



Key Contact

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“Firms can opt in to the common platform requirements at any time up to 1 November”

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SYSTEMS AND CONTROLS REQUIREMENTS: THE “COMMON PLATFORM”

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Overview

The FSA have introduced new rules on Systems and Controls which arise from requirements in the Capital Requirements Directive (CRD) and the Markets in Financial Instruments Directive (MiFID). The FSA’s approach is to combine the requirements, wherever possible, into the so called “common platform” which will apply to firms subject to either or both Directives. This note seeks to identify some key changes and areas where firms may need to take action in order to comply with the new rules.

The requirements arising from the CRD, which came into force in force from 1st January this year, have been incorporated within the existing SYSC rules in Chapter 3 of the Handbook. The MiFID requirements come into force on 1st November 2007 and the FSA’s common platform rules will be effective from that date. The FSA has made a transitional rule allowing firms to opt into the common platform rules at any time up until 1st November, provided they record their decision to do so and the effective date. Existing Chapter 3 rules will continue to apply to firms who are not subject to either directive, although the FSA will be consulting on introducing the common platform model for all firms (except insurers) in due course.

Key Changes and Actions

Whilst the new rules introduce potentially onerous new requirements, those requirements are intended to be proportionate to the nature, scale and complexity of a firm’s business. FSA continue to place emphasis on senior management to decide what is appropriate and proportionate given the size and complexity of the firm’s operations. The following are areas where firms may need to review their arrangements and take action to ensure they remain compliant.

General Organisational Requirements

The provisions here are similar to the high level systems and controls requirements in the current FSA Handbook. However, within the detailed rules there is a higher level of formality in terms of recording, documenting and reporting on systems and controls. This chapter includes requirements relating to business continuity which provide that firms must have a policy and prescribes the contents of that policy. Firms will need to review their high level arrangements to ensure they are compliant with the new requirements and can evidence their business continuity policy.

Employees and Agents

There is a new requirement that firms’ “relevant persons” (anyone acting on behalf of the firm and involved in providing services which are regulated activities) are aware of the procedures to be followed to do their jobs properly. This will entail a greater level of formality as to how firms inform and update their staff about internal procedures.

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Compliance (including internal audit)

The key requirement here is for an independent compliance function. This is softened by the proportionality test but it is nevertheless clear that the compliance function, although it may not be fully independent, must operate independently when undertaking compliance activities. Emphasis is placed on monitoring the effectiveness of compliance and the importance of following up identified deficiencies. There is a higher burden than under present SYSC as the requirement arising from MiFID is to “ensure compliance” with obligations under the regulatory system, rather than to take “reasonable care” to establish and maintain effective systems and controls for compliance. This chapter also places specific emphasis on measures aimed at prevention of financial crime including money laundering and the requirement to assess risks.

Risk Control

In this area, the current rules are primarily detailed guidance which will be replaced by high level rules. The key new requirement is for firms to establish adequate risk management policies and procedures which identify and set risk levels relating to their activities. Firms may be required to have a separate risk control function where proportionate to the business and will need to review their business and current arrangements to ensure they have adequate risk assessment procedures and controls.

Outsourcing

The new rules introduce new concepts of ‘critical’ and ‘important’ functions. The FSA has resisted some calls for further guidance on those definitions and placed emphasis on firms’ senior management deciding upon the critical and important functions of their business. The essential message is that firms need to exercise due care in outsourcing arrangements, including those for bringing outsourced functions back in house. Any outsourcing must not materially impair the quality of the firm’s internal controls or the FSA’s ability to carry out its supervisory activities. Firms with outsourced functions should review their arrangements in the light of the new requirements.

Conflicts of Interest

The key requirement is for a written policy which will now apply to all classes of customer (market counterparties have previously been excluded). Under the new regime disclosure can only be used as a means of managing conflict as a “last resort” where the firm is not reasonably confident that its procedures and measures for managing the conflict or potential conflict will prevent risk of damage to the interests of its clients. Again the concept of proportionality is important and FSA acknowledge that often in practice a combination of management and disclosure will be appropriate. All firms will need to have a written policy in place and to consider how they identify and manage conflicts within their business.

Next steps

The new rules are lengthy and contain considerable guidance. The work required to implement the new requirements will be dependent upon individual firms’ current systems and controls architecture. What is clear is that the common platform requirements will lead to an increased focus on high level systems and controls by the FSA. Accordingly, the importance of having a robust, wide ranging and seamless systems and controls architecture cannot be underestimated.

If you require assistance with any aspect of implementation of the new rules or in relation to reviewing the effectiveness or completeness of existing arrangements, please get in touch.