

FINANCIAL SERVICES AND MARKETS ACT 2000

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part V: Performance of Regulated Activities

129. This Part confers on the Authority a range of powers which will enable it to ensure that people who work for authorised persons for certain purposes are fit and proper to perform the functions for which they have been engaged. While the focus of regulation is on authorised firms, the Part gives the regulator powers to prevent harm which might otherwise be caused by persons attached to firms.
130. Under the preceding regulatory framework, there is considerable variation between the arrangements applying to employees working in different sectors. The SROs have introduced a contractual system which requires employees to sign up to regulatory and disciplinary arrangements. Lloyd's has applied similar regulation to employees of underwriting agents, using its byelaw making powers. Banking and insurance legislation provides for pre-vetting of certain senior management positions, in some cases as part of the regime for the regulation of controllers of such firms. That legislation does not provide for the regulator to take disciplinary action against those managers, although senior managers, as officers of the firm, could commit a criminal offence where the firm itself had committed such an offence. There is, in addition to the vetting arrangements, a power in section 59 of the FS Act 1986 for the Authority to prohibit a person's employment in connection with investment business. The above arrangements will be replaced by arrangements under this Part.
131. The Part seeks to harmonise these arrangements. It provides a power for the Authority to ban unfit individuals from carrying out specified functions within the financial services sector. It also provides for:
- the Authority to require its approval to be obtained before a person may perform specified functions;
 - the Authority to issue statements of principle with which approved persons must comply, and codes of conduct elaborating on the statements; and
 - a disciplinary regime for those who fail to comply with the statements of principle.
132. This Part provides for firms and individuals concerned to refer matters to the Tribunal if the Authority proposes to:
- issue a prohibition order;
 - refuse an application to vary or revoke a prohibition order;
 - refuse an application for approval;
 - take disciplinary action; or

- withdraw approval.
133. The Part is primarily directed at the employees of authorised firms. However, it extends beyond employees to include, for example, directors, representatives and contractors of an authorised person, and extends to bodies corporate where relevant. If, for example, a life insurance company entered into a marketing agreement with a firm of estate agents to sell life insurance, the agency and relevant sales staff giving investment advice might need prior approval. Part V would also cover “matrix managers” who carry out certain functions, often on a fairly informal basis, for a group of companies even though technically they are “employees” of a sister company rather than of the authorised person for whom they carry out relevant functions. Such arrangements are increasingly common in multi-national groups.

Section 56: Prohibition orders

134. This section enables the Authority to make an order prohibiting any individual whom it considers is not fit and proper to perform functions in connection with regulated activities. A prohibition may relate to all functions in relation to any regulated activities carried on by all authorised (or exempt) persons or it can specify the kind of functions, activities or authorised (or exempt) persons to which it relates. A prohibition order may be varied or revoked.
135. *Subsection (4)* makes it an offence for an individual not to comply with a prohibition order. The maximum penalty for this offence is a fine at level 5 on the standard scale (currently £5,000). There is, however, a defence under *subsection (5)* for a person who can show that he took all reasonable precautions and exercised all due diligence to avoid committing the offence.
136. *Subsection (6)* imposes an obligation on an authorised person to take reasonable care not to engage individuals who have been disqualified under this section from performing relevant functions. Failure to comply with this requirement could trigger the use of the Authority’s powers to amend the authorised person’s permission or discipline the firm. It also potentially gives rise to a cause of action under section 71 from a private person who suffers a loss as a consequence of the breach.
137. *Subsection (8)* enables a prohibition order to be issued preventing an individual from performing functions in relation to a regulated activity carried on by an exempt person or a person to whom section 327(1) applies, that is by members of a profession or persons controlled or managed by members of a profession, who benefit from the exemption from the general prohibition under Part XX.

Section 59: Approval for particular arrangements

138. This section requires authorised persons to take reasonable care not to allow persons, natural or corporate, to perform certain functions without the approval of the Authority. *Subsection (2)* similarly requires an authorised person to take reasonable steps to ensure that any contractor does not allow a person to perform such functions without the approval of the Authority. A person in respect of whom approval is given is an “approved person”. The nature of the functions requiring approval will be specified by the Authority’s rules, within the limits set out in *subsections (5) to (7)* and subject to the normal consultation requirements under Part X. The limits can be summarised:
- The function may enable a person significantly to influence the conduct of the authorised person (for example a director). By virtue of *subsection (9)* account may be taken of influence which might result from a failure properly to carry out that function (for example a proprietary trader).
 - The function involves dealing with customers (for example a financial adviser) or dealing with their property (such as a stockbroker) in a way that is substantially connected with the carrying on of a regulated activity by the firm.

139. *Subsection (8)* limits the application of this section in the case of EEA or Treaty firms. The Authority will only have powers to act in relation to functions over which it, rather than the home State regulator, has jurisdiction.

Section 60: Applications for approval

140. This section requires an application for approval to be submitted by the authorised person concerned or, in the case of new firms awaiting authorisation, a prospective authorised person.
141. *Subsection (2)* gives the Authority the powers to specify the information it will require to support applications for different types of posts and *subsection (3)* enables it to request any additional information it needs to assess the suitability of each candidate.

Section 61: Determination of applications

142. This section sets out the basis on which the Authority is to assess the suitability of a candidate for approval, whether they are an individual or a body corporate. *Subsection (1)* requires the Authority to be satisfied that a candidate is fit and proper to perform the functions in question before it is able to give its approval. Where the Authority proposes to refuse an application, section 62 requires it to give a warning and decision notice. Notice must be given to the authorised person, the candidate and, where relevant, a contractor.

Section 63: Withdrawal of approval

143. This section gives the Authority power to withdraw the approval granted for the purposes of section 59 where it no longer considers that the person is a fit and proper person to carry out the functions for which they had been approved, for example because the Authority had obtained new information which cast doubt over its initial assessment.

Section 64: Conduct: statements and code

144. This section gives the Authority power, as part of its wider rule-making functions, to issue statements of principle, setting out in general terms the kinds of behaviour which it requires from approved persons in respect of any particular type of function. Any statements of principle issued under this section must be elaborated by a code of practice. Such a code would not need to be exhaustive but it would have to illustrate the circumstances in which it would regard a principle as having been complied with, or not complied with, as the case may be. Different statements of principle and codes could be made to apply to employees of different categories. The purpose of requiring a code to elaborate on a statement of principle is to prevent the Authority taking a disciplinary action for an alleged breach of a principle in cases where a person had acted in accordance with the code.
145. *Subsection (8)* makes it clear that failure to comply with a principle does not give a third party grounds for action against the approved person. Therefore, if for example a financial adviser employed by an insurance company failed to comply with a statement of principle when arranging a personal pension, that would not give a customer a right of action against the employee, with whom they had no contractual relationship. This provision would not remove or lessen any rights, including those under contract or by virtue of section 71, the customer may have against the authorised person who had entered into an agreement to provide the pension.

Section 65: Statements and codes: procedure

146. This section sets out the procedure that the Authority is required to follow when issuing a statement or code under section 64. The procedures, including the requirements to consult and publish a cost-benefit analysis, are broadly the same as the procedures that

will apply when the Authority exercises other powers to issue codes (for example under section 119) and its rule-making powers under Part X.

Section 66: Disciplinary powers

147. This section gives the Authority a power to take disciplinary action against an approved person when the two conditions set out in *subsection (1)* have been met. The Authority must be satisfied that it is appropriate to take action against him. In this context, the Authority would have to have regard, among other things, to its regulatory objectives set out in Part I. The Authority would need to take into account whether disciplinary action against the approved person, rather than action against the authorised person for whom he works, would be appropriate, taking into account the responsibility of the senior management of the firm for the conduct of the firm and its employees. A second important factor would be to ensure that any action, or any particular course of action, it takes should be proportionate to the nature and seriousness of the misconduct.
148. In addition, the Authority must be satisfied that the person has engaged in misconduct, as defined in *subsection (2)*. One possibility is that the approved person has acted in breach of a statement of principle, issued under section 64, as evidenced by a breach of a code of practice. The other possible situation is that an approved person has been knowingly involved in a breach by the authorised firm of rules made by the Authority or of any requirement imposed by or under the Act.
149. *Subsection (3)* gives the Authority powers to impose a penalty on an approved person or to make a public statement about their misconduct.
150. *Subsection (4)* restricts the period during which the Authority may take action under this section to a period of two years after the Authority became aware of the misconduct. This period reflects the time available to the Secretary of State to bring disqualification proceedings against a company director under the Company Directors Disqualification Act 1986.

Section 69: Statement of policy

151. This section requires the Authority to issue a statement of its policy on the circumstances in which it will impose penalties on approved persons under section 66 and the basis on which the level of penalties will be determined for different types of misconduct. The policy set out in the statement must take into account a number of factors which are set out in *subsection (2)*.
152. *Subsection (8)* requires the Authority to have regard to the statement in force at the time of the misconduct when imposing penalties under this Part.

Section 70: Statements of policy: procedure

153. This section sets out the procedure for issuing a statement of policy under section 69. Before deciding on its policies in these areas, or changing those policies, the Authority will be required to consult the public on its proposals.

Section 71: Actions for damages

154. If a private person suffers a loss because an authorised person has acted in breach of the duty under section 56(6) or 59(1) or (2) (failing to take care to prevent a person carrying out functions in contravention of a prohibition under section 56, or without obtaining the Authority's approval under section 59) he may bring an action for damages against the authorised person (or an exempt person or person to whom clause 327(1) applies in the case of a contravention under section 56(6)). *Subsections (2) and (3)* confer powers on the Treasury, by regulations, to define a "private person" and to specify circumstances in which this section applies to a person other than a private person.