



Key Contact

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“... nine additional significant influence controlled functions will be introduced...”

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EFFECTIVE CORPORATE GOVERNANCE (FSA CONSULTATION PAPER 10/3)

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Overview

CP 10/3 demonstrates the greater emphasis now placed by the FSA on the role of senior management in firms. The proposals in it are intended to implement recommendations in Sir David Walker’s review of corporate governance, which included encouraging listed banks and insurers to establish board risk committees. Proposed changes to the approved persons regime may apply to regulated firms of all sizes.

Nine Additional Controlled Functions

Nine additional significant influence controlled functions will be introduced, providing more “granularity”. By more clearly identifying an individual’s role, the FSA will increase their ability to vet them and track changes to responsibilities. The functions being added are: chairman (CF2a); senior independent director (CF2b); chairman of risk committee (CF2c); chairman of audit committee (CF2d); chairman of remuneration committee (CF2e); parent entity significant influence function (CF00); finance function (CF13); risk function (CF14); and internal audit function (CF15). The first six will be populated by individuals currently registered as a director (CF1) or non-executive director (CF2). The last three will be populated by individuals currently registered for systems and controls (CF28) – which will disappear.

Finance, Risk and Internal Audit Functions

For the new finance, risk and internal audit functions, the FSA envisage a firm submitting a notification form reallocating individuals from CF28. A timescale of three months is anticipated. If an individual with a governing controlled function is currently also undertaking a systems and controls role that requires relevant “specific technical competences”, the FSA propose to require a parallel registration under the finance, risk or internal audit functions. Recognising that such combined responsibilities are more likely in smaller firms, the FSA will generally allow them twelve months to obtain approval.

Parent Entity Significant Influence Function

Firms switching existing CF1 and CF2 individuals to the new parent entity significant influence function will be permitted a similar time frame and notification form. However, the criteria for the parent entity significant influence function will also be extended to include individuals from within a parent undertaking or holding company of an LLP or a non-body corporate, plus individuals where the parent is itself FSA-authorized. The transitional period for anybody falling under these provisions will be six months, with a Long Form A required.

Governing Functions (and Significant Management Function)

For individuals performing activities that come under the other five new governing functions, again there will be a three-month period for notification. Where this person is a director, it appears their existing controlled function may continue alongside any additional one. If a UK Branch of an incoming EEA firm accepts retail deposits, the FSA

are proposing to extend the significant management function (CF29) to cover applicable individuals. This will not include anybody whose role relates solely to activities undertaken within the home state.

Six Key Competences

While the transitional arrangements are intended to minimise the short-term impact of the changes, the FSA will be assessing the continuing capability of individuals to perform the new controlled functions as part of what is a “more intrusive supervisory approach”. There will be six key competences for assessing significant influence function candidates: market knowledge; business strategy and model; risk management and control; financial analysis and controls; governance, oversight and controls; and regulatory framework and requirements.

In determining the level of competence required, the FSA may consider the knowledge, skills and experience of other team members. They will also look at a candidate’s non-technical skills and behaviours, particularly their ability to deliver “effective governance” and willingness to work with the FSA in an open and cooperative way. The firm will be expected to have observed its statutory duties regarding equal pay and non-discrimination.

Interviews

The FSA already interview senior management candidates, and 25 have withdrawn from the application process since their approach changed. A firm should establish clearly the time commitment required of an individual and this, in the light of their other commitments, together with the person’s motivation and own due diligence will be discussed. The FSA will also take more interest in the firm’s due diligence process, and possibly meet representatives such as the chairman of the nomination committee to obtain more insight into this.

The possibility of a firm asking the FSA at an early stage for information on “adverse indicators” held in otherwise inaccessible information sources such as overseas regulators is mentioned, particularly if an individual’s background is “opaque or complex” or the appointment is sensitive or urgent. The FSA will not normally permit a candidate to be accompanied at interview by another individual from the firm. The FSA intend to develop a programme of briefings on regulatory matters to keep those undertaking significant influence functions up-to-date with their concerns and expectations.

Liability of Non-Executive Directors

SYSC contains limitations on the liability of non-executive directors, which the FSA propose to delete. The intention is not to take action in future against a person for matters clearly falling outside the scope of their responsibilities. However, the FSA are concerned about present guidance being misinterpreted, and want to emphasise instead the broad responsibilities of the non-executive director role. In particular, there is an expectation individuals undertaking it should intervene and challenge a firm’s executives where they appear to have persistently made poor decisions.

Other Issues Raised

The FSA have used this Consultation Paper to flag up other changes. They are seeking to curtail the ability of firms not to disclose information on departing individuals because of confidentiality clauses in “compromise agreements”. They have also promised to provide more clarity in a separate consultation about their interpretation of the expression “acting in concert”. This is mentioned in the context of implementing Walker review recommendations - the subject of a separate Annex plus three questions on which feedback is specifically sought. There will be a further Consultation Paper considering proposals for a protection of client assets controlled function and a further controlled function simply described as “a new senior role” – the Business Resolution Officer.

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