

08/25\*\*

Financial Services Authority

The approved persons  
regime – significant  
influence function  
review

December 2008



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**Annex 1:** Cost benefit analysis and compatibility statement

**Annex 2:** List of questions

**Appendix 1:** Draft handbook text

The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by 31 March 2009.

Comments may be sent by electronic submission using the form on the FSA's website at ([www.fsa.gov.uk/Pages/Library/Policy/CP/2008/cp08\\_25\\_response.shtml](http://www.fsa.gov.uk/Pages/Library/Policy/CP/2008/cp08_25_response.shtml)).

Alternatively, please send comments in writing to:

Rachel Donaldson  
Operational and Reporting Policy Team  
Permissions Decisions and Reporting Department  
Financial Services Authority  
25 The North Colonnade  
Canary Wharf  
London  
E14 5HS

Telephone: 0207 066 0754

E-mail: [cp08\\_25@fsa.gov.uk](mailto:cp08_25@fsa.gov.uk)

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

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

# 1 Overview

- 1.1 The approved persons regime (the regime) differs from many other tools that we use for regulation as it applies to individuals. This means that, as well as firms being responsible for ensuring that they comply with our rules, individuals who perform key functions within firms also have a responsibility for complying with the Statements of Principle and the Code of Practice for Approved Persons as described in our Handbook under APER.
- 1.2 Under the Financial Services and Markets Act (FSMA) we have powers to regulate two different types of individuals: those that have a significant influence on a firm and those who deal with customers (or the property of customers). In this consultation we put forward proposals that focus on individuals who have a significant influence on a firm and, in particular, those who are responsible for corporate governance. Firms with robust corporate governance arrangements are more likely to be both willing and able to face up to their key risks.
- 1.3 The regime is implemented through various parts of our Handbook such as : the Fit and Proper test for approved persons (FIT); the Statements of Principle and Code of Practice for Approved Persons (APER); the Supervision manual (SUP 10) and Senior Management, Systems and Controls (SYSC). All these elements are designed to ensure that approved persons carry out their controlled functions in accordance with appropriate regulatory standards.
- 1.4 We believe that appropriate standards of behaviour are necessary to protect the interests of firms and their customers, and that regulatory oversight can assist in delivering this. Our ability to hold individuals accountable for carrying out their responsibilities provides additional incentives for honest, prudent and sensible management.
- 1.5 The regime is also one of the ways that we can bring about our continued emphasis on senior management responsibility within the industry.

## The Supervisory Enhancement Programme (SEP)

- 1.6 At the end of 2007 our senior executive team commissioned an Internal Audit review of lessons learned from our supervision of Northern Rock. Recommendations from that report<sup>1</sup> were published in March 2008. In response to those recommendations and other initiatives SEP was established to implement those improvements. The recommendations included “FSA to increase the rigour of its day-to-day supervision.”
- 1.7 This recommendation specifically mentioned a focus on increasing the thoroughness of our supervision where issues regarding the competence of firms’ management were identified. As a result we reviewed our approach to the significant influence controlled functions<sup>2</sup> to see where improvements could be made and to examine whether the regime reflected corporate governance structures within the industry.
- 1.8 We have already made a number of changes in our approach to Significant Influence Controlled Functions as a result of our review. These are set out in Chapter 2. This consultation sets our further changes which would require amendment to our handbook.

### Structure of this consultation

- 1.9 This consultation paper (CP) contains proposals to:
- extend the definition of the existing CF1 (director) and CF2 (non-executive director) controlled functions to include those individuals who exercise significant influence on a regulated firm from a parent undertaking or holding company within its group which is unregulated by us or any other European Union financial services regulator;
  - clarify the role of non-executive directors within our Code of Practice for Approved Persons (contained in APER in our Handbook);
  - extend the definition of the CF29 controlled function to include appropriate proprietary traders with the expectation that this will capture all proprietary traders;
  - amend the application of the approved persons regime to UK branches of third country firms<sup>3</sup> so that all the controlled functions may apply; and
  - extend the rule obliging firms to provide references for applicants of the CF30 (customer function) to all controlled functions.

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1 [http://www.fsa.gov.uk/pubs/other/nr\\_report.pdf](http://www.fsa.gov.uk/pubs/other/nr_report.pdf).

2 The significant influence controlled functions include: the governing controlled functions (CF1 (director), CF2 (non-executive director), CF3 (CEO), CF4 (partner), CF5 (director of unincorporated association) and CF6 (small friendly society)); the required controlled functions CF8 (apportionment and oversight), CF10 (compliance oversight), CF11 (money laundering reporting officer), CF12 (actuarial), CF12A (with-profits actuary) and CF12B (Lloyd’s actuary function); the systems and controls controlled function (CF28); and the significant management controlled function (CF29).

3 Overseas firms based outside the EEA.

4 Approved persons: significant influence (December 2008)

## **Who should read this CP?**

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

## **Next steps**

- 1.11 Consultation on the proposals closes on 31 March 2009. We will then finalise the proposals and publish the final rules in a Policy Statement during the second quarter of 2009.

## **Consumers**

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

# 2 Key messages

- 2.1 Since the formation of the regime we have continuously emphasised the importance of senior management responsibilities and the creation of the significant influence controlled functions was designed to reflect those responsibilities. During 2008 we have been reviewing our approach to those who carry out a significant influence function to ensure, as far as possible, that the regime meets the expectations of our stakeholders. This CP includes a number of proposals that will bring additional individuals into the approved persons regime if they have a significant influence on an authorised firm.

## **Reviewing our approach to significant influence controlled functions.**

- 2.2 The following areas are changes that do not require handbook amendments:
- We will be seeking to hold individuals exercising significant influence over authorised firms accountable for poor conduct at those firms with regard to regulated activities. Previously, for individuals holding significant influence controlled functions, we have tended to focus on cases of dishonesty or lack of integrity where prohibition or withdrawal of approval was the most appropriate outcome. In the future, we will also consider the competence of significant influence function holders and we would not shy away from pursuing cases against individuals who breach our Principles and the Code of Practice for Approved Persons (APER). In these cases, fines may be more appropriate than prohibitions. We have made a strategic decision to investigate more individuals. So, even though that could mean that cases take longer and quick public outcomes are delayed, we consider our increased focus on individuals to be a price worth paying to achieve credible deterrence.
  - From 1 October 2008 we have started interviewing more of those applying to become significant influence functions at the largest firms. We anticipate that the majority of those we interview will go on to be approved – those invited to interview as part of our scrutiny process should not feel that they have been singled out for attention. We expect (the results of the pilots have been

encouraging) that those we interview will take on their new roles with more awareness of their regulatory responsibilities. Our supervisors should have greater assurance that they can rely on those holding significant influence functions to make more principles based regulation a reality at their firms. We want to get away from the idea that our approval is a ‘tick box exercise’. We encourage all firms to take it seriously and ensure that those they put forward are fit for the role for which they are proposed.

- We have also made changes to the Form A (Application for a controlled function) which will require all firms to provide supplementary information about the competence and capability of the candidate.

## **Clarifying how parts of the Approved Persons regime apply**

- 2.3 We have looked at how we can clarify certain areas of the regime to make its application clearer and what the consequences of approval are.

### **Non-executive directors**

- 2.4 Since the regime was created we have recognised the valuable role of the non-executive director within regulated firms. Although their role is different to that of an executive director we expect them to ask challenging questions in order to understand (and if necessary, positively influence) the business model and inherent risks within the regulated firm. In order to do this effectively firms must have high quality non-executive directors committed to ensuring that their firms are run effectively. In this consultation we are proposing some changes to the APER Code of Practice to better reflect the duties of non-executive directors. We also want to make it clear that in the future we will be more likely to hold non-executive directors accountable, as well as the firm and its executives, if there is evidence to suggest that they have failed to fulfil their duties with competence and/or integrity.

## **Competence and capability**

- 2.5 In paragraph 2.2 we said that we will be looking more closely at the competence and capability of individuals holding significant influence controlled functions. We have said in past consultation papers<sup>4</sup> that we expect firms to perform their own due diligence before submitting an application for us to approve an individual. Our vetting process is designed to complement a firm’s own recruitment practices. It is not a substitute for a firm undertaking proper due diligence.
- 2.6 We expect senior management to assess, using a risk-based approach, with a combination of checks to ensure an individual is suitable for a particular role. We also expect senior management to take responsibility for managing the risks in their firms properly and ensuring they have systems and controls to mitigate those risks.

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4 [http://www.fsa.gov.uk/pubs/cp/cp06\\_15.pdf](http://www.fsa.gov.uk/pubs/cp/cp06_15.pdf).

# 3 Extending the scope and application of controlled functions CF1 and CF2

- 3.1 Under FSMA we have powers to regulate two types of individuals; those who have a significant influence on the conduct of a firm's affairs and those who deal with customers (or the property of customers).
- 3.2 We created the significant influence controlled functions to capture those individuals who, in our opinion, exercise a significant influence on a firm. We recognise that the board and senior management of firms have a crucial role to play in ensuring that effective governance structures, systems and controls are developed and operate well.

## Reasons for change

- 3.3 The existing significant influence controlled functions reflect the fact that many large complex firms are not primarily managed within that legal entity. They may be managed by function or product line, with some individuals in a matrix management structure being located in the authorised firm or, for example, its parent undertaking or holding company. The current regime captures individuals in matrix management structures if there has been a significant delegation of authority for management decisions by the governing body of an authorised firm<sup>5</sup>. However, the regime does not necessarily reflect the increasing significant influence exerted on an authorised firm by individuals based in parent undertakings or holding companies to which the authorised firm is accountable.

## The proposal

- 3.4 The proposal is designed to reflect the increasing role of certain individuals in parent undertakings or holding companies to which an authorised firm is accountable.
- 3.5 In forming these proposals we have looked at the current definitions of two significant influence controlled functions CF1 (Director) and CF2 (Non-executive director). Currently, the definitions of CF1s and CF2s include persons appointed to direct affairs, persons who are a member of a firm's governing body, persons who

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<sup>5</sup> These individuals should be approved as the CF29 significant management controlled function.

occupy the position of director (by whatever name called), or persons with whose instructions or directions the directors of that body are accustomed to act, or a director who has no responsibility for implementing the decisions or the policies of the governing body (i.e. CF2). Together, the definitions do not necessarily extend to individuals outside the authorised firm.

- 3.6 Some authorised firms already recognise that individuals, based in companies that the firm is accountable to, do have a significant influence and apply for approval accordingly. However, the application of controlled functions in this manner is uneven and our proposal seeks to clarify when we expect these individuals to be approved to ensure a consistent approach.
- 3.7 We propose to extend the definitions of both CF1 and CF2 to make it clear when we expect individuals, having a significant influence on an authorised firm, to be approved. The role of the extended controlled functions will be to include individuals, such as directors, non-executive directors or senior managers employed by a parent undertaking or holding company whose decisions, opinions or actions are regularly taken into account by the governing body of the authorised firm and therefore likely to have a significant influence on the conduct of an authorised firm's affairs.

### **Who do we expect to be included in the extended controlled functions?**

- 3.8 Whether an individual is included will depend on the circumstances. For example, in a situation where an authorised firm relies on a group audit committee to fulfil functions that might otherwise be conducted by the audit committee of the board of the authorised firm we would seek to register key members of the group audit committee on the basis that their decisions, opinions or actions would be regularly taken into account by the board of the authorised firm.
- 3.9 We set out some guidance in the draft Handbook text (Appendix 1) describing the situations that we consider are most likely to prompt the required approval of an individual under the extended controlled functions.

### **Which types of companies can we apply the extended controlled function to?**

- 3.10 Having considered the legal implications of our proposal and how they comply with European Directives and Treaties, we propose applying the extended CF1 and CF2 to individuals, exercising a significant influence over an authorised firm, in the following types of company:
- Regulated and unregulated UK parent undertakings and holding companies;
  - Regulated and unregulated third country parent undertakings and holding companies; and
  - EEA unregulated parent undertakings and holding companies.

3.11 We do not propose to include the following types of firms:

- UK branches with an EEA regulated company: These are firms who have passported<sup>6</sup> into the UK using the Single Market Directives. If we were to propose any changes here it would require close inspection of the provisions of the various Single Market Directives to see what, if anything, were possible. We do not propose any changes at this time.
- UK incorporated authorised firm with an EEA regulated company: We consider it would be disproportionate to apply the approved persons regime to an individual based in an EEA regulated company. These individuals may already be subject to an equivalent individuals regime in their EEA state.

## **Other considerations**

3.12 We would expect robust corporate governance arrangements to continue within firms as a result of this proposal. We believe that robust corporate governance arrangements should identify where individuals in parent undertakings and holding companies are exercising a significant influence on the authorised firm. Therefore, we will be looking closely at corporate governance arrangements to see if they sufficiently identify where significant influence lies. We then expect firms to consider if the extended controlled functions apply.

3.13 Our proposals do not diminish the role of individuals currently approved as significant influence controlled functions in authorised firms. The proposed extended controlled functions will only apply if the circumstances warrant it with the aim of extending the range of individuals for whom the firm would need to apply for approval and closing the gap between our expectations of the regime and its current application. For example, if the governing body of an authorised firm is sufficiently robust and autonomous then we would not expect individuals in any company to which the firm is accountable to need approval. If governance arrangements in the authorised firm relies heavily on the governing bodies or other individuals within a company in its group then the extended controlled functions are likely to apply. We have included some examples of when the extended CF1 and CF2 are likely to apply in the draft handbook text (Appendix 1).

Q1: Do you agree with our proposal to extend CF1 and CF2 to those individuals exercising significant influence?

## **Practical issues and implementation**

3.14 The effect of extending CF1 and CF2 will be two related but distinct roles under one controlled function. To avoid needless change and expense we do not propose to create new controlled functions as some large groups already have individuals in this capacity approved as CF1 or CF2. All individuals will appear as CF1 or CF2 on the

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<sup>6</sup> Any EEA firm that wishes to carry on business in another EEA state may do so if it is within the scope of a relevant EU Single Market Directive. This is referred to in the Financial Services and Markets Act as an EEA right, and the exercise of such rights is known as 'passporting'.

register regardless of which aspects of the controlled function they are approved for. This is the same approach we use for other controlled functions such as CF30.

- 3.15 We will publish a policy statement in the second quarter of 2009 with our final rules. From the day of publication, firm may apply to have individuals approved. However, there will be a transitional period of six months from the date our final rules are published for firms to identify and arrange for the appropriate individuals to be approved. We have a statutory duty to determine applications within three months of their receipt. However, we have made a public commitment to aim to complete 85% of applications within seven working days of receipt. To ensure that applications are determined in time, firms will need to submit them no later than three months before the transitional period ends. If approval has not been granted after the transitional period ends that individual will not be able to continue in their role until approval is granted.
- 3.16 We are aware there may be some individuals already approved for other controlled functions. If they already hold a CF1 or a CF2 then no action is required. If they hold other controlled functions (e.g. CF29 significant management controlled functions) the firm may wish to assess whether the extended CF1 or CF2 is more appropriate.
- 3.17 If a firm does consider that the new extended controlled functions are more appropriate then an application form will need to be submitted in line with the timescales in paragraph 3.16. As these individuals will already be approved as a significant influence controlled function, we will only require the submission of a short form A, which requires less information. As is the case now, the approved individual will appear on our register under the authorised firm.

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

# 4 Clarifying the role of non-executive directors

- 4.1 Non-executive directors are included in the approved persons regime through controlled function CF2. This controlled function was created to recognise the importance of non-executives as part of the governing body of a firm and to distinguish their duties from that of an executive.
- 4.2 We consider the duties of a non-executive to cover the following responsibilities:
- Assisting executive colleagues within the firm's governing body in setting and monitoring the firm's strategy
  - Providing an independent perspective to the overall running of the business, scrutinising the approach of executive management, the firm's performance and standards of conduct
  - Carrying out other responsibilities as assigned by the board, for example as a member of a board committee, such as an audit or remuneration committee.
- 4.3 Our expectations of non executives and executives are different. In the past we have said that we will not discipline non-executives if they have acted in accordance with their roles and responsibilities when things go wrong. In the future, we will look at non-executives more closely in these cases if we believe that they should have intervened where executives are making sustained poor decisions.
- 4.4 With this in mind we have looked at the Statements of Principle and the Code of Practice to see if they sufficiently describe what we expect from non-executives. Our view is that the Code of Practice, while containing a large amount of guidance on our expectations of executive responsibilities, needs to include our expectations of non-executive directors.
- 4.5 Our aim is to clarify rather than impose any new requirements on non-executives that don't already exist in the various industry codes<sup>7</sup>. We made our intention clear when the regime was created that we did not expect non-executives to have executive responsibilities. We believe that amending the Code of Practice will make our Handbook clearer about our expectations of non executives which have

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<sup>7</sup> Higgs Report: Review of the role and effectiveness of non-executives directors (January 2003) and The Combined Code on Corporate Governance (June 2008).

previously been expressed by us in various speeches and documents. We are basing our proposed non-executive guidance on the various industry codes of conduct that are already available; this ensures that we are reinforcing standards that already exist and not creating new ones.

- 4.6 Reference to industry codes in relation to our Code of Practice for approved persons is not new as we already refer to the Combined Code.

Q3: Do you agree with our proposed guidance to the Handbook (as outlined in Appendix 1) that clarifies the role of non-executive directors?

# 5 Proprietary traders

- 5.1 Certain proprietary traders are currently caught by the approved persons regime if they are senior managers and either are the head of a trading desk or have trading limits that could expose their firm to significant risk if anything went wrong. If this description applies to a proprietary trader then they will need to be approved for controlled function CF29 (the significant management function).
- 5.2 When the regime was established we made the decision not to include all proprietary traders<sup>8</sup>, although there was a good deal of support from the industry and trade bodies for us to do so. At that time our view was that other regulatory tools, such as senior management responsibilities and robust systems and controls, were sufficient. However, we also confirmed that we would keep the situation under review.

## Reasons for change

- 5.3 Recent events suggest that the risks of proprietary trading in firms and the current market situation now warrant us reviewing the position of all proprietary traders in relation to the approved persons regime. We consider the ability to take enforcement action for breaches of our Code of Practice for Approved Persons (APER) and the risk of (personal) enforcement action being taken against proprietary traders may assist in deterring both senior and junior proprietary traders from undertaking activity for short term advantage that is either unauthorised, exposes the firm to risk of financial failure or jeopardises confidence in UK markets.
- 5.4 Therefore, we are consulting upon including all proprietary traders within the approved persons regime where it is likely that function will enable them to exercise a significant influence on their firm.

## The proposal

- 5.5 The proposal is designed to capture those proprietary traders who are likely to exercise a significant influence on a firm but are not currently captured by the

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8 CP53 The regulation of approved persons: controlled functions – feedback on CP53 and final rules (June 2000).

approved persons regime. At the moment, a proprietary trader may be caught in two ways:

- CF29 (significant management) controlled function. As stated in paragraph 5.1 above, proprietary traders are expected to be approved for CF29 if they are a senior manager and are either the head of a proprietary trading department or have trading limits that may put the firm at risk; and
- CF30 (customer function) controlled function. This applies where the proprietary trader may deal with customers who are not market counterparties.

- 5.6 Our proposal seeks to extend CF29 so it includes those proprietary traders who are not senior managers but who are likely to enable them to exercise a significant influence on their firm through their trading activities. This would include those currently approved for CF30, who would also have to be approved for CF29.
- 5.7 The legal test under FSMA for the FSA to bring individuals into the approved persons regime under the significant influence controlled function is that they must be acting in relation to an authorised firm's regulated activity and the function they perform is "likely" to enable them to exercise "significant influence" on the firm's affairs, so far as relating to the regulated activity. In assessing whether the function performed is "likely" to enable them to exercise "significant influence" on the firm's affairs, we may take into account the likely consequence of a failure to discharge that function properly. However, we take the view that there is an expectation that all proprietary traders would be caught, and have included proposed guidance in the draft handbook text to this effect.
- 5.8 We appreciate that our proposal is not strongly supported by the cost benefit analysis (Annex 1) but we consider there are other reasons, beyond economic ones, why we should consult. We recognise that proprietary traders have the potential to cause substantial harm to firms, which can have far reaching effects. There is also a question of fairness when considering how they should be accountable for their actions or failures; for example, other individuals with similar exposure to a firm's accounts or undertaking similar trading activities can be held to account for their actions in their personal capacity. As things stand, this element of personal accountability does not apply to proprietary traders. Further, the approved persons regime, as well as providing the means to discipline individuals, also provides us and firms with information about candidates before they are approved. For example a qualified withdrawal will tell us the circumstances about why an individual left a firm, this may be useful to other firms who may then not wish to seek approval for an individual based on that information. The approved persons regime also places an obligation on individuals to meet certain standards of behaviour contained in APER.
- 5.9 We supervise firms according to the risks they present to our statutory objectives. In relation to medium and high-impact firms, which we expect to be most affected by this proposal, we carry out regular risk assessments and impose risk mitigation programmes proportionate to the risks identified. This will include the conduct and actions of approved persons where necessary and is designed to prevent issues escalating to a level where enforcement referral is required. The approval of

proprietary traders on its own may not deter or stop rogue traders but when combined with effective supervision, it may assist to detect and mitigate issues before they crystallise.

Q4: Do you agree with our proposal to extend the description of CF29 to include more proprietary traders?

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

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

## **Practical issues and implementation**

5.10 We will publish a policy statement in the second quarter of 2009 with our final rules. From the day of publication, firms may apply to have individuals approved. However, there will be a transitional period of six months from the date our final rules are published for firms to identify and arrange for the appropriate individuals to be approved. We have a statutory duty to determine applications within three months of their receipt. However, we have made a public commitment to aim to complete 85% of applications within seven working days of receipt. To ensure that applications are determined in time, firms will need to submit them no later than three months before the transitional period ends. If approval has not been granted after the transitional period ends that individual will not be able to continue in their role until approval is granted.

5.11 We are aware there may be some proprietary traders already approved as either CF29 or CF30. For those already approved as CF29 no action is required. However, for those who are currently approved as CF30 then it may be appropriate for them to also seek approval for CF29. CF30 captures those proprietary traders who also deal with customers who are not market counterparties – we do not see the application of CF30 changing in this respect. It may well be the case that these individuals also exercise a significant influence solely through their proprietary trading activities – in which case CF29 will also apply under this proposal.

5.12 This means that some proprietary traders may be approved for two controlled functions. If firms wish to change anyone who is approved as CF30 to CF29 they will need to submit a form C to withdraw CF30 and a form A to apply for CF29. Unless any of those individuals is already approved as a significant influence controlled function the firm will need to submit a long form A.

Q7: Do you agree that a transitional period of 6 months is sufficient time for implementation?

# 6 Other proposed changes

- 6.1 This chapter contains two further proposals to make changes to the approved persons regime, which are:
- amend the application of the approved persons regime to UK branches of third country firms so that all the controlled functions may apply; and
  - extend the rule obliging firms to provide references for applicants of the CF30 (customer controlled function) to all controlled functions.

## **The approved persons regime and UK branches of third country firms<sup>9</sup>**

- 6.2 Currently only certain controlled functions apply to UK branches of third country firms. Most notably CF1 and CF2 do not apply. We think that this limited application of the regime should now be removed in order to better reflect current corporate governance arrangements and to ensure regulatory consistency between third country firms who form subsidiaries in the UK and third country firms that branch into the UK. The consequence is that all controlled functions may apply to UK branches of third country firms.

## **How will controlled functions CF1 and CF2 apply?**

- 6.3 We appreciate that the structure of a UK branch of a third country firm will be different to that of a UK subsidiary of a third country firm. Most notably, the directors of a UK branch may well be domiciled abroad. We foresee CF1 and CF2 applying to UK branches in a similar fashion to the controlled function CF3 (Chief Executive Officer) that currently applies.
- 6.4 Under the current requirements, the person approved as CF3 is the person responsible for the conduct of business for the UK branch. We are not prescriptive about how a UK branch chooses to allocate responsibilities to meet

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<sup>9</sup> Overseas non EEA firms.

UK regulatory requirements: so an individual performing CF3 could be based in the UK or overseas.

- 6.5 Under our proposal, we expect a similar scenario for CF1 and CF2. However, we expect that many individuals who perform CF1 and CF2 will be domiciled overseas rather than based in the UK branch itself. The regime has always recognised that some individuals performing controlled functions will be domiciled overseas: it is also highly likely that we have an existing relationship with these individuals. The fact they have been previously excluded from the regime does not mean we do not have any existing contact with them to discuss strategy and other regulatory matters.
- 6.6 We expect that the proposed extended versions of CF1 and CF2 (as outlined in chapter 3) will apply to individuals on the governing bodies of third country firms which have a branch in the UK where it can be shown that a particular individual based in the legal entity outside the UK, has significant influence of the UK branch.
- 6.7 To make it clear how the proposal will work in practice, the following table shows how the controlled functions will apply once the limitation is removed:

<b>Controlled function</b>	<b>Current application to a UK branch of a third country firm</b>	<b>Proposed application to a UK branch of a third country firm</b>
CF1 (director)	Does not apply	Will apply
CF2 (non-executive director)	Does not apply	Will apply
CF3 (chief executive officer)	Currently applies	No change
CF4 (partner)	Does not apply	No change
CF5 (director of unincorporated association)	Does not apply	No change
CF6 (Small friendly society function)	Does not apply	No change
CF8 (apportionment and oversight)	Currently applies	No change
CF10 (compliance oversight)	Currently applies	No change
CF11 (money laundering reporting)	Currently applies	No change
CF12 (actuarial)	Currently applies	No change
CF12A (with-profits actuary)	Currently applies	No change
CF12B (Lloyd's actuary)	Currently applies	No change
CF28 (systems and controls)	Does not apply	Will apply but only when appropriate
CF29 (significant management)	Currently applies	No change (subject to extension to include proprietary traders)
CF30 (customer function)	Currently applies	No change

- 6.8 The main differences will be the application of CF1 and CF2 which should apply in all cases, and controlled function CF28 which will only apply when it is appropriate for the circumstances of the UK branch.

## **Practical issues and implementation**

- 6.9 The effect of this proposal is that more controlled functions will apply to UK branches of third country firms. We will publish a policy statement with final rules in the second quarter of 2009. There will be a transitional period of six months from the date the final rules are published for firms to identify and arrange for appropriate individuals to be approved. We have a statutory duty to determine applications within three months of their receipt. However, we have made a public commitment to aim to complete 85% of applications within seven working days of receipt. To ensure that applications are determined in time, firms will need to submit them no later than three months before the transitional period ends. If approval has not been granted after the transitional period ends that individual will not be able to continue in their role until approval is granted.

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

## **References requested by firms for candidates applying for approved person status**

- 6.10 Currently, firms that employ individuals who have already been approved as a controlled function in another firm, with a view to approving them for CF30 (Customer function) status can request certain information from the previous firm.
- 6.11 The onus then falls on the previous firm to supply the new firm with a considered reference based on specified factual information<sup>10</sup>. If opinions are expressed then this can only be done on the basis of that factual information.
- 6.12 This requirement is only available to firms in connection with an application for CF30. We propose to extend the requirement to all controlled functions. Therefore, firms will be able to ask for factually based references for those applying for any controlled functions.
- 6.13 This change will not require firms to always provide a reference for employees that have moved on to other firms, but only if the new firm requests the information.

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

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10 SUP 10.13.12R.

# Cost benefit analysis and compatibility statements

We set out here a cost-benefit analysis on:

- extending the definition of the existing CF1 and CF2 controlled functions to include certain individuals who exercise significant influence on a regulated firm from a parent undertaking within its group which is unregulated by us or any other European Union Financial Services regulator.
- extending the definition of the CF29 controlled function to include appropriate proprietary traders with the expectation that this will capture all proprietary traders;
- amending the application of the approved persons regime to UK branches of third country firms so that all the controlled functions may apply; and
- extending the rule obliging firms to provide references for applicants of CF30 to all controlled functions.

**Extend the definition of the existing CF1 and CF2 to include certain individuals who exercise significant influence on a regulated firm from a parent undertaking within its group that is unregulated by us or any other European Union Financial Services regulator.**

## Costs

Extending the definitions of the existing CF1 and CF2 will result in initial and on-going costs to us and the industry. The total costs will depend on the number of applicants.

Compliance costs – We anticipate receiving up to 200 initial new approved persons applications and then approximately 200 applications per annum on an on-going basis as a result of the proposal. According to the ‘RealAssurance Estimation of FSA Administrative Burdens’ (June 2006)<sup>11</sup> it costs a firm £200 to prepare and submit an approved persons application form (there should be no other on-going costs). Costs to the industry may also arise from compliance officers assessing and implementing

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11 [http://www.fsa.gov.uk/pubs/other/Admin\\_Burdens\\_Report\\_20060621.pdf](http://www.fsa.gov.uk/pubs/other/Admin_Burdens_Report_20060621.pdf).

the new policy. It is estimated that each compliance officer may spend 0.5 days, at a cost of £285, determining how the extended controlled functions apply to their firm. Therefore, the proposal could initially cost firms £485 for each new approved person. The total one-off costs to the industry are estimated at £100,000. Once the policy is embedded we expect the only costs to arise from preparing and submitting an application (in this case £200). Therefore, on-going costs to the industry will be £40,000 per annum.

Costs to the FSA – It is estimated that costs to us for processing each additional application will be £44 assuming that each case is straightforward. Therefore, our initial costs and on-going costs are both £9,000 per annum (based on us receiving an initial 200 applications and then 200 extra applications per annum on an ongoing basis). However, our costs will increase with each contentious application.

## **Benefits**

The original consultation paper<sup>12</sup> consulting on the establishment of the approved persons regime outlines the benefits associated with a vetting and approval system. This includes ensuring that individuals who exert a significant influence on a firm are assessed against appropriate standards of behaviour necessary to protect the interests of firms and their consumers, and that regulatory oversight could assist in delivering this. The ability to hold individuals accountable for the carrying out of their responsibilities could assist prudent and sensible management, which could lead to a reduction in failure and correspondingly a reduction in the wide costs potentially associated with failure of financial firms.

There will be no incremental benefits in comparison to the benefits discussed in the original consultation paper (as the original consultation took into account the benefits of reduced failure associated with a vetting and approval system). However, there would be some additional benefits when compared with the current practice, to the extent of the number of unsuitable people who will be stopped from exerting significant influence over authorised firms.

## **Extending the definition of the CF29 controlled function to include appropriate proprietary traders with the expectation that this will capture all proprietary traders;**

### **Costs**

Extending the definition of the CF29 controlled function will result in initial and on-going costs to us and the industry. The total costs will depend on the number of applicants.

Compliance costs – Costs to firms will arise through identifying which additional controlled functions apply as a result of the proposal. We anticipate that a minimum of 2,000 initial new approved persons applications reducing to 1,000 per annum will be required as a result of the proposal. Based on the same costs described

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12 <http://www.fsa.gov.uk/pubs/cp/cp53.pdf> (chapter 8 on costs and benefits).

above, the total one-off costs to the industry are estimated at £1million. Once the policy is embedded we expect the only costs to arise from preparing (this includes ensuring the candidate is fit and proper according to our requirements in the FIT handbook) and submitting an application (in this case £200). Therefore, on-going costs to the industry will be £200,000.

Costs to the FSA – It is estimated that costs to us for processing each additional applications will be £44 assuming that each case is straightforward. FSA costs will increase with each contentious application. Therefore, our initial costs will be £88,000 reducing to £44,000 for on-going costs. Our costs will increase with each contentious application.

## **Benefits**

If the proposal could successfully either deter rogue traders from becoming proprietary traders or stop proprietary traders from carrying out activities that put their firm and potentially the financial system at risk, then some of the benefits associated with an effective vetting and approval systems – reduction of the failures of financial firms and therefore a corresponding reduction of wider costs to the economy associated with the failure of financial firms – may be realised.

However, it is not clear that the proposal as described – to approve proprietary traders before they start (costs as estimated in the previous paragraph) – alone can successfully address the issue of rogue traders. Existing approved person regimes for certain proprietary traders do not seem to have been effective in deterring some traders from taking on excessive risks. In addition, looking back at cases involving individual rogue traders who took on excessive risk and therefore placed firms at significant risk, or even failure, they usually involve deception and going over the limits the traders were allowed, so one could argue that the systems and controls in these firms have not been strong enough. The punishment for some of these rogue traders was a jail sentence. There is no evidence to suggest that fine will create a stronger deterrent than the history of criminal convictions and jail sentences. This is particularly the case where junior traders, unlikely to have substantial wealth, may still seek to gamble on excessive risks where the potential windfall (from the gamble pay-off) is likely to be much larger than the threat of a fine by us. Nevertheless, this proposal could make traders more aware of the sanctions (in addition to sacking by the firm and prohibiting by the FSA) that could apply. Better awareness on sanctions may lead to more compliant behaviour for some traders.

The benefits of this proposal will therefore depend on the extent to which it can effectively stop potentially rogue traders from entering the financial system, the extent to which the additional sanction of a fine can effectively deter traders from taking on excessive and unauthorised risk, and the extent to which better information and awareness on sanctions could lead to more compliant behaviours among traders.

## **Amending the application of the approved persons regime to individuals in third country firms who exercise significant influence over UK branches of that third country firm so that all controlled functions may apply<sup>13</sup>**

### **Costs**

Compliance costs – Costs to firms will arise through identifying which additional controlled functions apply as a result of the proposal. We anticipate that up to 120<sup>14</sup> new approved persons applications per annum will be required as a result of the proposal. Based on the same costs described above, the total one-off costs to the industry are estimated at £60,000. Once the policy is embedded we expect the only costs to arise from preparing and submitting an application (in this case £200). Therefore, on-going costs to the industry will be £24,000.

Costs to the FSA – It is estimated that costs to us for processing each additional applications will be £44 assuming that each case is straightforward. FSA costs will increase with each contentious application. Therefore, our initial costs and on-going costs are both £5,000.

### **Benefits**

There will be some additional benefits, compared to the original benefits identified when the regime was established and with current market practice, to the extent that some of the benefits associated with a vetting and approval systems outlined in the original approved persons CP could now be realised in relation to UK branches of third country firms as well.

## **Extending the rule obliging firms to provide references for applicants of the CF30 to all controlled functions**

### **Costs**

Compliance costs – Costs will arise when firms, seeking an external candidate for a controlled function, ask the applicant's previous firm for a reference. The cost has been based on the hourly rate for a compliance officer spending thirty minutes in preparing the required reference. Using the hourly rates in the 'RealAssurance: Estimation of FSA Administrative Burdens' (June 2006) we estimate the cost to prepare each reference is £40. We receive approximately 10,000 applications each year seeking approval for a significant influence controlled function, if all firms request a reference as a result of this proposal the total estimated cost to the industry

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13 This will not include the proposed extension to CF1 and CF2 contained in chapter 3 of this consultation paper

14 Approximately 80 third country firms have branches which operate in the UK. Based on the new policy we anticipate that all 80 firms may need to apply for one CF1 (director) and approximately 40 may need to apply for one CF2 (non-executive director)

is £400,000 (this is based on an hourly rate of £81.25<sup>15</sup> for a compliance officer in a large firm spending thirty minutes in preparing a reference) However, the cost will only be incurred for those firms if they use the option of requesting the reference, as it is not mandatory to request a reference. In addition, there will be costs to the firms associated with the (unavoidable) delay in obtaining the references.

## **Benefits**

The aim of the proposal is to allow firms to access relevant information on their new employees to assist them in assessing fitness and propriety. However, the incremental benefits of this proposal will depend on how effective those references<sup>16</sup> are in shedding light on candidates' suitability for the proposed controlled functions.

## **Compatibility statement**

### **Introduction**

As required under Sections 155 and 157 of FSMA, here we set out how our proposals in this CP are compatible with our general duties under section 2 of FSMA and the regulatory objectives set out in sections 3-6 of FSMA. We also outline how our proposals are consistent with our principles of good regulation to which we must have regard.

### **a) Our statutory objectives**

#### **Market confidence**

We expect our proposals to have a positive impact on market confidence by reinforcing senior management responsibilities, ensuring firms continue to have robust internal governance that reflects the reality of how they are governed and have access to information to assist them in assessing fitness and propriety. Ensuring that individuals who exercise a significant influence are approved persons may reduce the risk that unapproved individuals will damage market confidence.

#### **Consumer protection**

Our proposals are designed to ensure that the most appropriate individuals who are exercising a significant influence on an authorised firm are included in the approved persons regime. Consumers are in a poor position to assess the competence of individuals within firms but the authorised firm would assess the competence and suitability of individuals exercising significant influence over it when applying for approval for that individual. Therefore consumers will indirectly benefit from these proposals, although they may bear some if not all of the costs associated with these proposals.

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15 Based on RealAssurance; Estimation of FSA Administrative Burdens (June 2006) – hourly rate for a senior manager in a large firm (£62.50 plus 30% overheads = £81.25 per hour)

16 This will include information based on the fit and proper criteria included in the FIT handbook

## **Financial crime**

Our proposals are designed to assess the suitability of a candidate and their fitness and propriety to perform a controlled function. This may help reduce the risk of unsuitable individuals exercising a significant influence over UK authorised firms for the purposes of financial crime.

## **Public awareness**

Our proposals will only contribute in a minor way to meeting this objective.

## **b) Principles of good regulation**

Section 2(3) of FSMA requires us to consider certain principles when carrying out our general functions. We set out below how our approach supports these principles.

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

We will process more applications as a result of these proposals but with the expectation that supervisors will be more confident about corporate governance arrangements in their firms.

While it is not clear that had all proprietary traders been included in the approved persons regime, as proposed at the start of the regime, that rogue trader incidents would have been prevented, the proposal (on proprietary traders) may lead to more compliant behaviours for some traders with better information and awareness of sanctions that can apply to them.

### **The responsibilities of those who manage the affairs of authorised persons**

We are required to take account of the responsibilities of those who manage the affairs of firms, and the proposed changes would bring persons who are employed by or who have a significant influence on their firm's affairs within the scope of our regulation. Our proposal to extend the use of references will enable firms to request specific information to assist their fit and proper assessment of a candidate.

### **The restrictions we impose on the industry must be proportionate to the benefits that are expected to result from those restrictions**

The extent of benefits from these proposals will depend heavily on the effectiveness of the approved persons regime. In particular, (1) the benefits of the proposal of extending the definition of CF29 controlled function will depend on the extent to which it can effectively stop potentially rogue traders from entering the financial system, the extent to which the additional sanction of a fine can effectively deter traders from taking on excessive and unauthorised risk, and the extent to which better information and awareness on sanctions could lead to more compliant behaviours among traders. (2) the benefits of extending the rule obliging firms to provide reference for applicants will depend on how effective these references are in shedding lights on candidates' suitability.

## **The desirability of facilitating innovation in connection with regulated activities**

We do not believe our proposals will restrict innovation.

## **The international character of financial services and markets and the desirability of maintaining the competitive position of the UK**

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

## **The need to minimise the adverse effects on competition that may arise from our activities and the desirability of facilitating competition between the firms we regulate**

In respect to our proposals to extend the definitions of CF1 and CF2 and amend the application of the approved persons regime to UK branches of third country firms we do not think that including individuals, based outside of UK authorised firms who exercise significant influence on UK branch of the third country firm, under the approved persons regime will have an adverse effect on competition. The proposals are designed to reflect the actual nature of corporate governance structures rather than enforce a change in those structures.

In respect to our proposal on proprietary traders, there may be some effect on competition due to the Single Market Directives. It is difficult for us to apply any of these proposals to individuals in incoming EEA firms or to their parent undertaking/holding company as competence is considered a matter for the Home State.

## **Acting in a way which we consider most appropriate for the purpose of meeting our statutory objectives**

These proposals are designed to identify those individuals who exercise a significant influence on an authorised firm and to ensure they are appropriately caught by the approved persons regime. While we recognise that some of these risks could be effectively mitigated through better systems and controls, we also consider the approved persons regime an effective tool in setting a consistent standard of fitness and propriety at approval stage, throughout the period of approved person status and ultimately provide us with the means to take action against an individual when necessary.



# Annex 2 – list of questions in this consultation

- Q1: Do you agree with our proposal to extend controlled functions CF1 (director) and CF2 (non-executive director) to those individuals exercising significant influence?
- Q2: Do you agree that a transitional period of 6 months is sufficient for implementation?
- Q3: Do you agree with our proposed guidance to the Handbook that clarifies the role of non-executive directors?
- Q4: Do you agree with our proposal to extend the description of CF29 to include more proprietary traders?
- Q5: Do you agree with our judgement that the proposed guidance in the draft handbook text (Appendix 1) supports the expectation that all proprietary traders will be approved persons?
- Q6: What are your views on the outcome of the cost benefit analysis compared to other reasons why we might implement this proposal?
- Q7: Do you agree that a transitional period of six months is sufficient for implementation?
- Q8: Do you agree that we should remove the limited application of the approved persons regime to UK branches of third country firms?
- Q9: Do you agree that we should extend the reference requirement in SUP 10.13.12R so it applies to all controlled functions?



# Draft Instrument

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

**Powers Exercised**

- A. The Financial Services Authority makes this instrument in the exercise of:
- (1) the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
    - (a) section 59 (Approval for particular arrangements);
    - (b) section 64 (Conduct: statements and codes);
    - (c) section 138 (General rule-making power);
    - (d) section 139 (Miscellaneous ancillary matters);
    - (e) section 156 (General supplementary powers); and
    - (f) section 157(1) (Guidance); and
  - (2) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.
- B. The rule-making powers referred to above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

**Commencement**

- C. This instrument comes into force [one month after the date of approval by the Board of the FSA].

**Amendments to the Handbook**

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

(1)	(2)
Glossary of definitions	Annex A
Statements of Principle and Code of Practice for Approved Persons (APER)	Annex B
Supervision manual (SUP)	Annex C

**Citation**

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

By order of the Board  
[                    ]

## Annex A

### Amendments to the Glossary of definitions

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

...

proprietary  
trader

a person whose responsibilities include committing a firm as part of the firm's proprietary trading namely dealing in investments as principal as part of a proprietary business of the firm of trading in specified investments.

For these purposes dealing in investments as principal includes any activities that would be included but for the exclusion in Article 15 (Absence of holding out) or Article 16 (Dealing in contractually based investments) of the Regulated Activities Order.

...

required function

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

...

## Annex B

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

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

#### 4 Code of Practice for Approved Persons: specific

##### 4.6 Statement of Principle 6

...

Continuing responsibilities where an issue has been delegated

...

4.6.15 G (1) An approved person performing the role of a non-executive director should seek to establish and continually maintain his confidence in the:

(a) conduct of the firm;

(b) performance of senior management;

(c) development of the firm's business strategy;

(d) adequacy of financial controls;

(e) risk management;

(f) appropriateness of remuneration;

(g) appointment and replacement of key personnel; and

(h) plans for management development and succession.

(2) An approved person performing the role of a non-executive director should provide an independent perspective, and should constructively challenge and help develop proposals on strategy.

(3) An approved person performing the role of a non-executive director should scrutinise the performance and approach of senior managers in meeting agreed goals, objectives, and standards of conduct.

...

**4.7 Statement of Principle 7**

...

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

...

4.7.11A E Where the *approved person* is a *proprietary trader* under *SUP* 10.9.1.2R, failing to maintain and comply with appropriate systems and controls in relation to that activity falls within *APER* 4.7.2E.

...

## Annex C

### Amendments to the Supervision manual (SUP)

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

#### 10.1 Application

...

Overseas firms: UK establishments

- 10.1.7 R Only the following *controlled functions* apply to an *overseas firm* which maintains an establishment in the *United Kingdom* from which *regulated activities* are carried on:
- (1) ~~the chief executive function~~ the director function where the person performing that function has responsibility for the regulated activities of a UK branch which are likely to enable him to exercise significant influence over that branch;
  - (2) ~~the required functions~~ the non-executive director function where the person performing that function has responsibility for a UK branch which is likely to enable him to exercise significant influence over that branch;
  - (3) ~~the significant management function~~ in so far as the function relates to:
    - (a) ~~designated investment business other than dealing in investments as principal, disregarding article 15 of the Regulated Activities Order; or~~
    - (b) processing confirmations, payments, settlements, insurance claims, client money and similar matters in so far as this relates to designated investment business; and the chief executive function;
  - (4) ~~{deleted}~~ the required functions;
  - (5) ~~the customer function~~ the significant management function in so far as the function relates to:
    - (a) designated investment business other than dealing in investments as principal, disregarding article 15 of the Regulated Activities Order; or
    - (b) processing confirmations, payments, settlements, insurance claims, client money and similar matters in so far as this relates to designated investment business; and
  - (6) the customer function.

...

- 10.4.5 R Controlled functions

....

Type	CF	Description of controlled function
...		
	28	{to follow }
	29	{to follow }

...

What the governing functions include

10.6.2 R Each of the *governing functions* (other than the *non-executive director function and the function described in SUP 10.6.4R(2)*) includes where apportioned under SYSC 2.1.1R or SYSC 4.3.1R and SYSC 4.4.3R:

...

10.6.3 G The effect of SUP 10.6.2R is that a *person* who is *approved* to perform a *governing function* (other than the *non-executive function and the function described in SUP 10.6.4R(2)*) will not have to be specifically approved to perform the *systems and controls function* or the *significant management function*. A *person* who is *approved* to perform a *governing function* will have to be additionally approved before he can perform any of the *required functions* or the *customer function*.

...

Director function (CF1)

10.6.4 R If a *firm* is a *body corporate* (other than a *limited liability partnership*), the *director function* is the function of acting in the capacity of either a:

- (1) *director* (other than *non-executive director*) of that *firm*; or
- (2) *director* (other than a *non-executive director*) or *senior manager* of a *parent undertaking* or *holding company* (except where that *parent undertaking* or *holding company* is an *EEA firm*) and whose *decisions, opinions, or actions* are regularly taken into account by the *governing body* of the *firm*.

10.6.5 G ~~{deleted}~~ Examples of where SUP 10.6.4R(2) would apply include (but are not limited to):

- (1) a *chairman* of an *audit committee* of a *parent undertaking* or *holding company* of a *UK firm* where that *audit committee* is working for that *UK firm* (that is, functioning as the *audit committee* for the *group*);
- (2) a *director* (other than a *non-executive director*) of a *parent undertaking* or *holding company* of a *UK firm* exercising significant influence by way of his involvement in taking decisions for that *UK firm*;

- (3) an individual (such as a *senior manager*) of a *parent undertaking* or *holding company* of a *UK firm* who is responsible for and/or has significant influence in setting the objectives for and the remuneration of executive *directors* of that *UK firm*;
- (4) an individual who is a *director* (other than a *non-executive director*) or a *senior manager* of a *parent undertaking* or *holding company* of a *UK firm* who is accustomed to influencing the operations of that *UK firm*, and acts in such a manner that it can reasonably be expected that a executive *director* or *senior manager* of that *UK firm*; or
- (5) an individual of an *overseas firm* which maintains an establishment in the *United Kingdom* from which *regulated activities* are carried on where that individual has responsibilities for those *regulated activities* which are likely to enable him to exercise significant influence over the *UK branch*.

...

#### Non-executive director function (CF2)

- 10.6.8 R (1) If a *firm* is a *body corporate*, the *non-executive director function* is the function of acting in the capacity of either a:
- (a) *non-executive director* of that *firm*; or
  - (b) *non-executive director* of a *parent undertaking* or *holding company* (except where that *parent undertaking* or *holding company* is an *EEA firm*) whose decisions, opinions or actions are regularly taken into account by the *governing body* of the *firm*.

...

- 10.6.9 G ~~{deleted}~~ Examples of where SUP 10.6.8R(1)(b) would apply include (but are not limited to):
- (1) an individual employed by a *parent undertaking* or *holding company* who takes an active role in the running of the business of a *UK firm*, for example, as a member of a board or committee (on audit or remuneration) of that *firm*;
  - (2) an individual employed by a *parent undertaking* or *holding company* having significant influence in setting and monitoring the business strategy of the *UK firm*;
  - (3) an individual employed by a *parent undertaking* or *holding company* of a *UK firm* involved in carrying out responsibilities such as scrutinising the approach of executive management, performance, or standards of conduct of the *UK firm*;
  - (4) an individual who is a *non-executive director* of a *parent undertaking* or *holding company* of a *UK firm* who is accustomed to influencing the operations of the *UK firm*, and acts in a way that it can reasonably be expected that a *non-executive director* of the *UK firm* would act; or

- (5) an individual of an overseas firm which maintains a branch in the United Kingdom from which regulated activities are carried on where that individual has responsibilities for those regulated activities which are likely to enable him to exercise significant influence over the UK branch.

...

## 10.9 Significant management functions

Application

- 10.9.1 R *SUP* 10.9 applies only to a *firm* which:
- (1) apportions a significant responsibility, within the description of the *significant management function*, to a *senior manager* of a significant business unit; or
  - (2) undertakes proprietary trading.
- 10.9.1A R (1) For the purposes of *SUP* 10.9.1R(2), proprietary trading means dealing in investments as principal as part of a proprietary business of the firm of trading in specified investments.
- (2) For these purposes dealing in investments as principal includes any activities that would be included but for the exclusion in Article 15 (Absence of holding out) or Article 16 (Dealing in contractually based investments) of the Regulated Activities Order.
- 10.9.2 G The *FSA* anticipates that there will be only a few *firms* needing to seek approval for an individual to perform the *significant management function* set out in *SUP* 10.9.1R(1). In most *firms*, those approved for the *governing functions*, *required functions* and, where appropriate, the *systems and controls function*, are likely to exercise all the significant influence at senior management level.
- 10.9.2A G A proprietary trader undertakes activities with the firm's money and has the ability to commit the firm. By virtue of this role, all proprietary traders have potential to be able to exercise significant influence on the firm for the purposes of section 59 (4) and (5) of FSMA. It is the FSA's expectation that firms will need to seek approval for all the firm's proprietary traders.
- 10.9.3 G ~~However, the~~ The scale, nature and complexity of the *firm's* business may be such that a *firm* apportions under *SUP* 10.9.1R(1) a significant responsibility to an individual who is not approved to perform the *governing functions*, *required functions* or, where appropriate, the *systems and controls function*. ...
- ...
- 10.9.5 G The question may arise whether a manager who is based overseas will be performing the *significant management function* under *SUP* 10.9.1R(1) and should therefore be an *approved person*. This is especially true where the *firm* operates matrix management. The fact there is a *person* performing the *apportionment and oversight function*, and who has responsibility for activities subject to regulation by the *FSA*, may have a bearing on this. It is a

factor to take into account when assessing the likely influence of the overseas manager.

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

...

#### Significant management function (CF29)

- 10.9.10 R (1) The *significant management function* under SUP 10.9.1R(1) is the function of acting as a *senior manager* with significant responsibility for a significant business unit that:
- (a) carries on *designated investment business* or other activities not falling within (b) – to (d);
  - (b) *effects contracts of insurance* (other than *contractually based investments*);
  - (c) makes material decisions on the commitment of a *firm's* financial resources, its financial commitments, its assets acquisitions, its liability management and its overall cash and capital planning;
  - (d) processes confirmations, payments, settlements, insurance claims, *client money* and similar matters.
- (1A) The significant management function also includes the function of committing the firm as part of its proprietary trading activities as defined in SUP 10.9.1R(2).
- (2) This *controlled function* does not include any of the activities described in any other *controlled function*.
- 10.9.10A G A *senior manager* carrying on the significant management function under SUP 10.9.1R(1) with significant responsibility for a significant business unit that carries on activities other than *designated investment business* for the purposes of SUP 10.9.10R(1)(a) could, for example, be the head of a unit carrying on the activities of: retail banking, personal lending, corporate lending, salvage or loan recovery, or proprietary trading; or a member of a committee (that is, a *person* who, together with others, has authority to commit the *firm*) making decisions in these functions. ~~The senior manager could also be a proprietary trader whose trading limits are such that he may put, or potentially put, his firm at significant risk. This function would not extend to every proprietary trader.~~
- 10.9.10B G A proprietary trader also undertakes activities which may have a significant influence on the firm. Such activities will require approval for CF29 under SUP 10.9.1R(2).

...

Who should make the application?

- 10.12.3 G (1) In accordance with section 60 of the *Act* (Applications for approval), applications must be submitted by, or on behalf of, the *firm* itself, not by:
- (a) the *candidate*;
  - (b) any parent undertaking or holding company where the candidate would be performing a controlled function for a UK firm Kingdom and is employed by a parent undertaking or holding company; or
  - (c) any group company where the candidate is a director or senior manager or non-executive director employed by that group company and would be performing a controlled function for a another group company which is a UK firm.
- (2) Usually this will be the *firm* that is employing the *candidate* to perform the *controlled function*. Where a *firm* has outsourced the performance of a *controlled function*, the details of the outsourcing determine where responsibility lies and whom the *FSA* anticipates will submit *approved persons application* forms. *SUP* 10.12.4G describes some common situations. The *firm* which is outsourcing is referred to as “A” and the *person* to whom the performance of the ~~function~~ *controlled function* has been outsourced, or which makes the *arrangement* for the ~~function~~ *controlled function* to be performed, is referred to as “B”. In each situation, A must take reasonable care to ensure that, in accordance with section 59(2) of the *Act*, no *person* performs a *controlled function* under an *arrangement* entered into by its contractor in relation to the carrying on by A of a *regulated activity*, without approval from the *FSA*. See also *SYSC* 3.2.4G and *SYSC* 8.1.1R, and for *insurers* *SYSC* 13.9.

...

Ceasing to perform a controlled function

- 10.13.12 R (1) If a *firm* (A):
- (a) is considering appointing a *person* to perform any of the ~~customer~~ *controlled functions*;
  - (b) requests another *firm* (B), as a former *employer* of that *person*, for a reference or other information in connection with that appointment; and
  - (c) indicates to B the purpose of the request;

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

...

TP 1 Transitional provisions

...

TP1.2

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...					
8E	<u>SUP 10.6.4R(2)</u>	<u>R</u>	<u>(1) This rule deals with a person (a “director”) who would otherwise have been performing the director function for a firm under SUP 10.6.4R(2) on [Date instrument comes into force] but who was not otherwise performing the director function for that firm at that date. This rule only applies if he was not approved at that date to perform the director function for that firm.</u>	<u>[Date instrument comes into force] – [5 months later]</u>	<u>[5 months after comes into force]</u>
			<u>(2) If an application is made for the director to perform the director function for that firm at any time between [Date instrument comes into force] and the date in column (6), the functions described in SUP 10.6.4R(2) are not treated as forming part of the director function as respects that firm unless they also fall under SUP 10.6.4.R(1).</u>		
			<u>(3) If this transitional rule has not already expired under column (5), this rule comes to an end as respects that director and that firm if and when that application is granted.</u>		

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

			<p><u>(2) If an application is made for the proprietary trader to perform the significant management function for that firm at any time between [Date instrument comes into force] and the date in column (6), the functions described in SUP 10.9.1R(2) are not treated as forming part of the significant management function as respects that firm unless they also fall under SUP 10.9.1R(1).</u></p>		
			<p><u>(3) If this transitional rule has not already expired under column (5), this rule comes to an end as respects that proprietary trader and that firm if and when that application is granted.</u></p>		
...					

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

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