



Corporate Governance and Changes to Approved Persons Roles

Introduction

The FSA issued a Policy Statement in September 2010 (PS10/15) giving feedback on consultation on Effective Corporate Governance following the Walker Review and proposals on changes to approved persons roles in a previous consultation paper CP10/03 issued in January 2010.

As an overview, the FSA is introducing a new framework for Significant Influence approved persons including six new governing functions, 3 new systems and controls functions and narrower controlled functions (CF's) for directors and general non-executive directors.

The policy statement also provides guidance on other related areas including:

- Guidance to non-executive directors on the responsibilities of the role including resources
- Setting out the FSA's current approach to interviewing candidates for approval under its intrusive approach
- Guidance on appropriate risk management corporate governance

This briefing paper provides a summary of changes to the approved persons roles from 1 May 2011. It is general advice, not firm specific and provides only a summary of the issues involved. For firm specific guidance on Significant Influence Functions, please contact Gillian Gallacher for further assistance.

A summary of the FSA's current approach to interviewing candidates for approval is covered in a separate briefing paper entitled Significant Influence Functions ('SIF') applications – FSA's current approach. This can be accessed by pasting the following link in your browser:
<http://www.gemcompliance.com/library/topics/SIF.html>

A summary of the feedback on Risk Management corporate governance including the introduction of a new SYSC chapter (SYSC 21) will also be detailed in a separate briefing paper due later this month.

Background

Any individual who exercises significant influence on an authorised firm is likely to be carrying out a Significant Influence Function ('SIF') and must be approved by the FSA before doing so. Disciplinary action may be taken against individuals and/or firms where an individual exercises influence without prior approval.

Each significant influence function is one which is likely to result in the person responsible for its performance exercising a significant influence on the conduct of a firm's affairs, so far as relating to a regulated activity of the firm. Different types of controlled functions exist for



different types of significant influence.

General Guidance

PS10/15 confirms that these changes will be implemented from 1 May 2011. They are intended to improve effective corporate governance and risk management. It is the firm's responsibility to ensure that individuals for SIF roles are competent, both at application and ongoing. The FSA will increasingly use ARROW visits to assess this, both of individuals and of the governing body as a whole.

The new roles are not mandatory roles for all firms. Individuals will only be required to be approved for the specific controlled function if firms consider individuals are performing these roles. This will depend upon the nature, scale and complexity of each firm. Where these roles or functions do not yet exist, firms may wish to consider whether they should exist in future. Firms may wish to discuss this further with their normal FSA supervisory contacts.

It is not prohibited for more than one person to perform a role. However in general the FSA expects only senior individuals need to be approved. This should be proportionate and it should be clear who is accountable for relevant responsibilities.

CF2 – Non-Executive Directors

Anyone who is appointed as a Non-Executive Director (NED) of an authorised firm must be approved for the controlled function of CF2. In future, where the individual performs any of the following specific roles, he/she will require additional approval for one of 5 new functions.

The new roles are as follows:

- Chairman – CF2a
- Senior independent director – CF2b
- Chairman of risk committee – CF2c
- Chairman of audit committee – CF2d
- Chairman of remuneration committee – CF2e

Additional points to note:

- There is no specific rule to say that executive directors cannot perform any of these roles. However by nature of the responsibilities expected, the FSA will normally only expect to see a non-executive director approved for roles CF2a to e.
- The FSA had considered deleting relevant guidance within SYSC regarding the responsibilities of NED's in relation to potential disciplinary action. However due to concerns raised at consultation whether this would increase the liabilities of NED's, guidance has remained (predominately at SYSC 4) although the wording has been amended.
- The FSA also considers that NEDs must be able to commit appropriate resources to any such appointment. New guidance at FIT (2.2.1) covers this and also that the FSA may review the firm's process in assessing this.



CF28 - Systems and Controls

The FSA is splitting the existing CF28 systems and controls function into three distinct functions of:

- CF13 - Finance
- CF14 – Risk
- CF15 – Internal Audit

Where an individual is already approved for the CF28 role, the FSA expects that person to be approved for one of the above three roles. Where firms have specific persons responsible for these functions, individuals must be separately approved for the new roles from May 2011. This is regardless of whether the individual is already approved for an existing governing function including CF1. The FSA consider that even though an individual may have already been approved for a governing function, this does not necessarily mean that they have the pre-requisite capability, skill, knowledge and experience to hold the specific roles and responsibilities detailed above.

Where an individual is approved for the CF15 role, due to the nature and responsibilities of the internal audit role, that person should not be approved for any other governing function to ensure independence.

The FSA has confirmed that it will expect internal people to be approved for these roles even if the work itself is outsourced to a third party.

CF29 – Significant Management Influence

This role has not changed in that anyone who is performing a governing function is also by definition performing the CF 29 role. Therefore only individuals who are performing this role and who are not approved for a governing function need to be separately approved for this role.

However the definition of the types of roles that are covered by this function has changed and will now include such senior managers of UK branches of incoming EEA banks accepting retail deposits.

CF00 – Parent Company Influence

From 6 August 2009, a revised definition of the existing CF1 (Director) role introduced the requirement that any 'directors or senior managers of parent or holding companies whose decisions or actions are regularly taken into account by the firm' should be individually approved. This requirement continues, however a new separate controlled function of CF00 has been created for this role from May 2011.

The policy statement also gives guidance on how this applies in practice, for example in group structures where a number of firms may be FSA authorised including the parent company itself or matrix management styles. This is by way of a new Questions and Answers section in the revised rules to be implemented at SUP 10 Annex 9.



The scope of application of CF00 has also increased. To date, it did not cover partnerships nor parent companies which was itself an FSA regulated firm. PS10/15 eliminates these exemptions and the requirement for CF00 will apply to all UK authorised firms regardless of corporate structure and regardless of whether the parent company is FSA regulated.

CF 1 – Directors

As a result of these changes, the scope of CF1 will be reduced to only include directors of the firm.

Implementation timetable

The new rules will be implemented with effect from 1 May 2011. There will be transitional arrangements for between 3 – 12 months depending upon the circumstances. In some situations, firms will be able to make notifications of the required changes rather than new applications.

As a general summary, for anyone performing roles covered by PS10/15, the changes will be implemented as follows:

- For individuals who are already SIF approved persons and are performing the new roles, notifications must be made between 1 May and 31 July 2011.
- For any individuals who are SIF approved persons, but will need to be separately approved for CF13 – CF15, in general applications for approval must be made between 1 May and 31 July 2011 (longer transition rules may apply in some circumstances).
- For any individuals who are not yet SIF approved persons but perform the new roles, applications for approval must be completed between 1 May and 31 October 2011.

All notifications and applications must be submitted via the FSA's Online Notifications and Applications system (ONA).

Next Steps

All firms should review (and evidence this review of) their existing corporate governance arrangements and structure. This review should identify who may be exerting significant influence over the firm and as a priority, must:

- Consider whether any individual is currently performing the parent company influence role (as currently defined under CF1) and if so, ensure that he/she is now approved, (an existing requirement from August 2009).
- Consider whether any individual will be performing the parent company influence role under the revised scope from 1 May 2011, and is so prepare for notifications for CF00 from 1 May 2011.
- Review their non-executive director appointments, identify which, if any, of the firm's existing CF2's are performing the new roles of CF2a – e and prepare for notifications from 1 May 2011.

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- Review the firm's systems and controls arrangements, identify who may be performing any of the roles of CF13 – CF15 as defined by PS10/15 and prepare for applications from 1 May 2011.

Where changes are required, firms should allow sufficient time in advance of the relevant deadline to ensure that any applications or notifications are considered by the FSA in sufficient time. Firms should bear in mind the likely increase in workload for the FSA that will occur during that time.

For further assistance on reviewing the firm's corporate governance structure and SIF roles, please contact Gillian Gallacher.