

FINANCIAL SERVICES (BANKING REFORM) ACT 2013

EXPLANATORY NOTES

COMMENTARY

Part 4 – Conduct of Persons Working in Financial Services Sector

Amendments of FSMA

Section 18: Functions for which approval is required

171. *Section 18* amends section 59 of FSMA. Under section 59, the appointments of all individuals who are to perform certain roles in a financial services firm require the prior approval of the regulator (the FCA or the PRA) that has specified that role as a “controlled function” in its rules. *Subsection (2)* omits section 59(5) of FSMA. This has the effect of enabling the FCA to designate any role in any authorised person as a controlled function. If the FCA specifies a role which meets the definition of a senior management function in new section 59ZA, new section 59(6A) (inserted by subsection (4)) provides that the controlled function must be designated as a senior management function in the FCA’s rules. “Relevant authorised person” is defined by section 71A of FSMA, which is inserted by *section 33*.
172. *Subsection (3)* inserts into FSMA a new section 59(6) providing for the PRA to have the power only to specify as controlled functions roles in PRA-authorised persons which meet the definition of a senior management function in new section 59ZA. If the PRA does so and the authorised person is a relevant authorised person, new section 59(6B) (inserted by subsection (4)) provides that the controlled function must be designated as a senior management function in the PRA’s rules.

Section 19: Senior Management Functions

173. *Section 19* inserts into FSMA a new section 59ZA to provide the definition of “senior management function”. Although the definition is of general application, it is only when the function is a designated senior management function in relation to a relevant authorised person that the new regime for senior managers and banking standards will apply (that is, mandatory statements of responsibility (see *section 20*), a reverse burden of proof (see *section 30*), and special register entries for senior managers (see *section 34*)).
174. *Section 59ZA(3)* gives a wide meaning to “managing one or more aspects of an authorised person’s affairs”. This includes participation in the taking of decisions as to how those affairs are to be carried on. The concept of a “senior manager” will therefore include non-executive directors of the firm itself and may also include, in relation to a firm, persons who are employed outside the firm – for example, directors of its parent undertaking – if they are involved in decisions that affect the business of the firm. It is not limited to those with responsibilities for managing people.

Section 20: Statements of responsibilities

175. *Section 20* amends section 60 of FSMA. Section 60 sets out the process for making applications for approval to perform a controlled function. The amendments to section 60 provide that, if an application is made for someone to perform a designated senior management function in relation to a relevant authorised person, it must be accompanied by a statement of responsibilities for that person, which sets out the aspects of the business of the firm which that person will be responsible for managing.

Section 21: Vetting by relevant authorised persons of candidates for approval

176. *Section 21* inserts section 60A into FSMA, requiring any relevant authorised person to be satisfied that anyone in relation to whom they propose to apply to the regulator for approval to carry on a controlled function is a “fit and proper” person to undertake that function before they make the application. It also sets out the considerations to which the authorised person in question must have regard in making that determination.

Section 22: Determination of applications for approval

177. *Section 22* amends section 61 of FSMA, to include the personal characteristics of candidates for approval in the factors to be considered by the regulator in determining whether or not to grant approval.

Section 23: Power to give approval subject to conditions or for a limited period

178. *Section 23* amends section 61 of FSMA. Section 61 provides for the circumstances in which a regulator may grant an application for approval made under section 60, and provides that the firm or the candidate may appeal under standard FSMA procedures if an application is rejected.
179. *Subsection (2)* inserts a new section 61(1) providing that, if a regulator receives an application for an individual to perform a designated senior management function in relation to a relevant authorised person, the regulator may only grant the approval in two cases. The first case restates the existing FSMA test which applies to all applications: the regulator can grant approval if it is satisfied the individual is fit and proper. The second case adds a new test: the regulator can grant approval if it is satisfied that the candidate will be fit and proper if the application is granted subject to conditions. This test would only apply in relation to applications to perform senior management functions in relevant authorised persons.
180. *Subsection (4)* inserts new subsections (2B), (2C) and (2D) into section 61. *Section 61(2B)* provides that, for an application to perform a senior management function in a relevant authorised person, the regulators may grant approval conditionally or subject to time limits. *Section 61(2C)* provides that a regulator may only exercise the new powers where it is desirable to do so to advance an appropriate regulatory objective.

Section 24: Changes in responsibilities of senior managers

181. *Section 24* inserts new section 62A into FSMA to provide for the updating of statements of responsibilities when there has been a significant change in the responsibilities of a senior manager. *Section 62A(2)* provides that the authorised person concerned (not the senior manager) must give the appropriate regulator a revised statement of responsibilities if there is a significant change in the senior manager’s responsibilities. (Where the senior manager is taking up a new role performing a different controlled function, the firm will need to submit an application for approval to perform the new controlled function. If this function is a designated senior management function in a relevant authorised person, a new statement of responsibilities will be required under section 60(2A).)

182. *Section 62A(3)* provides that the regulators can require the firm to provide information in a form which the regulator directs, and to verify that information in a way which the regulator directs. This corresponds to the power the regulators have in *section 60(4)* over the form and verification of information supplied in an initial application for approval to perform a controlled function.

Section 25: Duty to notify regulator of grounds for withdrawal of approval

183. *Section 25* amends *section 63* of FSMA to require relevant authorised persons to consider at least once a year for each of the people who have been approved by the regulator whether any grounds have arisen which might cause the regulator to withdraw that approval, and to notify the regulator if this is the case.

Section 26: Variation of approval

184. *Section 26* inserts new sections 63ZA, 63ZB and 63ZC into FSMA. These sections provide for the variation of a senior manager's approval at the request of a relevant authorised person or on the regulator's own initiative, and deal with the procedure to be followed in those cases.

185. *Section 63ZA* provides that, if an approval to perform a designated senior management function in relation to a relevant authorised person has been granted subject to conditions, the firm that made the application may apply for the permission to be varied by adding, removing or varying the conditions. *Subsections (4) and (5)* provides that the regulators have a fixed 3-month period within which to grant the application or, if they propose to refuse it, to give a warning notice. *Subsections (6) and (7)* provide that the regulators may refuse such an application if desirable to advance their regulatory objectives. *Subsection (8)* applies procedural provisions about an application for approval to perform a controlled function, about how the regulators must determine an application and about the giving of warning and decision notices.

186. *Section 63ZB* allows a regulator to vary an approval where it considers this is desirable in order to advance its operational objectives (in the case of the FCA), and any of its objectives (in the case of the PRA). *Subsection (1)* provides that the FCA may vary an approval it, or the PRA, has given in relation to a designated senior management function being performed in relation to a relevant authorised person. *Subsection (2)* provides that the PRA may vary an approval it gave itself, or an approval given by the FCA in relation to a PRA-authorised person. *Subsection (3)* provides that an approval can be varied by imposing, varying or removing a condition, or by the imposition of time limits on an approval.

187. *Section 63ZC* sets out the procedure a regulator must follow when varying an approval. *Subsections (2) and (3)* provide that a proposed variation will take effect on the date specified in the first notice sent by the regulator to the interested parties or when the matter is no longer open for review, but that, if a regulator reasonably considers it is necessary, the variation may take immediate effect. *Subsections (4) and (5)* require a regulator proposing to vary an approval to give a written notice setting out prescribed information to the interested parties listed in *subsection (6)*. *Subsections (8) and (9)* require a regulator to give written notices to the interested parties when, after considering their representations, it has decided whether or not to proceed with a proposed variation, or to vary an approval in a different way from that initially proposed. *Subsection (10)* provide that a notice confirming that a variation will be made, or maintained, must let the interested parties know about their right to refer the matter to the Tribunal. *Subsection (11)* provide that, if a regulator proposes to vary an approval in a different way, it must set out in the written notice the information required to be set out for the initially proposed variation (so the process of entertaining representations is repeated for the new proposal to vary). *Subsection (13)* provides that whether a matter is open to review is determined in accordance with the standard FSMA provisions in *section 391(8)*. (A matter remains open to review until either it is too late to refer it

to the Tribunal, or it has been referred to the Tribunal and dealt with, and the period for an appeal against the Tribunal's decision has elapsed.)

Section 27: Statement of policy

188. *Section 27* inserts new sections 63ZD and 63ZE into FSMA. These sections require the regulators to prepare and issue statements of policy about the giving of approvals subject to conditions or time limits.
189. *Section 63ZD* requires both regulators to prepare and issue a policy about how they will use the power to give conditional or time-limited approval for performance of a designated senior management function in relation to a relevant authorised person, and how they will vary such approvals after they have been given (whether on application by a firm or on their own initiative). The regulators will be free to update their policy at any time, but they must always ensure the most recent policy has been published (so that it is accessible to those whom it may affect).
190. *Section 63ZE* sets out the procedure to be followed before issuing a statement of policy. *Subsection (1)* requires the regulators to consult each other before publishing a statement of policy (or revising a previously published statement). However, the FCA only has to consult the PRA where the policy relates to FCA-designated senior management functions in PRA-authorised persons. *Subsection (1)* also requires a regulator to publish a draft of a statement of policy. The draft policy must be accompanied by a notice inviting representations within a specified time (*subsection (3)*). The issuing regulator must have regard to any representations made (*subsection (4)*) and, if it goes ahead and issues the statement, it must also publish a general account of the representations made to it and its response to them (*subsection (5)*). The process must be repeated if the regulator decides to proceed with a significantly different policy and it must also publish details of the differences (*subsection (6)*). If a regulator proposes to alter or replace an existing statement it must also follow the procedural requirements set out in this section.

Section 28: Extension of limitation periods for imposing sanctions

191. *Section 28* amends sections 63A and 66 of FSMA to extend the limitation periods for imposing sanctions for misconduct. Section 63A allows the regulators to impose penalties on persons who perform a controlled function without the appropriate regulator's approval. Section 66 provides for the regulators to impose penalties, suspensions or restrictions on an approved person, or to publicly censure that person when the approved person is guilty of misconduct.
192. In each case, the period within which the regulator may commence proceedings (that is, issue a warning notice) is increased from three years to six years after the regulator knew of the contravention, provided the contravention occurs after the new provisions come into force. The existing three-year limitation periods are retained for action in respect of contraventions occurring before that date.

Section 29: Certification of employees by relevant authorised persons

193. *Section 29* inserts new sections 63E and 63F in FSMA. Under *new section 63E* the regulator may specify in its rules functions which, although not controlled functions requiring approval, are "significant-harm functions" (that is, functions which may give rise to a risk of significant harm either to the firm or to its customers). A relevant authorised person may not employ a person to perform a function that has been specified under this power unless the relevant authorised person has been able to certify under *new section 63F* that the person concerned is a fit and proper person to exercise the function. The regulators are required to keep the power to specify functions under review, with a view to minimising the risk that anyone would be employed to perform a significant-influence function which they are not a fit and proper person to perform.

194. *New section 63F* sets out the rules under which a relevant authorised person (“RAP”) may issue a certificate to one of its employees. The RAP must be satisfied that the person concerned is a fit and proper person to perform the function covered by the certificate, having considered whether they have the qualifications, training, level of competence and personal characteristics required by rules made by the regulators in relation to the function in question. The certificate will describe the role to which the person concerned is being appointed, and will confirm that the person is fit and proper to act in that role. It will be valid for twelve months. Where the RAP decides not to issue such a certificate, it must give the person concerned written notice of that fact, including details of the steps the RAP proposes to take in consequence and the reasons for them.

Section 30: Rules of conduct

195. *Section 30* repeals sections 64 and 65 of FSMA, and insert new sections 64A and 64B into FSMA. *Subsection (1)* of section 64A gives the FCA the power to make rules about the conduct of persons it has approved to perform a controlled function and of anyone employed in the relevant authorised person, at whatever level. *Subsections (2) and (3)* give the PRA a power to make rules about the conduct of persons it has approved to perform senior management functions in PRA-authorised firms and of anyone employed in a relevant authorised person that is PRA-authorised. (The FCA can approve people to perform controlled functions in relation to PRA-authorised firms and the PRA can make rules of conduct applying to such people, if they are performing a senior management function.) *Subsections (4) and (5)* make clear that the rules can only relate to the conduct of individuals while working for the authorised person who applied for their approval to perform controlled functions, or, if the individual is not an approved person, his or her employer. *Subsection (6)* ensures that the definition of “employee” will be broad enough to capture someone who, although they are formally self-employed or employed by some other person, are in practice in a position equivalent to an employee, e.g. sub-contractors, employees of sub-contractors or employees of a company in the same group as the firm which is responsible for employing the staff who work for group companies.
196. *New section 64B* imposes an obligation on RAPs to notify all their employees, and approved persons, of any rules which the regulators have made under section 64A of FSMA which relate to them, and to ensure that the persons concerned understand how the rules apply to them. Where the RAP becomes aware (or suspects) that any of their employees, or approved persons, has breached the rules, the RAP must inform the regulator of this fact.

Section 31: Requirement to notify regulator of disciplinary action

197. *Section 31* inserts new section 64C into FSMA. Under this new section, RAPs are under a duty to inform the regulator in the event that they issue a formal written warning to any of their employees or approved persons, suspend or dismiss any of them, or take any clawback action in relation to the remuneration of any of them.

Section 32: Definition of misconduct

198. *Section 32* amends section 66 of FSMA and inserts new sections 66A and 66B into FSMA. *Subsection (1)(a)* inserts a new subsection (1A) in section 66. Subsection (1A) defines misconduct by reference to section 66A (for the purposes of action by the FCA) and section 66B (for the purposes of action by the PRA). *Subsection (1)(b)* omits subsections (2), (2A), (6) and (7) of section 66, which contain the existing definitions of misconduct for the purpose of action by the regulators.
199. *Subsection (2)* inserts sections 66A and 66B into FSMA. *Section 66A* provides that the FCA may take enforcement action (following standard FSMA procedures) against a person if any of conditions A, B and C apply. *Subsection (2)* sets out condition A which allows the FCA to take enforcement action against an approved person or an

employee of a relevant authorised person who has failed to comply with rules of conduct made by the FCA under section 64A. *Subsection (3)* sets out condition B which allows the FCA to take enforcement action against an approved person or an employee of a relevant authorised person, if they were knowingly concerned in a breach of a relevant requirement (defined in *subsection (4)*) by the authorised person for whom they work. *Subsection (5)* sets out condition C which allows the FCA to take enforcement action against senior managers in a relevant authorised person if a regulatory contravention occurs in a part of the business for which they are responsible. This is subject to *subsection (6)*, which provides that a senior manager will not be guilty of misconduct if he or she can show they took such steps to prevent the contravention as could reasonably be expected of a person in their position. *Subsections (7) and (8)* provide the definitions of “senior manager”, “approved person” and “employee” (which has the wide meaning given in section 64A, so including persons who are in an equivalent position to an employee).

200. *Section 66B* makes equivalent provision allowing the PRA to take enforcement action (following standard FSMA procedures) against a person if the same conditions apply.

Section 33: Meaning of “relevant authorised person”

201. *Section 33* inserts new section 71A, which defines “relevant authorised person”. Under new section 71A, “relevant authorised person” for the purposes of Part 5 of FSMA includes all deposit-takers, including building societies and credit unions, and those investment firms which are authorised by the PRA. It does not include any insurers which have a deposit-taking permission under FSMA. The term “relevant authorised person” for the purposes of Part 5 is also restricted to institutions that are incorporated in the UK (in the case of bodies corporate such as companies), or formed under the law of any part of the UK (in the case of other classes of institution such as a partnership). However, *new section 71A(4)* gives the Treasury power by order to extend the definition of “relevant authorised person” to include branches of non-UK credit institutions and investment firms of a specified description. Under section 429 of FSMA, as amended by section 136 of this Act, this power is subject to draft affirmative procedure.

Section 34: Recording information about senior managers

202. *Section 34* amends section 347 of FSMA. Section 347 requires the FCA to maintain a publicly available record of financial services firms and approved persons and sets out the information that must be included in the record.
203. *Subsection (2)* amends section 347(2) to require the FCA to record whether an approved person in relation to a relevant authorised person is a senior manager, whether the senior manager has been sent any final notice, and any published information about the matter to which the final notice relates. (A ‘final notice’ is a final notice of actions that a regulator can take, such as the imposition of a penalty for misconduct.) *Subsection (3)* inserts section 347(8A) which provides definitions of “senior manager”, “relevant authorised person” and “designated senior management function”.

Section 35 and Schedule 3: Consequential amendments relating to Part 4

204. *Section 35 and Schedule 3* make various minor and consequential amendments to FSMA and the Financial Services Act 2012 which are necessary in connection with *sections 21 to 33*.
205. *Paragraph 1 and 4* of Schedule 3 make consequential amendments to sections 59 and 63A of FSMA respectively, arising from the introduction of the power for the regulators to give conditional approval to an application to perform a senior management function in relation to a relevant authorised person.
206. *Paragraph 2* of the Schedule amends section 59A of FSMA, which requires the FCA and the PRA to co-ordinate how they specify controlled functions. It removes references

in section 59A to the concept of a “significant-influence function” and replaces them with references to a “senior management function”.

207. *Paragraph 3* of the Schedule amends section 63 of FSMA, replacing references to a significant-influence function with references to a senior management function. The effect is that the PRA can withdraw a person’s approval if they were approved by the FCA but the function is a senior management function performed in relation to a PRA-
authorised person.
208. *Paragraph 5* of the Schedule makes consequential amendments to section 66 of FSMA, which sets out the disciplinary powers of the regulators in relation to approved persons. It give regulators the power to impose conditions rather than ‘restrictions’, reflecting the regulators’ power to grant conditional approvals.
209. *Paragraph 6* of the Schedule makes consequential changes to section 67 of FSMA, which sets out the procedure the regulators must follow when taking disciplinary action against approved persons. The changes are consequential on the changes to section 66 of FSMA. It also requires the regulators, if they propose to limit the time for which an approval has effect, to state in a warning notice how long the approval would have effect for (*paragraph 6(4)*). The same information would also have to be provided in a decision notice about limiting the period of an approval (*paragraph 6(7)*).
210. *Paragraph 7* of the Schedule makes consequential changes to section 69 of FSMA, which requires the regulators to issue statements of policy about the imposition of penalties on approved persons. These changes also reflect the grant to the regulators of the power to give conditional approvals.
211. *Paragraphs 8 and 9* of the Schedule make changes necessary to reflect the power for the regulators to make rules of conduct under new section 64A. *Paragraph 8* ensures that the regulators may not modify or waive rules of conduct made under section 64A in relation to a particular person. *Paragraph 9* ensures that a private person cannot bring an action for damages if they suffer loss as the result of a contravention by an approved person of a rule of conduct made under section 64A.
212. *Paragraph 10* of the Schedule removes references to section 64 from section 140A, a consequential change required by the repeal of section 64.
213. *Paragraph 11* of the Schedule makes a consequential amendment to section 347 of FSMA (which makes provision about the record of authorised persons to be kept by the FCA), by replacing references to a “relevant authorised person” in that section with references to an “authorised person concerned” (defined in subsection (9), as inserted by *section 34*), to avoid confusion with the definition in section 71A.
214. *Paragraphs 12 to 14* of the Schedule make consequential changes to the provisions of FSMA setting out what must be included in a decision notice and a warning notice, and to the provisions of FSMA requiring the regulators to determine their procedure for making decisions which would require them to issue a supervisory notice.
215. *Paragraph 15* of the Schedule makes consequential changes to section 415B of FSMA, which makes provision about consultation between the regulators about the taking of certain enforcement action.
216. *Paragraphs 16 and 17* of the Schedule make consequential changes to Schedules 1ZA and 1ZB to FSMA to ensure that the issuing of a policy about the grant and variation of conditional approvals by the PRA or the FCA is treated as a legislative function which must be done through their governing bodies.
217. *Paragraphs 18 and 19* of the Schedule make consequential changes to the Financial Services Act 2012 to ensure that issuing a policy statement about the grant and variation of conditional approvals by the PRA or the FCA is a legislative function for the purposes of a complaints scheme under section 85 of that Act. This means that the regulators

do not have to make arrangements for the investigation by an independent person of complaints relating to the issuing of policy statements about the exercise of the new powers. (Complaints about the granting or variation of conditional approvals in individual cases will be considered under the complaints scheme).

Section 36: Offence relating to a decision causing a financial institution to fail

218. *Section 36* creates a new criminal offence of taking a decision that results in the failure of certain types of financial institution. These are: a UK incorporated bank or building society or a UK investment firm that is regulated by the PRA (a “relevant financial institution”). This section defines the offence and specifies the penalties applicable to those found guilty of it.
219. *Subsection (1)(a)* provides that only those individuals who are senior managers in relation to a relevant financial institution (“F”) can commit the offence. Senior management functions will be designated by the PRA or the FCA under the powers in section 59 of FSMA as amended by *section 18*. The conduct for which an individual can be prosecuted is taking a decision on behalf of F, or failing to prevent a decision being taken on behalf of F, where the decision leads to the failure of F or another relevant financial institution in the same group as F. *Subsection (1)(b)* provides that in either case the person concerned must be aware that the decision may cause the failure.
220. *Subsection (1)(c)* provides that the individual’s behaviour in taking the decision in question must be far below that which could reasonably be expected of a person performing the senior management function that the individual performs.
221. *Subsection (1)(d)* makes it an essential element of the offence that the implementation of the decision for which the person is being prosecuted causes the relevant financial institution to fail. (‘Failure’ is defined in subsections (9) and (10) of *section 37*.)
222. *Subsection (2)* defines “group institution”. It has the effect that a senior manager can be prosecuted for causing the failure not only of F (the relevant financial institution which they manage), but also of any other relevant financial institution in the same group as F.
223. *Subsection (4)* sets out the maximum penalties for the offence. The maximum penalties on summary conviction vary according to the different powers of the lower courts in different parts of the United Kingdom. The maximum penalty on conviction on indictment (in all parts of the United Kingdom) is 7 years imprisonment or an unlimited fine (or both).

Section 37: Section 36: interpretation

224. *Section 37* provides for the interpretation of the terms used in the offence. The effect of *subsections (1) to (6)* is that the offence applies to senior managers in UK institutions which have permission to carry on the regulated activity of accepting deposits (other than insurers and credit unions) and to senior managers in UK investment firms that are authorised by the PRA. This means that the offence covers only the failure of banks, building societies and PRA-authorized investment firms which are incorporated in the UK or formed under the law of part of the UK.
225. *Subsection (7)* defines “senior manager” for the purpose of the offence, limiting it to individuals performing a function which has been designated as a senior management function by the FCA or the PRA. The FCA and the PRA are given power to designate senior management functions by section 59 of FSMA as amended by *section 18*.
226. *Subsections (9) and (10)* define when a relevant financial institution is to be regarded as having failed for the purposes of the offence.

Section 38: Institution of proceedings

227. *Section 38* sets out who may bring proceedings for the offence. *Subsections (2) and (3)* provide that in England, Wales and Northern Ireland, prosecutions could be brought by the FCA, the PRA, the Secretary of State or the Director of Public Prosecutions (in Northern Ireland this is the Director of Public Prosecutions for Northern Ireland). Others may bring prosecutions with the consent of the Director of Public Prosecutions. In Scotland, prosecutions could (in any event) only be brought by the Procurator Fiscal.
228. *Subsections (4) and (5)* allow the Treasury to restrict the regulators' powers to prosecute, both generally and with regard to specific proceedings or categories of proceedings, providing it does so in writing.