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FSA Confirms Extension of the Approved Persons Regime to Certain Directors and Employees of Parent Entities

The UK Financial Services Authority recently published new rules relating to the approved persons regime. The new rules extend the definition of the existing CF1 (director function) and CF2 (non-executive director function) designations to include directors, partners, officers, members (in the case of LLPs), senior managers and employees of a non-EU regulated parent undertaking or holding company of an FSA authorised firm if their decisions or actions are regularly taken into account by the governing body of the FSA authorised firm. The effect of this action is that those persons will need to apply to the FSA for approved person status, make declarations to the FSA as to their employment history and regulatory record and will be subject to the FSA's rules relating to approved persons.

Introduction and Summary

The UK Financial Services Authority ("FSA") published Policy Statement PS09/14: The approved persons regime - significant influence function review (the "Policy Statement") on 27 July 2009 in which it sets out feedback on its December 2008 Consultation Paper CP08/25, and final amended rules.

The new rules, which came into effect on 6 August 2009, extend the definition of the existing CF1 (director function) and CF2 (non-executive director ("NED") function) designations to include directors, partners, officers, members (in the case of LLPs), senior managers and employees of a non-EU regulated parent undertaking or holding company of an FSA authorised firm if their decisions or actions are regularly taken into account by the governing body of the FSA authorised firm.

The effect of this action is that those persons will need to apply to the FSA for approved person status, make declarations to the FSA as to their employment history and regulatory record and will be subject to the FSA's rules relating to approved persons.

If a person was not registered as a CF1 or CF2 on 6 August 2009 but would, on that date, have been required to be so registered under the new rules, a transitional rule has the effect that FSA approval under the new rules must be obtained by 5 February 2010. Any person proposing to assume a role after 6 August which would entail CF1 or CF2 registration under the new rules would need to obtain FSA approval before doing so.

Background

Under the UK's Financial Services and Markets Act 2000 persons performing certain functions (known as 'controlled functions') for FSA authorised firms in relation to their regulated activities are required to be approved by the FSA for the performance of the particular function. Controlled functions fall into three broad categories relating to (1) the exercise of a significant influence on the conduct of the firm's affairs; (2) dealing with the firm's customers; and (3) dealing with the property of customers. To approve a particular person the FSA needs to be satisfied that he is a fit and proper person to perform the function to which the application relates. If he is not deemed fit and proper, the FSA will refuse to grant him

approval. As a result of being an approved person, an individual is, amongst other things, subject to the FSA's Statements of Principle and Code of Practice for Approved Persons.

An applicant for approved person status has to make a declaration to the FSA of their employment history for the last five years, the circumstances of any departures from previous employments, and of any regulatory and/or criminal breaches, licence refusals etc. For some individuals such disclosures may be sensitive because of concerns about confidentiality of information or because of unfavourable information that would need to be disclosed to the FSA.

Changes

The principal changes made by the FSA in the Policy Statement are as follows:

1. Directors and non-executive directors

1.1 The scope and application of the CF1 (the director function) and CF2 (the NED function) designations have been extended to include directors, partners, officers, members (in the case of LLPs), senior managers and employees of an unregulated parent undertaking or holding company whose decisions or actions are regularly taken into account by the governing body of the relevant FSA authorised firm, provided that there is an arrangement with the authorised firm in place relating to the relevant role. 'Unregulated' in this context means unregulated by the FSA or any other European Union financial services regulator. Before the extension, the CF1 and CF2 designations under the approved persons regime were relevant only to directors of an FSA authorised firm and persons in accordance with whose directions or instructions (not being advice given in a professional capacity) those directors were accustomed to act. One point to note regarding the new CF1/ CF2 rules is that they do not extend to shareholders in parent companies.

1.2 The new text of the FSA's Supervision Manual gives several examples of when the FSA is likely to require CF1 registration. Firms should consider whether they have any individuals in these positions and whether they need to obtain CF1 approved persons status for them:

- 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);

- 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;
- 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;
- 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 a manner in which it can reasonably be expected that an executive director or senior manager of that UK firm would act;
- 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.

1.3 Application to FSA-authorised firms that are limited liability partnerships

The extended CF1 requirements are expressly stated in the new rules to apply to all FSA authorised firms that are bodies corporate *other than* LLPs. The equivalent provision in relation to LLPs remains that the relevant designation, CF4, extends only to members of the LLP and persons in accordance with whose directions or instructions (not being advice given in a professional capacity) the members are accustomed to act. This would not extend to the directors of a company which is a controlling member of the LLP by virtue only of their being directors of that company.

The extended CF2 requirements, by contrast, do apply to FSA authorised firms that are LLPs. Thus, a NED of an unregulated parent undertaking or holding company of such a firm whose decisions or actions are regularly taken into account by the governing body of the firm would need to become a CF2 FSA approved person.

2. Proprietary Traders

The definition of controlled function CF29 (the significant management function) has been extended to include all proprietary traders who are not senior managers but who are considered likely to exert significant influence on the relevant FSA authorised firm.

3. Branches

The approved persons regime has been extended so that all controlled functions will apply to relevant persons working in UK-based branches of non-EEA overseas firms (subject to certain differences in relation to the application of the significant management function (CF29)).

4. References

Where requested, firms are now required by FSA rules to provide employment references for applicants to all controlled functions (formerly this applied to applicants for the customer functions only).

Rationale

The FSA states in PS09/14 that in its view the benefits of the extended approved persons regime include the ability to hold individuals accountable for the carrying on of their responsibilities and that this should assist prudent and sensible management within FSA authorised firms.

Corporate Governance and NEDs

The FSA's original proposals in CP08/25 included clarifying the role of NEDs to make clear that the FSA will look at NEDs more

closely where it believes they should have intervened more actively within a firm's management. Before making a final decision on this issue, the FSA wishes to consider the relevant recommendations of Sir David Walker's review of corporate governance in UK banks and other financial institutions and the Financial Reporting Council's review of the Combined Code on Corporate Governance which should be available in the third or fourth quarter of 2009.

Timing

The rule changes in the Policy Statement came into effect on 6 August 2009. Transitional arrangements apply in relation to any person who would, on 6 August 2009, have been required to be approved under the new rules. Such persons need to apply for and receive FSA approval under the new rules by 5 February 2010. Any person proposing to assume a role after 6 August which would entail registration under the new rules will need to obtain FSA approval before doing so. Firms should accordingly be reviewing relevant arrangements in place on 6 August 2009 with a view to making applications within the 6 month transitional period, and monitoring any relevant new arrangements to establish whether application for FSA approved person status needs to be made under the new rules.

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