or controls 20% or more of the voting rights or capital of CL.

2.3.1B G Paragraph 2C of Schedule 6 to the *Act* sets out the effective supervision
[FCA] *threshold condition* for firms carrying on, or seeking to carry on, *regulated activities* which do not include a *PRA-regulated activity*.

2.3.1C UK **Paragraph 3B of Schedule 6 to the Act**
[FCA]

(1) B must be capable of being effectively supervised by the FCA having regard to all the circumstances including-

(a) the nature (including the complexity) of the regulated activities that B carries on or seeks to carry on;

(b) the complexity of any products that B provides or will provide in carrying on those activities;

(c) the way in which B's business is organised;

(d) if B is a member of a group, whether membership of the group is likely to prevent the FCA's effective supervision of B;

(e) whether B is subject to consolidated supervision required under any of the relevant directives;

(f) if B has close links with another person ("CL")-

(i) the nature of the relationship between B and CL;

(ii) whether those links are or that relationship is likely to prevent the FCA's effective supervision of B; and

(iii) if CL is subject to the laws, regulations or administrative provisions of a territory which is not an EEA State ("the foreign provisions"), whether those foreign provisions, or any deficiency in their enforcement, would prevent the FCA's effective supervision of B.

(2) B has close links with CL if-

(a) CL is a parent undertaking of B;

(b) CL is a subsidiary undertaking of B;

- (c) CL is a parent undertaking of a subsidiary undertaking of B;**
- (d) CL is a subsidiary undertaking of a parent undertaking of B;**
- (e) CL owns or controls 20% or more of the voting rights or capital of B; or**
- (f) B owns or controls 20% or more of the voting rights or capital of CL.**

- 2.3.1D [FCA] G Paragraph 3B of Schedule 6 to the Act sets out the effective supervision threshold condition which is relevant for the discharge by the FCA of its functions under the Act in relation to firms carrying on, or seeking to carry on, regulated activities which include a PRA-regulated activity.
- 2.3.1E [FCA] G The guidance in COND 2.3 should be read as applying to both paragraph 2C of Schedule 6 of the Act and, as far as relevant to the discharge by the FCA of its functions under the Act in respect of firms carrying on, or seeking to carry on, a PRA-regulated activity, paragraph 3B of Schedule 6 of the Act.
- 2.3.1F [FCA] G Firms carrying on, or seeking to carry on, a PRA-regulated activity, should note that the PRA is also responsible for assessing effective supervision under its own threshold conditions. Paragraphs 4F and 5F of Schedule 6 to the Act set out the effective supervision threshold conditions which are relevant to the discharge by the PRA of its functions under the Act in relation to firms carrying on, or seeking to carry on, a PRA-regulated activity. For the avoidance of doubt, this guidance does not apply to the threshold conditions set out in paragraphs 4F and 5F of Schedule 6 to the Act.
- 2.3.2 [FCA] G Threshold conditions 3 (Close links) Paragraphs 2C and 3B of Schedule 6 to the Act implements requirements of the Post BCCI Directive, but the Act extends this condition to firms from outside the EEA and other firms which are outside the scope of the Single Market Directives and the UCITS Directive.
- 2.3.3 [FCA] G In assessing this ~~threshold condition~~ the threshold conditions set out in paragraphs 2C and 3B of Schedule 6 to the Act, factors which the FSA FCA will take into consideration include, among other things, whether:
- (1) it is likely that the FSA FCA will receive adequate information from the firm, and those persons with whom the firm has close links, to enable it to determine whether the firm is complying with the requirements and standards under the regulatory system for which the FCA is responsible and to identify and assess the impact on ~~the regulatory objective in section 2 of the Act (The FSA's general duties)~~ its statutory objectives; this will include consideration of whether the firm is ready, willing and organised to comply with Principle 11 (Relations with regulators) and the rules in SUP on the provision of information to the FSA FCA;

- (2) the structure and geographical spread of the *firm*, the *group* to which it belongs and other *persons* with whom the *firm* has *close links*, might hinder the provision of adequate and reliable flows of information to the *FSA FCA*; factors which may hinder these flows include the fact there may be branches or connected *companies* in territories which supervise *companies* to a different standard or territories with laws which restrict the free flow of information, although the *FSA FCA* will consider the totality of information available from all sources; and
- (3) ~~the *firm* and the *group* to which it belongs are, or will be, subject to supervision on a consolidated basis (consolidated supervision) (for example, if a financial resources requirement is determined for the *group* as a whole); and [deleted]~~
- (4) in respect of a *firm* not carrying on, or seeking to carry on, a *PRA-regulated activity*, it is possible to assess with confidence the overall financial position of the *group* at any particular time; factors which may make this difficult include lack of audited consolidated accounts for a *group*, if companies in the same *group* as the *firm* have different financial years and accounting dates and if they do not share common auditors.

2.3.4 G When assessing whether the *firm* will satisfy and continue to satisfy this
[FCA] ~~*threshold condition*, the *FSA* will have regard to all relevant matters, whether arising in the *United Kingdom* or elsewhere. [deleted]~~

2.3.5 G The *FSA* will take into account relevant matters only in so far as they are
[FCA] significant (see *COND 1.3.3G*). In determining the weight to be given to any relevant matter, the *FSA* will consider its significance in the context of its ability to supervise the *firm* adequately, having regard to the *regulatory objectives* in section 2 of the *Act*. In this context, a series of matters may be significant when taken together, even though each of them in isolation might not give serious cause for concern. [deleted]

Meaning of "parent undertaking" and "subsidiary undertaking"

2.3.6 G ...
[FCA]

- (3) Paragraph ~~3(3)~~ 1A of Schedule 6 to the *Act* extends the meaning of "*subsidiary undertaking*" for the purposes of ~~this *threshold condition* 3 (Close links)~~ the *threshold conditions* to all the cases in articles 1(1) and (2) of the *Seventh Company Law Directive* in which one *undertaking* may be a *subsidiary* of another *undertaking* (see *COND 2.3.11G*).

2.3.7 G (1) For the purposes of ~~this *threshold conditions* 3 (Close links)~~ the
[FCA] *threshold conditions* set out in paragraphs 2C and 3B of Schedule 6 to the *Act*, and except in relation to an *incorporated friendly society*, an *undertaking* is a *parent undertaking* of another *undertaking* (a

subsidiary undertaking) if any of the following apply to it:

...

- (2) ~~A flowchart of COND 2.3.7 G(1) is set out in COND 2 Annex 1G.~~
[deleted]

...

- 2.3.10 G Section 420(3) of the *Act* (Parent and subsidiary undertaking) ~~(supplemented~~
 [FCA] ~~by paragraph 3 (Close links) of Schedule 6 to the Act)~~ states that an
incorporated friendly society is a *parent undertaking* of another *body*
corporate (a *subsidiary undertaking*) if it has the following relationship to it:

...

- 2.3.11 G For the purposes of ~~this threshold condition~~ the threshold conditions set out
 [FCA] in paragraphs 2C and 3B of Schedule 6 to the Act, an *undertaking* is a
subsidiary undertaking of another *undertaking* if:

...

- 2.3.11 G Paragraphs ~~3(2)(e) to (f)~~ 2C(2)(e) to (f) and 3B(2)(e) to (f) of Schedule 6 to
 A the *Act* reflect legislation initially introduced in the *Post-BCCI Directive*,
 [FCA] which defines close links, in part, by reference to participation. Recital 5 of
 the *Post-BCCI Directive* gives further guidance on what is meant by
 “participation” for the purposes of the directive. It states that the sole fact of
 having acquired a significant proportion of a company's capital does not
 constitute participation for the purposes of the directive if that holding has
 been acquired solely as a temporary investment which does not make it
 possible to exercise influence over the structure or financial policy of the
 undertaking.

- 2.3.12 G ...
 [FCA]

COND ~~Threshold condition 4: Adequate~~ Appropriate resources
 2.4

2.4.1 UK **Paragraph 4, Schedule 6 to the Act**

(1)	The resources of the person concerned must, in the opinion of the [FSA], be adequate in relation to the regulated activities that he seeks to carry on, or carries on.
(2)	In reaching that opinion, the [FSA] may-
(a)	take into account the person's membership of a group and any effect which that membership may have; and
(b)	have regard to-
(i)	the provision he makes and, if he is a member of a group, which other members of the group make in respect of liabilities (including contingent and future liabilities); and
(ii)	the means by which he manages and, if he is a member of a group, which other members of the group manage the incidence of risk in connection with his business.

[deleted]

2.4.1A UK **Paragraph 2D of Schedule 6 to the Act**

[FCA]

- (1) **The resources of A must be appropriate in relation to the regulated activities that A seeks to carry on, or carries on.**
- (2) **The matters which are relevant in determining whether A has appropriate resources include-**
- (a) **the nature and scale of the business carried on, or to be carried on, by A;**
 - (b) **the risks to the continuity of the services provided by, or to be provided by, A; and**
 - (c) **A's membership of a group and any effect which that membership may have.**
- (3) **The matters which are relevant in determining whether A has appropriate financial resources include-**
- (a) **the provision A makes and, if A is a member of a group, which other members of the group make, in respect of liabilities; and**
 - (b) **the means by which A manages and, if A is a member of a group, by which other members of the group manage, the**

incidence of risk in connection with A's business.

- (4) The matters which are relevant in determining whether A has appropriate non-financial resources include-
- (a) the skills and expertise of those who manage A's affairs;
 - (b) whether A's non-financial resources are sufficient to enable A to comply with -
 - (i) requirements imposed or likely to be imposed on A by the FCA in the course of the exercise of its functions;
 - (ii) any other requirement in relation to which the FCA is required to maintain arrangements under section 1L(2).

2.4.1B G Paragraph 2D of Schedule 6 to the *Act* sets out the appropriate resources
[FCA] threshold condition for firms carrying on, or seeking to carry on, regulated activities which do not include a PRA-regulated activity.

2.4.1C UK Paragraph 3C of Schedule 6 to the Act
[FCA]

- (1) The non-financial resources of B must be appropriate in relation to the regulated activities that B seeks to carry on, or carries on, having regard to the operational objectives of the FCA.
- (2) The matters which are relevant in determining whether the condition in sub-paragraph (1) is met include-
- (a) the nature and scale of the business carried on, or to be carried on, by B;
 - (b) the risks to the continuity of the services provided by, or to be provided by, B;
 - (c) whether B is a member of a group and any effect which that membership may have;
 - (d) the skills and experience of those who manage B's affairs;
 - (e) whether B's non-financial resources are sufficient to enable B to comply with-
 - (i) requirements imposed or likely to be imposed on B by the FCA in the course of the exercise of its functions; or
 - (ii) any other requirement in relation to which the FCA is required to maintain arrangements under section 1L(2).

- 2.4.1D [FCA] G Paragraph 3C of Schedule 6 to the Act sets out the appropriate non-financial resources *threshold condition* which is relevant for the discharge by the FCA of its functions under the Act in relation to *firms* carrying on, or seeking to carry on, *regulated activities* which include a *PRA-regulated activity*.
- 2.4.1E [FCA] G The *guidance* in COND 2.4 should be read as applying to both paragraph 2D of Schedule 6 of the Act and, as far as relevant to the discharge by the FCA of its functions in respect of *firms* carrying on, or seeking to carry on, a *PRA-regulated activity* under the Act, paragraph 3C of Schedule 6 of the Act.
- 2.4.1F [FCA] G As the *threshold condition* contained in paragraph 3C of Schedule 6 to the Act does not relate to financial resources, the *guidance* in COND 2.4 relating to appropriate financial resources only applies to the FCA's assessment of the *threshold condition* contained in paragraph 2D of Schedule 6 of the Act.
- 2.4.1G [FCA] G *Firms* carrying on, or seeking to carry on, a *PRA-regulated activity*, should note that the *PRA* is responsible for assessing their financial resources. Paragraphs 4D and 5D of Schedule 6 to the Act contain the *threshold conditions* relating to financial resources which are relevant to the discharge by the *PRA* of its functions under the Act in relation to *firms* carrying on, or seeking to carry on, a *PRA-regulated activity* (in addition to additional non-financial resources *threshold conditions* which are also relevant to the discharge by the *PRA* of its functions). For the avoidance of doubt, this *guidance* does not apply to *threshold conditions* set out in paragraphs 4D and 5D of Schedule 6 to the Act.
- 2.4.2 [FCA] G (1) ~~*Threshold condition 4* (Adequate resources), requires the FSA to ensure that a *firm* has adequate resources in relation to the specific *regulated activity* or *regulated activities* which it seeks to carry on, or carries on. [deleted]~~
- (2) The FSA-FCA will interpret the term “adequate” “appropriate” as meaning sufficient in terms of quantity, quality and availability, and “resources” as including all financial resources (though only in the case of *firms* not carrying on, or seeking to carry on, a *PRA-regulated activity*), non-financial resources and means of managing its resources; for example, capital, provisions against liabilities, holdings of or access to cash and other liquid assets, human resources and effective means by which to manage risks.
- (2A) Paragraph 1A(2) of Schedule 6 to the Act provides that “non financial resources” of a *firm* for the purposes of the *threshold conditions* include any systems, controls, plans, information or policies that the *firm* maintains and the human resources that the *firm* has available.
- (3) High level systems and control requirements are in SYSC. ~~Detailed financial resources and systems requirements are in the relevant section of the Prudential Standards part of the Handbook, including specific provisions for particular types of *regulated activity*.~~ The FSA FCA will consider whether the *firm* is ready, willing and organised to comply with these and other applicable systems Handbook

requirements when assessing if it has appropriate non-financial resources for the purposes of ~~this threshold condition~~ the threshold conditions set out in paragraphs 2D and 3C to Schedule 6 of the *Act*.

- (4) Detailed financial resources requirements are in the relevant section of the Prudential Standards part of the *FCA Handbook*, including specific provisions for particular types of *regulated activity*. The *FCA* will consider whether *FCA-authorised persons* are ready, willing and organised to comply with these requirements when assessing if they have appropriate financial resources for the purposes of ~~this~~ the threshold condition set out in paragraph 2D of Schedule 6 to the *Act*.

2.4.3 G (1) ~~When assessing this threshold condition, the *FSA* may have regard to any *person* appearing to it to be, or likely to be, in a relevant relationship with the *firm*, in accordance with section 49 of the *Act* (*Persons connected with an applicant*); for example, a *firm's* *controllers*, its *directors* or *partners*, other *persons* with *close links* to the *firm* (see *COND 2.3*), and other *persons* that exert influence on the *firm* which might pose a risk to the *firm's* satisfaction of the threshold conditions and would, therefore, be in a relevant relationship with the *firm*. [deleted]~~

[FCA]

- (2) ~~In particular, although Although it is the *firm* that is being assessed, the *FSA* *FCA* may take into consideration the impact of other members of the *firm's* *group* on the adequacy of its resources, where relevant to the discharge of the *FCA's* functions. For example, in relation to *FCA-authorised persons*, or *firms* seeking to become *FCA-authorised persons*, the *FSA* *FCA* may assess the consolidated solvency of the *group*. The *FSA* *FCA's* approach to the consolidated supervision of a ~~*firm*~~ *FCA-authorised person*, or a *firm* seeking to become an *FCA-authorised person*, and its *group* is in the relevant part of the Prudential Standards part of the *FCA Handbook*.~~

2.4.4 G (1) ~~When assessing whether a *firm* will satisfy and continue to satisfy threshold condition 4, the *FSA* will have regard to all relevant matters, whether arising in the *United Kingdom* or elsewhere. [deleted]~~

[FCA]

- (2) Relevant matters to which the *FCA* may have regard when assessing whether a *firm* will satisfy, and continue to satisfy, this threshold condition may include but are not limited to:
- (a) in relation to a *firm* not carrying on, or seeking to carry on, a *PRA-regulated activity* only, whether there are any indications that the *firm* may have difficulties if the application is granted (see *COND 2.4.6G*), at the time of the grant or in the future, in complying with any of the *FSA* *FCA's* prudential *rules* (see the relevant part of the Prudential Standards part of the *Handbook*);
- (b) in relation to a *firm* not carrying on, or seeking to carry on, a *PRA-regulated activity* only, whether there are any indications that the *firm* will not be able to meet its debts as they fall due;

...

- (d) whether the *firm* has taken reasonable steps to identify and measure any risks of regulatory concern that it may encounter in conducting its business (~~see COND 2.4.6G~~) and has installed appropriate systems and controls and appointed appropriate human resources to measure them prudently at all times; see ~~SYSC 3.1 (Systems and Controls), SYSC 3.2 (Areas covered by systems and controls) and SYSC 4.1.1R (Organisational requirements)~~; and
- (e) whether the *firm* has conducted enquiries into the financial services sector in which it intends to conduct business (~~see COND 2.4.6G~~) that are sufficient to satisfy itself that:
- (i) it has access to adequate capital, by reference to the ~~FSA's~~ *FCA's* prudential requirements, to support the business including any losses which may be expected during its start-up period (in relation to a *firm* not carrying on, or seeking to carry on, a PRA-regulated activity only); and
- (ii) *Client money, deposits, custody assets and policyholders' rights* will not be placed at risk if the business fails; and
- (f) whether the resources of the *firm* are commensurate with the likely risks it will face.
- (3) ~~In the context of *threshold condition 4* (Adequate resources), the *FSA* will only take into account relevant matters which are material (see COND 1.3.3G). The *FSA* will consider the materiality of each relevant matter in relation to the *regulated activities* for which the *firm* has, or will have, *permission*, having regard to the *regulatory objectives* in section 2 of the *Act* (The *FSA's* general duties). It should be noted that a series of matters may be significant when taken together, even if each of them in isolation might not be significant. [deleted]~~
- (4) ~~In making its assessment, the *FSA* will consider the individual circumstances of each *firm* on a case-by-case basis. [deleted]~~
- 2.4.5 G In complying with SYSC (Systems and controls), a *firm* should plan its business appropriately so that it is able to identify, measure and manage the likely risks of regulatory concern it will face (~~SYSC 3.2.17G (Business strategy) and SYSC 7 (Risk Control)~~). [deleted]
- 2.4.6 G (1) ~~Any newly formed *firm* can be susceptible to early difficulties. These difficulties could arise from a lack of relevant expertise and judgment, or from ill-constructed and insufficiently tested business strategies. A *firm* may also be susceptible to difficulties where it substantially changes its business activities. [deleted]~~
- [FCA]
- (2) ~~As a result, the *FSA* would expect a *firm* which is applying for *Part IV*~~

~~permission, or a substantial variation of that permission, to take adequate steps to satisfy itself and, if relevant, the FSA that:~~

- ~~(a) it has a well-constructed business plan or strategy plan for its product or service which demonstrates that it is ready, willing and organised to comply with the relevant requirements in the Prudential Standards part of the Handbook and SYSC that apply to the regulated activity it is seeking to carry on;~~
 - ~~(b) its business plan or strategy plan has been sufficiently tested; and~~
 - ~~(c) the financial and other resources of the firm are commensurate with the likely risks it will face. [deleted]~~
- ~~(3) The FSA would expect the level of detail in a firm's business plan or strategy plan in (2) to be appropriate to the complexity of the firm's proposed regulated activities and unregulated activities and the risks of regulatory concern it is likely to face (see SYSC 3.2.11G (Management information) and SYSC 7 (Risk control)). Notes on the contents of a business plan are given in the business plan section of the application pack for Part IV permission. A firm requiring specific guidance on the contents and level of detail of its business plan should contact the Firm Contact Centre (020 7066 3954), or, if relevant, its usual supervisory contact at the FSA, or seek professional assistance. [deleted]~~

2.5 Threshold condition 5: Suitability

2.5.1 UK Paragraph 5, Schedule 6 to the Act

The person concerned must satisfy the [FSA] that he is a fit and proper person having regard to all the circumstances, including-	
(a)	his connection with any person;
(b)	the nature of any regulated activity that he carries on or seeks to carry on; and
(c)	the need to ensure that his affairs are conducted soundly and prudently.

~~[deleted]~~

2.5.1A UK Paragraph 2E to Schedule 6 of the Act

[FCA]

- (1) A must be a fit and proper person having regard to all the circumstances, including-**

- (a) A's connection with any person;**
- (b) the nature of any regulated activity that A carries on or seeks to carry on;**
- (c) the need to ensure that A's affairs are conducted in an appropriate manner, having regard in particular to the interests of consumers and the integrity of the UK financial system;**
- (d) whether A has complied and is complying with obligations imposed by the FCA in the course of the exercise of its functions, or requests made by the FCA, relating to the provision of information to the FCA and, where A has so complied or is so complying, the manner of that compliance;**
- (e) whether those who manage A's affairs have adequate skills and experience and act with probity;**
- (f) whether A's business is being, or is to be, managed in such a way as to ensure that its affairs will be conducted in a sound and prudent manner; and**
- (g) the need to minimise the extent to which it is possible for the business carried on by A, or to be carried on by A, to be used for a purpose connected with financial crime.**

2.5.1B G Paragraph 2E of Schedule 6 to the *Act* sets out the suitability *threshold*
[FCA] *condition* for firms carrying on, or seeking to carry on, regulated activities which do not consist of or include a PRA-regulated activity.

2.5.1C UK **Paragraph 3D to Schedule 6 of the Act**
[FCA]

- (1) B must be a fit and proper person, having regard to the operational objectives of the FCA.**
- (2) The matters which are relevant in determining whether B satisfies the condition in sub-paragraph (1) include-**
 - (a) B's connection with any person;**
 - (b) the nature of any regulated activity that B carries on or seeks to carry on;**
 - (c) the need to ensure that B's affairs are conducted in an appropriate manner, having regard in particular to the interests of consumers and the integrity of the UK financial system;**
 - (d) whether B has complied and is complying with obligations**

imposed by the FCA in the course of the exercise its functions, or requests made by the FCA, relating to the provision of information to the FCA and, where B has so complied or is so complying, the manner of that compliance;

(e) whether those who manage B's affairs have adequate skills and experience and act with probity; and

(f) the need to minimise the extent to which it is possible for the business carried on by B, or to be carried on by B, to be used for a purpose connected with financial crime.

- 2.5.1D [FCA] G Paragraph 3D of Schedule 6 to the Act sets out the suitability *threshold condition* which is relevant for the discharge by the FCA of its functions under the Act in relation to *firms* carrying on, or seeking to carry on, regulated activities which include a PRA-regulated activity.
- 2.5.1E [FCA] G The guidance in COND 2.5 should be read as applying to both paragraph 2E of Schedule 6 to the Act and, as far as relevant to the discharge by the FCA of its functions under the Act in respect of *firms* carrying on, or seeking to carry on, a PRA-regulated activity, paragraph 3D of Schedule 6 of the Act.
- 2.5.1F [FCA] G *Firms* carrying on, or seeking to carry on, a PRA-regulated activity, should note that the PRA is also responsible for assessing suitability under its own *threshold conditions*. Paragraphs 4E and 5E of Schedule 6 to the Act set out the *suitability threshold conditions* which are relevant to the discharge by the PRA of its functions under the Act in relation to *firms* carrying on, or seeking to carry on, a PRA-regulated activity. For the avoidance of doubt, this guidance does not apply to the *threshold conditions* set out in paragraph 4E and 5E of Schedule 6 to the Act.
- 2.5.2 [FCA] G (1) ~~*Threshold condition 5* (Suitability), requires the *firm* to satisfy the FSA that it is 'fit and proper' to have *Part IV permission* having regard to all the circumstances, including its connections with other *persons*, the range and nature of its proposed (or current) *regulated activities* and the overall need to be satisfied that its affairs are and will be conducted soundly and prudently (see also PRIN and SYSC). [deleted]~~
- (2) ~~The FSA FCA will also take into consideration anything that could influence a *firm's* continuing ability to satisfy this *threshold condition* the *threshold conditions* set out in paragraphs 2E and 3D of Schedule 6 to the Act. Examples include the *firm's* position within a UK or international *group*, information provided by *overseas regulators* about the *firm*, and the *firm's* plans to seek to vary its *Part IV 4A permission* to carry on additional *regulated activities* once it has been granted that *permission* by the FSA appropriate regulator.~~
- 2.5.3 [FCA] G (1) ~~The emphasis of this *threshold condition* the *threshold conditions* set out in paragraphs 2E and 3D of Schedule 6 of the Act is on the suitability of the *firm* itself. The suitability of each *person* who performs a *controlled function* will be assessed by the FSA FCA and/or~~

the *PRA*, as appropriate, under the *approved persons* regime (see *SUP 10* (Approved persons) and *FIT*). In certain circumstances, however, the *FSA FCA* may consider that the *firm* is not suitable because of doubts over the individual or collective suitability of *persons* connected with the *firm*.

- (2) ~~When assessing this *threshold condition* in relation to a *firm*, the *FSA* may have regard to any *person* appearing to it to be, or likely to be, in a relevant relationship with the *firm*, as permitted by section 49 of the *Act* (Persons connected with an applicant) (see *COND 2.4.3G*).~~
- (3) ~~In relation to a *firm* which is an *EEA regulated entity*, the *Financial Groups Directive* provides that the *FSA* should consult other competent authorities when assessing the suitability of the shareholders and the reputation and experience of directors involved in the management of another entity in the same group. [deleted]~~

- 2.5.4 G [FCA] (1) ~~When determining whether the *firm* will satisfy and continue to satisfy *threshold condition 5*, the *FSA* will have regard to all relevant matters, whether arising in the *United Kingdom* or elsewhere. [deleted]~~
- (2) ~~Relevant matters which the *FCA* may have regard when assessing whether a *firm* will satisfy, and continue to satisfy, this *threshold condition* include, but are not limited to, whether a *firm*: Examples of the kind of general considerations to which the *FCA* may have regard when assessing whether a *firm* will satisfy, and continue to satisfy, the *threshold conditions* set out in paragraphs 2E and 3D of Schedule 6 to the *Act* include, but are not limited to, whether the *firm*:~~
- ...
- (3) ~~The *FSA* will take into account relevant matters only to the extent that they are significant (see *COND 1.3.3G*). In determining whether relevant matters are significant to the *firm*, the *FSA* will consider significance in the context of the suitability of the *firm*, having regard to the *regulatory objectives* in section 2 of the *Act* (The *FSA*'s general duties); a series of matters may be significant when taken together, even if each of them in isolation may not be significant. [deleted]~~
- (4) ~~In making its assessment, the *FSA* will, therefore, consider the individual circumstances of each *firm* on a case-by-case basis. [deleted]~~

- 2.5.5 G Where a *firm* is applying for *Part IV permission* or a substantial variation of that *permission*, the guidance in *COND 2.4.6G* is relevant. For the purpose of *threshold condition 5*, however, the *FSA* would expect the *firm*'s business plan or strategy plan to take into account the interests of *consumers* and demonstrate that it is ready, willing and organised to comply with the relevant requirements in the *Handbook* that apply to the *regulated activity* it is seeking to carry on. [deleted]

~~Conducting business with integrity and in compliance with proper standards~~

- 2.5.6 G ~~In determining whether a *firm* will satisfy, and continue to satisfy, threshold condition 5 in respect of conducting its business with integrity and in compliance with proper standards, the relevant matters, as referred to in COND 2.5.4G(2), may include, but are not limited to whether: Examples of the kind of particular considerations to which the *FCA* may have regard when assessing whether a *firm* will satisfy, and continue to satisfy, this *threshold condition* include, but are not limited to, whether:~~
- [FCA]
- (1) ~~the *firm* has been open and co-operative in all its dealings with the *FSA FCA* and any other regulatory body (see *Principle 11* (Relations with regulators)) and is ready, willing and organised to comply with the requirements and standards under the *regulatory system* (such as the detailed requirements of *SYSC* and, in relation to a *firm* not carrying on, or seeking to carry on, a *PRA-regulated activity* only, the Prudential Standards part of the *FCA Handbook*), and in addition to other legal, regulatory and professional obligations; the relevant requirements and standards will depend on the circumstances of each case, including the *regulated activities* which the *firm* has *permission*, or is seeking *permission*, to carry on;~~
 - (1A) ~~the *firm* has made arrangements to put in place an adequate system of internal control to comply with the requirements and standards for which the *FCA* is responsible under the *regulatory system*.~~
 - (2) ~~the *firm* has been convicted, or is connected with a *person* who has been convicted, of any criminal offence; this must include, where provided for by the *Rehabilitation Exceptions Orders* to the Rehabilitation of Offenders Act 1974 or the Rehabilitation of Offenders (Northern Ireland) Order 1978 (as applicable) , any spent convictions; particular consideration will be given to offences of dishonesty, fraud, financial crime or an offence under legislation relating to companies, building societies, industrial and provident societies, credit unions, friendly societies, banking , other financial services, insolvency, consumer credit companies, insurance, consumer protection, *money laundering*, market manipulation and *insider dealing*, whether or not in the ~~United Kingdom~~ United Kingdom;~~
 - (3) ~~the *firm* has been the subject of, or connected to the subject of, any existing or previous investigation or enforcement proceedings by the *FSA FCA*, the *Society of Lloyd's* or by other regulatory authorities (including the *FSA FCA*'s predecessors), *clearing houses* or exchanges, *professional bodies* or government bodies or agencies; the *FSA FCA* will, however, take both the nature of the *firm's* involvement in, and the outcome of, any investigation or enforcement proceedings into account in determining whether it is a relevant matter;~~
 - (4) ~~the *firm* has contravened, or is connected with a *person* who has~~

- contravened, any provisions of the *Act* or any preceding financial services legislation, the *regulatory system* or the rules, regulations, statements of principles or codes of practice (for example the *Society of Lloyd's Codes*) of other regulatory authorities (including the *FSA FCA's* predecessors), *clearing houses* or *exchanges*, *professional bodies*, or government bodies or agencies or relevant industry standards (such as the Non-Investment Products Code); the *FSA FCA* will, however, take into account both the status of codes of practice or relevant industry standards and the nature of the contravention (for example, whether a *firm* has flouted or ignored a particular code);
- (5) the *firm*, or a *person* connected with the *firm*, has been refused registration, authorisation, membership or licence to carry out a trade, business or profession or has had that registration, authorisation, membership or licence revoked, withdrawn or terminated, or has been expelled by a regulatory or government body; whether the *FSA FCA* considers such a refusal relevant will depend on the circumstances;
 - (6) ~~the *firm* has taken reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system that apply to the *firm* and the regulated activities for which it has, or will have, permission (see SYSC 3.2.6R to SYSC 3.2.8R (Compliance) and SYSC 6.1.1R to SYSC 6.1.5R and SYSC 6.3); [deleted]~~
 - (7) the *firm* has put in place procedures which are reasonably designed to:
 - (a) ensure that it has made its *employees* aware of, and compliant with, those requirements and standards under the *regulatory system* that apply to the *firm* for which the *FCA* is responsible and the *regulated activities* for which it has, or will have *permission*;
 - (b) ensure that its *approved persons* (whether or not employed by the *firm*) are aware of those requirements and standards under the *regulatory system* applicable to them;
 - (c) determine that its *employees* are acting in a way compatible with the *firm* adhering to those requirements and standards; and
 - (d) determine that its *approved persons* are adhering to those requirements and standards;
 - (8) the *firm* or a *person* connected with the *firm* has been dismissed from employment or a position of trust, fiduciary relationship or similar or has ever been asked to resign from employment in such a position; whether the *FSA FCA* considers a resignation to be relevant will depend on the circumstances, for example if a *firm* is asked to resign in circumstance that cast doubt over its honesty or integrity; ~~and~~
 - (9) the *firm* or a *person* connected with the *firm* has ever been disqualified

from acting as a *director*;

- (10) the *governing body* of the *firm* is made up of individuals with an appropriate range of skills and experience to understand, operate and manage the *firm's regulated activities*;
- (11) where appropriate, the *governing body* of the *firm* includes non-executive representation, at a level which is appropriate for the control of the *regulated activities* proposed, for example, as members of an audit committee;
- (12) those *persons* who perform *controlled functions* under certain *arrangements* entered into by the *firm* or its contractors (including *appointed representatives* or, where applicable, *tied agents*) act with due skill, care and diligence in carrying out their *controlled function* (see *APER 4.2* (Statement of Principle 2) or managing the business for which they are responsible (see *APER 4.7* (Statement of Principle 7));
- (13) the *firm*, or a *person* connected with the *firm*, has been a *director*, *partner* or otherwise concerned in the management of a *company*, *partnership* or other organisation or business that has gone into insolvency, liquidation or administration while having been connected with that organisation or within one year of such a connection;
- (14) the *governing body* of the *firm* is organised in a way that enables it to address and control the *regulated activities* of the *firm*, including those carried on by *managers* to whom particular functions have been delegated;
- (15) the *firm* has developed human resources policies and procedures that are reasonably designed to ensure that it employs only individuals who are honest and committed to high standards of integrity in the conduct of their activities;
- (16) the *firm* has taken reasonable care to ensure that robust information and reporting systems have been developed, tested and properly installed;
- (17) the *firm* has in place appropriate systems and controls against financial crime, including, for example, *money laundering*;
- (18) in the case of a *firm* that carries on *insurance mediation activity*:
- (a) a reasonable proportion of the *persons* within its management structure who are responsible for the *insurance mediation activity*; and
- (b) all other *persons* directly involved in its *insurance mediation activity*;
- demonstrate the knowledge and ability necessary for the performance of their duties; and

(c) all the persons in the firm's management structure and any staff directly involved in insurance mediation activity are of good repute (see MIPRU 2.3.1R (Knowledge, ability and good repute)); and

(19) where appropriate, the firm has appointed auditors and actuaries, who have sufficient experience in the areas of business to be conducted.

Competent and prudent management and exercise of due skill, care and diligence

2.5.7
[FCA]

G ~~In determining whether a firm will satisfy and continue to satisfy *threshold condition 5* in respect of having competent and prudent management and exercising due skill, care and diligence, relevant matters, as referred to in COND 2.5.4G(2), may include, but are not limited to whether:~~

- (1) ~~the *governing body* of the firm is made up of individuals with an appropriate range of skills and experience to understand, operate and manage the firm's regulated activities;~~
- (2) ~~if appropriate, the *governing body* of the firm includes non-executive representation, at a level which is appropriate for the control of the regulated activities proposed, for example, as members of an audit committee;~~
- (3) ~~the *governing body* of the firm is organised in a way that enables it to address and control the regulated activities of the firm, including those carried on by managers to whom particular functions have been delegated (see SYSC 2.1 (Apportionment of responsibilities) and SYSC 3.2 (Areas covered by systems and controls) and SYSC 4.1.1R (General organisational requirements));~~
- (4) ~~those persons who perform controlled functions under certain arrangements entered into by the firm or its contractors (including appointed representatives or, where applicable, tied agents) act with due skill, care and diligence in carrying out their controlled function (see APER 4.2 (Statement of Principle 2) or managing the business for which they are responsible (see APER 4.7 (Statement of Principle 7));~~
- (5) ~~the firm has made arrangements to put in place an adequate system of internal control to comply with the requirements and standards under the regulatory system (see SYSC 3.1 (Systems and Controls) and SYSC 4.1 (General organisational requirements));~~
- (6) ~~the firm has approached the control of financial and other risk in a prudent manner (for example, by not assuming risks without taking due account of the possible consequences) and has taken reasonable care to ensure that robust information and reporting systems have been developed, tested and properly installed (see SYSC 3.2.10 G (Risk assessment) and SYSC 7.1 (Risk control));~~
- (7) ~~the firm, or a person connected with the firm, has been a director,~~

~~partner or otherwise concerned in the management of a company; partnership or other organisation or business that has gone into insolvency, liquidation or administration while having been connected with that organisation or within one year of such a connection;~~

- (8) ~~the firm has developed human resources policies and procedures that are reasonably designed to ensure that it employs only individuals who are honest and committed to high standards of integrity in the conduct of their activities (see, for example, SYSC 3.2.13G (Employees and agents) and SYSC 5.1 (Employees, agents and other relevant persons));~~
- (9) ~~the firm has conducted enquiries (for example, through market research or the previous activities of the firm) that are sufficient to give it reasonable assurance that it will not be posing unacceptable risks to consumers or the UK financial system;~~
- (10) ~~the firm has in place systems and controls against money laundering of the sort described in SYSC 3.2.6R to SYSC 3.2.6JG and SYSC 6.3 (Financial crime);~~
- (11) ~~where appropriate, the firm has appointed auditors and actuaries, who have sufficient experience in the areas of business to be conducted (see SUP 3.4 (Auditors' qualifications) and SUP 4.3.8G to SUP 4.3.10G (Actuary's qualifications)); and~~
- (12) ~~in the case of a firm that carries on insurance mediation activity:~~
- (a) ~~a reasonable proportion of the persons within its management structure who are responsible for the insurance mediation activity; and~~
- (b) ~~all other persons directly involved in its insurance mediation activity;~~

~~demonstrate the knowledge and ability necessary for the performance of their duties; and~~

- (c) ~~all the persons in its management structure and any staff directly involved in insurance mediation activity are of good repute (see MIPRU 2.3.1 R (Knowledge, ability and good repute)).~~
~~[deleted]~~

...

Insert the following new sections after COND 2.6. This text is all new and is not underlined.

2.7 Business model

- 2.7.1 UK **Paragraph 2F to Schedule 6 of the Act**
[FCA]
- (1) **A’s business model (that is, A’s strategy for doing business) must be suitable for a person carrying on the regulated activities that A carries on or seeks to carry on.**
 - (2) **The matters which are relevant in determining whether A satisfies the condition in sub-paragraph (1) include-**
 - (a) **whether the business model is compatible with A’s affairs being conducted, and continuing to be conducted, in a sound and prudent manner;**
 - (b) **the interests of consumers; and**
 - (c) **the integrity of the UK financial system.**
- 2.7.2 G Paragraph 2F of Schedule 6 to the *Act* sets out the business model *threshold condition* for *firms* carrying on, or seeking to carry on, *regulated activities* which do not include a *PRA-regulated activity*.
[FCA]
- 2.7.3 UK **Paragraph 3E to Schedule 6 of the Act**
[FCA]
- B’s business model (that is, B’s strategy for doing business) must be suitable for a person carrying on the regulated activities that B carries on or seeks to carry on, having regard to the FCA’s operational objectives.**
- 2.7.4 G Paragraph 3E of Schedule 6 to the *Act* sets out the business model *threshold condition* which is relevant for the discharge by the *FCA* of its functions under the *Act* in relation to *firms* carrying on, or seeking to carry on, *regulated activities* which include a *PRA-regulated activity*.
[FCA]
- 2.7.5 G The *guidance* in *COND 2.7* should be read as applying to both paragraph 2F of Schedule 6 to the *Act* and, as far as relevant to the discharge by the *FCA* of its functions under the *Act* in respect of *firms* carrying on, or seeking to carry on, a *PRA-regulated activity*, paragraph 3E of Schedule 6 of the *Act*.
[FCA]
- 2.7.6 G *Firms* carrying on, or seeking to carry on, a *PRA-regulated activity*, should note that the *PRA* states in its Approach Documents that analysis of such *firms’* business models will form an important part of the *PRA’s* supervisory approach. For the avoidance of doubt, this guidance does not apply to the *PRA’s* own assessment of the *firms’* business models.
[FCA]
- 2.7.7 G In assessing whether the *threshold conditions* contained in paragraphs 2F and 3E of Schedule 6 to the *Act* are satisfied, the *FCA* may consider all matters that might affect the design and execution of a *firm’s* business model, taking into account the nature, scale and complexity of a *firm’s* business.
[FCA]

- 2.7.8 [FCA] G In deciding how they will satisfy and continue to satisfy the *threshold conditions* set out in paragraphs 2F and 3E of Schedule 6 to the *Act*, *firms* should consider matters including (but not limited to) the following:
- (1) the assumptions underlying the *firm's* business model and justification for it;
 - (2) the rationale for the business the *firm* proposes to do, its competitive advantage, viability and the longer-term profitability of the business;
 - (3) the needs of and risks to *consumers*;
 - (4) the expectations of stakeholders, for example shareholders and regulators;
 - (5) the products and services being offered and product strategy;
 - (6) the governance and controls of the *firm* and of any member of its *group* (if appropriate);
 - (7) the growth strategy and any risks arising from it;
 - (8) any diversification strategies; and
 - (9) the impact of the external macroeconomic and business environment.
- 2.7.9 [FCA] G *Firms* should consider the manner in which they intend to bring their business model into operation. This plan could, for example, include matters such as procurement, outsourcing, and recruitment.
- 2.7.10 [FCA] G *Firms* should consider scenarios which may negatively impact on the *firm's* business model with a view to ensuring the sustainability of the *firm* and, further, to consider the vulnerability of the business model to specific events and the risks and consequences that might arise. Where appropriate, this might include reverse stress-testing (see *SYSC 20 'Reverse stress testing'*). A *firm* should put in place a credible plan to minimise the risks that it identifies from, or in relation to, its business model and a contingency plan for dealing with risks that have crystallised.
- 2.7.11 [FCA] G Firms should ensure that any adjustments to its business model:
- (1) are approved at an appropriate level in the business;
 - (2) are considered in the light of any potential risks, impacts and consequences of the proposed changes; and
 - (3) appropriately take into account the needs of and risks to *clients* and relevant *consumers*.
- 2.7.12 [FCA] G The *FCA's* assessment of a *firm's* satisfaction of this *threshold conditions* set out in paragraphs 2F and 3E of Schedule 6 to the *Act* will not necessarily be limited to a *firm's regulated activities* if the *FCA* believes the *firm's* other business activities, if

any, may impact on a firm's *regulated activities*.

2.8 Appointment of claims representatives

2.8.1 UK Paragraph 3F to Schedule 6 of the Act

[FCA]

(1) If-

- (a) the regulated activity that B is carrying on, or is seeking to carry on, is the effecting or carrying out of contracts of insurance, and**
- (b) contracts of insurance against damage arising out of or in connection with the use of motor vehicles on land (other than carrier's liability) are being, or will be, effected or carried out by B,**

B must have a claims representative in each EEA State other than the United Kingdom.

- (2) For the purposes of sub-paragraph (1)(b), contracts of reinsurance are to be disregarded.**
- (3) A claims representative is a person with responsibility for handling and settling claims arising from accidents of the kind mentioned in Article 1(2) of the fourth motor insurance directive.**
- (4) In this paragraph "fourth motor insurance directive" means Directive 2000/26/EC of the European Parliament and of the Council of 16th May 2000 on the approximation of the laws of the Member States relating to insurance against civil liability in respect of the use of motor vehicles and amending Council Directives 73/239/EEC and 88/357/EEC.**

2.8.2 G Paragraph 3F of Schedule 6 to the *Act* sets out the appointment of claims representatives *threshold condition* for *firms* carrying on, or seeking to carry on, *regulated activities* which consist of or include *effecting or carrying on contracts of insurance*, where *contracts of insurance* against damage arising out of or in connection with the use of motor vehicles on land (other than the carrier's liability) are being or will be, effected or carried out by that *firm*.
[FCA]

2.8.3 UK There is no appointment of claims representatives *threshold condition* for *firms* who are not carrying on, or are seeking to carry on, *regulated activities* which include a *PRA-regulated activity*.
[FCA]

2.8.4 G *Rules and guidance* concerning a *motor vehicle liability insurer's* obligations in relation to the appointment of its claims representatives, and the responsibilities and duties that the *motor vehicle liability insurer* must give
[FCA]

to, or impose on, its claims representatives are set out in *ICOB*S 8.4.

COND 2 Annex 1G is deleted in its entirety. The deleted text is not shown.

Appendix 6

Designation of changes to the Threshold Conditions sourcebook (COND)

1. FSA Handbook provisions will be ‘designated’ to create a FCA Handbook and a PRA Handbook on the date that the regulators exercise their legal powers to do so. Please visit our website¹ for further details about this process.
2. We plan to designate the Handbook Provisions which we are proposing to create and/or amend within this Consultation Paper as follows:

Handbook Provision	Designation
COND 1.1A.1	FCA
COND 1.1A.2	FCA
COND 1.2A.3	FCA
COND 1.1A.4	FCA
COND 1.1A.5	FCA
COND 1.1A.6	FCA
COND 1.1A.7	FCA
COND 1.2.1	FCA
COND 1.2.2	FCA
COND 1.2.3	FCA
COND 1.2.5	FCA
COND 1.3.1	FCA
COND 1.3.2	FCA
COND 1.3.3	FCA
COND 1.3.3A	FCA
COND 1.3.3B	FCA
COND 1.3.3C	FCA
COND 1.3.3D	FCA
COND 1.1.3E	FCA

¹ One-minute guide <http://media.fsahandbook.info/latestNews/One-minute%20guide.pdf>

COND 1.3.4	FCA
COND 1.3.5	FCA
COND 2.2.1A	FCA
COND 2.2.1B	FCA
COND 2.2.1C	FCA
COND 2.2.2	FCA
COND 2.2.3	FCA
COND 2.2A	FCA
COND 2.3.1A	FCA
COND 2.3.1B	FCA
COND 2.3.1C	FCA
COND 2.3.1D	FCA
COND 2.3.1E	FCA
COND 2.3.1F	FCA
COND 2.3.2	FCA
COND 2.3.3	FCA
COND 2.3.6	FCA
COND 2.3.7	FCA
COND 2.3.8	FCA
COND 2.3.9	FCA
COND 2.3.10	FCA
COND 2.3.11	FCA
COND 2.3.11A	FCA
COND 2.3.12	FCA
COND 2.4.1A	FCA
COND 2.4.1B	FCA
COND 2.4.1C	FCA
COND 2.4.1D	FCA
COND 2.4.1E	FCA
COND 2.4.1F	FCA
COND 2.4.1G	FCA
COND 2.4.2	FCA
COND 2.4.3	FCA
COND 2.4.4	FCA
COND 2.5.1	FCA
COND 2.5.1A	FCA
COND 2.5.1B	FCA
COND 2.5.1C	FCA
COND 2.5.1D	FCA
COND 2.5.1E	FCA
COND 2.5.1F	FCA
COND 2.5.2	FCA
COND 2.5.3	FCA
COND 2.5.4	FCA
COND 2.5.6	FCA
COND 2.5.7	FCA
COND 2.7.1	FCA
COND 2.7.2	FCA
COND 2.7.3	FCA

COND 2.7.4	FCA
COND 2.7.5	FCA
COND 2.7.6	FCA
COND 2.7.7	FCA
COND 2.7.8	FCA
COND 2.7.9	FCA
COND 2.7.10	FCA
COND 2.7.11	FCA
COND 2.7.12	FCA
COND 2.8.1	FCA
COND 2.8.2	FCA
COND 2.8.3	FCA
COND 2.8.4	FCA

Appendix 7

Draft FCA statement of policy on the use of the power to direct qualifying parent undertakings

Background

1. This statement sets out the Financial Conduct Authority's (FCA) policy on the use of its power to direct a qualifying parent undertakings under section 192C of the [Financial Services and Markets Act 2000] as amended by the Financial Services Bill 2010-2013 (the 'Act'). This statement is required by section 192H of the [Act].¹

Conditions for the exercise of the power of direction

2. The statutory provisions relating to the power of direction are set out in sections 192A to 192I of the Act. In order for the FCA to be able to exercise the power of direction:
 - a) The parent company must be a 'qualifying parent undertaking' of a 'qualifying authorised person'; and
 - b) Either the 'general condition' or the 'consolidated supervision condition' must be satisfied.

¹ As part of the consultation by the PRA, the Bank of England has also published separately a statement setting out its policy on the use of its power to direct a qualifying parent undertakings of recognised clearing houses under section 192C of the Act (as applied to the Bank of England and recognised clearing houses by paragraph 17 of Schedule 17A of the Act.

Identification of qualifying parent undertakings

3. A 'qualifying parent undertaking' is defined under the Act as a parent undertaking² of a qualifying FCA regulated entity that is:
 - a body corporate incorporated in any part of the United Kingdom or has a place of business in the United Kingdom;
 - is not itself an authorised person, a recognised investment exchange or a recognised clearing house; and
 - it is a financial institution of a kind prescribed by the Treasury by order.
4. This definition is expected to cover any UK incorporated unauthorised financial parent undertaking in an ownership chain, even if that undertaking is not itself at the head of the ownership chain. In general, the FCA would consider action to be most effective when taken in relation to the ultimate parent undertaking at the head of the ownership chain, as that is usually where the majority of the power to direct and control the group resides.
5. However, where the ultimate parent undertaking is not a qualifying parent undertaking under the Act (for example if the group is headed by a non-UK or non-financial entity) then the FCA may consider that use of the Power of Direction over another qualifying parent undertaking in the ownership chain may still be helpful in addressing group risks on a more regional or local level.
6. The FCA will only have powers over the UK parent undertaking and therefore may also consider taking action in relation to an intermediate qualifying parent undertaking where the FCA regulated entity is headed by a third country parent. There may be other circumstances to take action in relation to an intermediary qualifying parent undertaking, for example, if there are restrictions on the powers of the ultimate parent undertaking in its constitution, if the ultimate parent undertaking fails to act, or if action is to be taken in relation to the immediate parent of the firm (particularly in cases where there are distinct sub-groups within wider groups).

Uses of the Power of Direction

7. The FCA can use the Power of Direction if either the general condition or the consolidated supervision condition is met.

General condition

8. The general condition is that the FCA considers that it is desirable to give direction in order to advance one or more of its operational objectives.
9. For example, the FCA consider that compliance with regulatory requirements is a key part of advancing its operational objectives which include securing an appropriate degree of

² Parent undertaking is defined in section [420] FSMA and section 1162 of the Companies Act 2006.

protection for consumers, protecting and enhancing the integrity of the UK financial system and/or promoting effective competition in the interests of consumers in the markets. Where any of the actions or omissions of the parent undertaking lead, or could lead, directly or indirectly, to the authorised firm or UK RIE being unable to ensure compliance with its own solo, consolidated or other group-wide regulatory requirements, the FCA may consider it desirable to make use of its powers of direction against qualifying parent holding companies under the general condition.

Consolidated supervision condition

10. The consolidated supervision condition is that:
 - a) the FCA is the competent authority for the purpose of consolidated supervision that is required, in relation to some or all of the members of the group of a qualifying authorised person, in pursuance of any of the relevant EU directives; and
 - b) the FCA considers that the giving of the direction is desirable for the purposes of the effective consolidated supervision of the group.
11. The FCA considers that the purpose of consolidated supervision is to enable supervisors to take necessary action to protect authorised firms from the adverse effects of being part of a group. These adverse effects may include: financial contagion (losses in a group entity impacting on a firm through financial linkages); reputational contagion (an event in one entity impacting adversely on another entity in the group through reputation damage); double/multiple gearing (i.e. use of the same capital resources more than once in the same group); leveraging (i.e. upgrading the quality of capital within a group by, for instance, using lower quality funds borrowed by the parent undertaking to create core equity tier 1 capital within the authorised firm); and the impact of intra-group relationships on authorised firms (exposures, contingent liabilities etc).
12. For example, the application of rules on a consolidated basis aims to address many of the risks above. Therefore, the FCA considers that where any act or omission of the parent undertaking leads, or could lead, directly or indirectly, to the authorised firm being unable to ensure compliance with rules applied at the consolidated level required by the relevant European legislation, it may be desirable to exercise its powers of direction on qualifying parent undertakings. In determining whether there is compliance, the FCA will also take into account the purpose of the rule and its intended effect. There may also be other circumstances where the FCA considers it appropriate to use its powers of direction against qualifying parent holding companies under the consolidated supervision condition. When using the powers of direction, the FCA will have due regard to the consolidated supervision for those firms that do not derive from EU legislation.
13. Annex 1 to this statement of policy contains a non-exhaustive list of possible scenarios in which the FCA may consider exercising the Power of Direction.

Use of powers in relation to FCA regulated entities

14. In deciding whether to give a direction, section 192C(5) of the Act provides that the FCA must have regard:
 - a) to the desirability where practicable of exercising its powers in relation to authorised persons or UK RIEs rather than its powers under this section; and
 - b) to the principle that a burden or restriction which is imposed on a person should be proportionate to the benefits, considered in general terms, which are expected to result from its imposition.
15. Under normal circumstances, the FCA would expect to use its powers over FCA regulated entities to try to achieve its objectives in the first instance. However there may be circumstances where the FCA would consider use of the power of direction in respect of the qualifying parent undertaking to be more appropriate or necessary.
16. In stressed circumstances, the potential conflicts between a parent undertaking and an FCA regulated entity can become heightened. In this case, the likelihood that actions taken in relation to the FCA regulated entity alone would be insufficient is increased and use of the Power of Direction may again be appropriate.

Content of Directions

17. A direction, specified in section 192D(1) of the Act, may require the parent undertaking:
 - a) to take specified action; or
 - b) to refrain from taking specified action.
18. The FCA would issue a direction designed to bring the FCA regulated entity and the group back into compliance with its regulatory requirements or to prevent the parent undertaking from taking action which may lead to disorderly failure of FCA regulated entities or the FCA regulated entity's group.
19. A requirement may be imposed by reference to the parent undertaking's relationship with:
 - a) its group; or
 - b) other members of its group.
20. The requirement would be imposed either in relation to whichever relationship(s) are causing the concern, including relationships between sister companies, or on the basis of the group generally if the concern is in respect of group-wide issues where the best control over those issues is held by the qualifying parent undertaking.
21. A requirement may refer to the past conduct of the parent undertaking (for example, by requiring the parent undertaking to review or take remedial action in respect of past conduct).

22. We may require a parent undertaking to pay redress to consumers for claims arising from professional negligence or firms providing unsuitable advice. Where there have been several causes for concerns over a period of time, with the effects of each specific issue being insufficient on its own to trigger the use of the Power of Direction, the cumulative effect of these may be included in the consideration on whether to use the Power of Direction.
23. Annex 2 contains a non-exhaustive list of type of directions which the FCA may consider making.

Annex 1

Non-exhaustive list of possible scenarios in which the FCA may consider exercising the power of direction

1. Examples of scenarios in which the FCA may consider the exercise of its Power of Direction include, but are not limited to:
 - the holding company sets financial objectives for the group, including the regulated entity, which conflict with consumer interests; for example the holding company expects the firm to generate a specific amount of income which leads to the firm to conduct high-pressure selling;
 - the holding company directs actions to the authorised firm and the authorised firm does not pay due regard to the interests of the consumers and treat them fairly, including communicating with them in a way that is clear, fair and not misleading;
 - the holding company fails to oversee the authorised firm's arrangements to provide adequate protection for client assets, where applicable;
 - where one or more directors of the parent company appear not to be fit and proper, or suitable;
 - where the holding company directors exert dominant influence on the regulated entity's board to obstruct its independence;
 - inadequate oversight of the development of a new product by the group board of directors;
 - insufficient quality or quantity of own funds or liquid assets or other assets that are made available to the authorised firms to meet their solo requirements;
 - intra-group transactions and allocation of risks and financial resources (including large exposures, booking practices, other channels of contagion and arrangements for the mitigation of risk such as by reinsurance) which do not meet the standards expected by the FCA;
 - where the orderly wind-down or (where relevant) group recovery and resolution plans do not meet the standards expected by the FCA;
 - where a proposed acquisition by the holding company may affect compliance with consolidated or group requirements or the solo requirements of any authorised firm in the group;
 - where actions of the parent undertaking in a stressed situation may increase the chance of disorderly failure of the FCA regulated entity;

- scenarios where the parent undertaking moves, or may move, impaired, sub-standard or high risk assets into an FCA regulated entity and allows that firm to fail in a disorderly way whilst the rest of the group carries on as a going concern;
- where only the actions of the parent company in relation to one of its unregulated subsidiaries may maintain the stability of the regulated firms, particularly in stressed circumstances, (e.g. where a regulated firm is reliant on services provided by an unauthorised sister company);
- where risks generated in an unauthorised part of the group could affect the stability of the authorised firms;
- where the close links of the authorised firm prevents the FCA from effective supervision of the authorised firm;
- acts or omissions of the qualifying parent undertaking that are affecting, or may affect a UK RIE's ability to continue to meet Recognition Requirements or other obligations to which it is subject under [FSMA] or directly applicable EU regulation;
- insufficient quality or quantity of own funds or liquid assets or other assets being available to meet consolidated group requirements;
- insufficient transferability of a group's own funds or liquid assets to support the group's regulated activities;
- complex or opaque group structures which hinder the authorised firm's and/or the FCA's ability to assess and manage the risks generated by the authorised firm's membership of its group;
- where funding by the holding company to the regulated entity is repaid to the holding company, compromising the own funds of the regulated entity;
- group-wide risk management or governance arrangements that do not meet the FCA's and/or internationally agreed standards;
- where the holding company controls the central control functions of the group and they are not able to adequately identify and assess the risks of the regulated entity; and
- group-wide systems and controls to manage group risks which do not meet the standards expected by the FCA.

Annex 2

Non-exhaustive list of possible Directions which the FCA may consider making

1. Directions which may be made by the FCA may include, but are not limited to:
 - A requirement to ensure the group entities undertake activities that are fair to consumers and maintain market integrity;
 - A requirement for the holding company to employ additional people or implement additional systems and controls if the regulated firm has not provided suitable advice;
 - A requirement for the holding company to intervene and prevent the regulated firm from selling inappropriate products;
 - An undertaking from the board of the holding company that they would not pay any senior management bonuses until such time as the level of redress from crystallised conduct risks are confirmed in the regulated entity;
 - An appointment by the holding company of an independent board of directors;
 - A restriction on dividend payments, or other payments in respect of capital instruments, in order to retain capital in the group;
 - A requirement to move funds or assets around the group to more appropriately address the risks;
 - A requirement for the group to be restructured to remove any material impediments to effective supervision;
 - A requirement directing the parent undertaking to take steps (in accordance, where relevant, with the Listing Rules, Company Law and/ or the undertaking's Articles of Association) to stop or restrict an acquisition or divesture (taking account of any potential conflict with Takeover rules);
 - A requirement to take steps (in accordance, where relevant, with the Listing Rules, Company Law and/ or the undertaking's Articles of Association) to remove a director, who is not fit and proper or suitable (including skills and knowledge), from his post;
 - A requirement to ensure the continuity of service is provided between relevant group entities and that outsourcing arrangements between group undertakings can operate effectively; and
 - A requirement to include relevant regulated and unregulated entities (including shadow banking entities, where appropriate) in consolidated calculations.

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