

C/M/S/ Cameron McKenna

# **A guide to the Financial Services and Markets Act 2000**

March 2002

Introduction

---

Glossary

---

Location of statutory  
instruments and FSA  
material

---

Commencement  
and transitional  
provisions

---

Analysis of FSM Act

A – Introductory material .....	8
1. Introduction .....	8
2. Contents .....	8
3. N2 Preparedness.....	9
4. How to use this Guide .....	9
5. A route map through the FSM Act .....	10
B - Glossary.....	13
C - Location of Statutory Instruments and FSA Material .....	16
D - Commencement and Transitional Provisions.....	23
1. Commencement of FSM Act.....	23
1.1 Commencement Order No 1: SI 2001 No. 516 .....	23
1.2 Commencement Order No 2: SI 2001 No. 1282 .....	23
1.3 Commencement Order No 3: SI 2001 No. 1820 .....	24
1.4 Commencement Order No 4: SI 2001 No. 2364 .....	24
1.5 Commencement Order No 5: SI 2001 No. 2632 .....	24
1.6 Commencement Order No 6: SI 2001 No. 3436 .....	24
1.7 Commencement Order No 7: SI 2001 No. 3538 .....	24
2. Commencement of FSA's Handbook .....	25
3. FSA's Rules .....	26
3.1 Application of FSA's rules .....	26
3.2 Power for FSA to make transitional rules.....	26
3.3 Grandfathering of rule waivers and modifications.....	26
3.4 CP89 – Grandfathering Concessions and Individual Guidance: April 2001 .....	26
4. Grandfathering of firms, products and individuals at N2 - the statutory framework and FSA's procedure.....	27
4.1 Grandfathered firms .....	27
4.2 Prohibitions and restrictions on firms will be carried forward.....	28
4.3 FSA's procedure for grant of permissions to firms at N2.....	28
4.4 Scope of Permission Notices (2001 No. 3771) .....	29
4.5 FSA may require compulsory reapplication for permission .....	30
4.6 Grandfathering of collective investment schemes.....	30
4.7 Grandfathering of individuals - Approved persons .....	30
4.8 Interim Permissions (2001 No. 3374).....	30
4.9 Grandfathering Of Firms, Individuals and Products (FSA Briefing Note - December 2000).....	31
5. Complaints .....	31
5.1 Complaints against firms.....	31
5.2 Complaints against FSA .....	32
6. Matters relating to change of control .....	32
7. FSA's civil and criminal powers .....	33

7.1	Civil remedies .....	33
7.2	Disciplinary powers .....	34
7.3	Formerly authorised deposit takers and building societies .....	34
7.4	Criminal offences.....	34
7.5	Information gathering and investigations .....	34
7.6	Miscellaneous provisions .....	34
8.	Transitional Provisions (Partly Completed Procedures) 2001 No. 3592 .....	35
8.1	Applications under former legislation outstanding at N2 are generally carried forward: .....	35
8.2	FSA's uncompleted pre-N2 own initiative proceedings .....	35
8.3	Pending applications for authorisations.....	36
8.4	Other pending procedures .....	36
8.5	Incomplete SRO Disciplinary Proceedings .....	36
8.6	Incomplete Appeals .....	37
8.7	SRO Intervention Measures .....	37
8.8	Interim Tribunal .....	37
8.9	Partly completed exercise of EEA Rights .....	37
8.10	Pending Appeals .....	38
9.	Information & Investigations - Transitional Provisions & Savings (Information Requirements and Investigations) 2001 No. 3646 .....	38
10.	Miscellaneous Transitional Provisions .....	38
10.1	The Consequential and Transitional Provisions (Miscellaneous) No. 2 Order (SI 2001 No. 2659) .....	38
10.2	Miscellaneous Provisions 2001 No. 3650.....	39
10.3	Dissolution of Board of Banking Supervision (Transitional Provisions) 2001 No. 3582 .....	40
10.4	Transitional Provisions and Savings (Business Transfers) (2001 No. 3639) .....	40
10.5	Transitional Provisions (Designated Dates for Certain SROs) (2000 No. 1734) .....	40
10.6	Consequential Amendments (Pre-Commencement Modifications) (2001 No. 2966) .....	40
E -	Analysis of FSM Act .....	41
1.	Financial Services Authority Sections 1 - 18, 404; Schedule 1.....	41
1.1	Constitution.....	41
1.2	Duties .....	42
1.3	Powers of FSA.....	42
1.4	Answerable to whom?.....	44
1.5	Public record .....	45
1.6	Key statements on policy and implementation .....	45
2.	General Prohibition Part II sections 19, 22-24, 26-29 .....	58
2.1	General prohibition (s19) .....	59

2.2	Carrying on regulated activity in UK .....	59
2.3	Offences .....	69
2.4	Enforceability .....	68
2.5	Miscellaneous .....	68
2.6	Key statements of policy and implementation .....	68
3.	Financial Promotion Part II sections 21, 25, 30 .....	69
3.1	Basic provisions .....	70
3.2	Disapplication of basic provision .....	69
3.3	Contravention of basic provision .....	69
3.4	Unenforceability .....	69
3.5	Key statements on policy and implementation .....	70
4.	Authorisation and Exemption Part III sections 31-39; Part XIII sections 193-204 .....	76
4.1	Authorised persons (s31) .....	76
4.2	Exempted persons .....	78
4.3	EEA passport rights (Schedule 3) .....	77
4.4	Treaty rights (Schedule 4) .....	78
4.5	FSA intervention .....	78
4.6	Key statements of policy and implementation .....	80
4.6.1	Exemption Order .....	79
5.	Permission to carry on regulated activities Part II section 20; Part IV sections 40-55 .....	85
5.1	Requirement for permission .....	86
5.2	Threshold conditions .....	86
5.3	Granting permission .....	86
5.4	Cancelling or varying permission .....	86
5.5	Procedure on granting or varying permission .....	86
5.6	Key statements on policy and implementation .....	86
5.7	Transitional provisions .....	87
6.	Approval for individual staff Part V sections 56-71 .....	88
6.1	Duty on authorised persons .....	88
6.2	Application for approval .....	88
6.3	Withdrawing approval .....	89
6.4	Prohibition order .....	89
6.5	Principles and codes .....	90
6.6	Misconduct – FSA'S power to discipline an approved person .....	89
6.7	Key statements on policy and implementation .....	90
6.8	Transitional provisions .....	97
6.9	Whistleblowing - CP101 (July 2001) .....	97
7.	Control over Authorised Persons Part XII sections 178-192 .....	98

7.1	Requirement to notify FSA .....	98
7.2	Definitions .....	98
7.3	Procedure .....	99
7.4	Conditional approval/FSA objection .....	99
7.5	Freezing for contravention .....	99
7.6	Offences .....	100
7.7	Treasury powers.....	99
7.8	Key statements on policy and implementation .....	99
7.9	Transitional provisions.....	101
8.	Rules and Guidance Part X sections 138 - 164 .....	101
8.1	Rules made by FSA.....	101
8.2	Disapplication or modification of a rule.....	102
8.3	Contravention.....	104
8.4	Consultation and guidance .....	104
8.5	Key statements on policy and implementation .....	105
9.	Information gathering Part XI sections 165-177, Section 413 .....	134
9.1	Providing information to FSA .....	134
9.2	Investigations.....	134
9.3	Offences .....	136
9.4	Key statements on policy and implementation .....	136
9.5	Transitional provisions.....	140
10.	Enforcement Part XIV sections 205-211; Part XXVI sections 387-396; Part IX sections 132-137; Part XXV sections 380 & 382 Part XXIII sections 347-354; Part XXVII sections 397-403 .....	141
10.1	FSA'S power to take discipline .....	141
10.2	Procedures relating to giving notices.....	142
10.3	Injunctions and restitution orders.....	143
10.4	Compensation scheme.....	143
10.5	Miscellaneous offences .....	143
10.6	Financial Services and Markets Tribunal.....	144
10.7	Protection of confidential information ("CI") (s348).....	147
10.8	Key statements on policy and implementation .....	148
10.9	Transitional provisions.....	153
11.	Market Abuse Part VIII sections 118 - 131 .....	154
11.1	The three elements of market abuse .....	154
11.2	Safe harbours .....	155
11.3	penalties .....	156
11.4	Further enforcement powers.....	156
11.5	Key statements on policy and implementation .....	156
12.	Collective Investment Schemes Part XVII sections 235 - 284 .....	160

12.1	Definitions .....	161
12.2	Restrictions on promotion (s238) .....	161
12.3	Authorised Unit Trust Schemes .....	162
12.4	Authorised OEICS .....	163
12.5	Recognised overseas schemes .....	163
12.6	Schemes from designated territories .....	163
12.7	Individually recognised schemes .....	164
12.8	Designated territory and individually recognised schemes .....	164
12.9	Investigations .....	165
12.10	Key statements on policy and implementation .....	164
12.11	Transitional provisions .....	165
13.	Financial Services Compensation Scheme Part XV sections 212 - 224 .....	166
13.1	Main provisions .....	166
13.2	Key statements on policy and implementation .....	166
14.	Ombudsman scheme Part XVI sections 225-234 .....	170
14.1	Main provisions .....	170
14.2	Constitution (Sch 17) .....	170
14.3	Compulsory jurisdiction (s226) .....	170
14.4	Voluntary jurisdiction (s227) .....	171
14.5	Key statements on policy and implementation .....	171
14.6	Disclosure of information .....	173
14.7	Transitional provisions .....	175
15.	Banking and Insurance Transfers Part VII sections 104 - 117 .....	174
15.1	Need for approval .....	174
15.2	Insurance business transfer scheme (s105) .....	174
15.3	Banking business transfer scheme (s106) .....	174
15.4	Procedure .....	175
15.5	Miscellaneous .....	177
15.6	Key statements on policy and implementation .....	175
16.	Recognised Investment Exchanges and Clearing Houses Part XVIII sections 285-313 .....	177
16.1	Main provisions .....	177
16.2	Recognition requirements regulations .....	177
16.3	Key statements on policy and implementation .....	177
17.	Official Listing Part VI Sections 72-103 .....	179
17.1	Competent authority .....	179
17.2	General duty of competent authority .....	179
17.3	Official list .....	180
17.4	Listing particulars .....	180

17.5	Supplementary listing particulars.....	180
17.6	Registration of listing particulars .....	181
17.7	Publication of prospectus.....	181
17.8	Compensation for false or misleading particulars .....	181
17.9	Breach of the listing rules.....	182
17.10	Sponsors.....	182
18.	Lloyd's Part XIX sections 314-324 .....	183
18.1	FSA's duty.....	183
18.2	Lloyd's authorisation (s315) .....	183
18.3	Lloyd's underwriting .....	183
18.4	Other provisions.....	183
18.5	Key statements on policy and implementation .....	184
19.	Professions Part XX sections 325-333 .....	185
19.1	FSA duty .....	185
19.2	Designation .....	185
19.3	Disapplication of general prohibition.....	186
19.4	FSA powers to re-apply prohibition .....	186
19.5	Rule making.....	188
19.6	Offence .....	187
19.7	Key statements on policy and implementation .....	187
20.	Auditors and Actuaries Part XXII sections 340 - 346.....	188
20.1	Duty on authorised persons .....	188
20.2	Auditory/Actuary duties and disclosure .....	188
20.3	Offence .....	190
20.4	Key statements on policy and implementation .....	188
21.	Insolvency Part XXIV sections 355-379.....	190
21.1	FSA's powers .....	190
21.2	Key statements on policy and implementation .....	190
22.	Miscellaneous and supplemental Part XXI sections 334-339; Part XXVIII sections 404-416; Part XXIX sections 417-425; Part XXX sections 426-433 .....	192
22.1	Mutual societies.....	192
22.2	Implementation of EU/International decisions/obligations.....	192
22.3	Gibraltar/Channel Islands/Isle of Man ("IOM") .....	192
22.4	Miscellaneous provisions.....	193
22.5	Commencement (s431).....	193
22.6	Interpretation (ss 417 and 420-425).....	194
22.7	Ministerial powers.....	194
22.8	Control of SIs.....	194
22.9	Relevant SIs.....	195





## A – Introductory material

### 1. Introduction

This Guide summarises, in bullet point fashion:

- the sections of the Financial Services and Markets Act 2000, broadly following the order in the FSM Act; and
- the principal Statutory Instruments made to implement FSM Act;
- FSA's Consultation Papers, and similar material, which contain draft rules and other proposals. Most CPs are in due course wholly superceded by Policy Statements which contain the final rules as set out in the Handbook.
- the principal parts of FSA's Handbook, which is made up of FSA's Principles, rules and guidance.

The purpose of this Guide is to enable a user to:

- gain an overview of the FSM Act's provisions at a reasonable level of detail;
- identify the key statutory provisions; and
- identify the relevant Statutory Instrument, Consultative Paper or rules which will provide further details on FSA's regulatory requirements.

This Guide necessarily omits much detail. There is no substitute for reviewing the source material, and this Guide should not be relied upon as providing a definitive statement of the areas which it covers. FSA's most up to date rules and other material should be consulted on [www.fsa.gov.uk](http://www.fsa.gov.uk).

### 2. Contents

The Guide is divided into 22 sections which cover all parts of the FSM Act. Each section follows the format of:

- brief summary;
- statutory provisions;
- Statutory Instruments; FSA Consultative Papers and rules relevant to that section.

The full contents are set out at the front of the Guide and can be summarised thus:

#### Areas relevant to all firms

A – Introduction

B – Glossary

C – Location of Statutory Investments and FSA Material

D – Commencement and Transitional Provisions

1. FSA
2. General prohibition
3. Financial promotion
4. Authorisation and exemption
5. Permission to carry on regulated activities
6. Approval for individual staff

7. Control over authorised persons
8. Rules and guidance
9. Information gathering
10. Enforcement
11. Market abuse

#### Areas relevant to special situations

12. Collective investment schemes
13. Financial services compensation scheme
14. Ombudsman scheme
15. Banking and insurance transfers
16. Recognised investment exchanges and clearing houses
17. Official listing
18. Lloyd's
19. Professions
20. Auditors and actuaries
21. Insolvency
22. Miscellaneous and supplemental

### 3. N2 Preparedness

There is a separate briefing note which discusses the steps which a firm should take in order to be prepared for N2 – 1<sup>st</sup> December 2001 - which is the date when the main provisions of the FSM Act and FSA's Handbook came into force. This is also available on [www.law-now.com](http://www.law-now.com)

### 4. How to use this Guide

- to find out about **commencement** of FSA Act and FSA's rules, see sections D1 and D2.
- to understand the **transitional provisions**, which govern how pre-N2 authorised firms and registered individuals will transfer to FSA's new regulations, see sections D3-D4 The way in which complaints and formal procedures underway at N2 will be dealt with is discussed in sections D5-D10.
- to locate discussion of any particular

- **Statutory Investment**

- **FSA Consultation Paper**

- **FSA rule**

see Section C. The separate parts and sections of FSM Act can be identified from the index.

## 5. A route map through the FSM Act

- FSA is the UK's **single regulator** for banks, insurers and investment firms. Its constitution, powers and duties are set out in Section 1. Also covered here are Policy Statements on
  - e-commerce
  - e-money
  - treating customers fairly after point of sale.
- A person may not **carry on a regulated activity** in the UK unless authorised or exempt. Section 2 analysis the elements of this general prohibition and the Regulated Activities Order, which defines the specified investments and activities.
- An **invitation or inducement to engage in investment activity** (termed "financial promotion") may only be communicated if made or approved by a person who holds FSA authorisation. This includes advertisements, telephone calls, personal visits and correspondence. What amounts to a financial promotion is discussed at Section 3, together with the numerous exclusions contained in the Financial Promotion Order.
- **Authorisation** will usually be obtained from FSA. This is discussed at Section 4. FSA's procedures are contained in its Authorisation Manual, summarised at Section 4.6.4. Certain EEA firms may 'passport in' under single market directives and do not require FSA authorisation – see Sections 4.3.1, 4.6.3, 4, 6. A UK firm may similarly 'passport out' into other EEA states – see Sections 4.3.2, 4.6.3, 5. Certain persons are **exempted** from the requirements to be authorised, notably firms' marketing agents termed 'appointed representatives' – Sections 4.2, 4.6.1, 2.
- FSA must approve **change of control** over a UK authorised firm – Section 7.
- Individuals who perform specified roles in an authorised firm, notably senior managers and those dealing with customers, must be **individually registered** with FSA. They are known as 'approved' persons. The specified categories are listed at section 6.7.3. A particularly important provision is that all approved persons are required to observe Statements of Principle (Section 6.7.6) and are liable to discipline for breach (Section 6.7.7). In addition, senior managers are subject to further Statements of Principle which require them to establish appropriate systems and controls, and ensure that their part of a firm's business is run compliantly (Section 6.7.5, 8).
- Authorised persons are subject to **FSA's rules**, principally when carrying on an activity regulated under FSM Act (Section 8.1). Contravention of a rule is not a criminal offence, but may give rise to civil liability (Section 8.3, 14). An authorised person can apply to FSA for a rule to be modified or waived. A person can only rely on guidance issued by FSA about its rules in stated circumstances (Section 8.4, 8.4.1). Rules and similar issued by FSA include:
  - Principles for Business (Section 8.5.1)
  - General provisions, which apply to FSA's rules as a whole and provide important material on their interpretation (Section 8.5.2)
  - Prudential standards, which are concerned with a firm's capital and systems (Section 8.5.3)
  - Customer Classification (Section 8.5.4)
  - Interprofessional Conduct (Section 8.5.5)

- Conduct of Business, which apply to firms' day to day business activities (Section 8.5.6), together with applicable transitional arrangements (Section 8.5.7)
  - Money Laundering (Section 8.5.8)
  - Training and competence (Section 8.5.9)
  - Mortgage Sourcebook, which will apply to mortgage lenders and administrators when it is brought into force, and will be extended to mortgage intermediaries (Section 8.5.10)
  - Outsourcing (Section 8.5.11)
  - Complaints Handling (Section 14.5.1)
  - Service company regime (Section 8.5.12)
- Authorised persons and others must **provide information** to FSA (Section 9.1) and FSA may carry out investigations (Section 9.2), for which FSA's policy is set out in the Enforcement Manual (Section 9.4.1). FSA will gather information about authorised persons on a routine basis by carrying out supervision in accordance with the policy and practices contained in its Supervision Manual (Section 9.4.2).
  - FSA may take **disciplinary action** against an authorised person for breach of a specified requirement (Section 10.1). FSA's policy is in its Enforcement Manual (Section 10.8.1), and FSA will reach a decision in accordance with its Decision Making Manual (section 10.8.2). This also sets out the internal FSA procedures open to an authorised person, after which it can seek a hearing before the Tribunal (Section 10.6). FSA may seek injunctions and restitution orders (Section 10.3). Miscellaneous offences are at Section 10.5.
  - **Market abuse** is a new civil offence for which FSA can take what is, in effect, disciplinary action. FSA has published a Code of Market Conduct to assist in explaining Market Abuse. See Section 11.
  - **Collective investment schemes** are unit trusts, OEICs and other pooled investment vehicles. Restrictions on promotion and procedures for obtaining authorisation/recognition are at Section 12.
  - FSA has established a **compensation scheme**, mainly for the benefit of private customers, for when an authorised person defaults (Section 13).
  - Authorised persons must establish **complaints handling procedures**, mainly for the benefit of private customers. If a complaint is not resolved, the customer may pass it to the Financial Ombudsman Service (Section 14).
- Other topics covered are:
    - **Banking and insurance business transfers** must follow a stated procedure (Section 15)
    - The procedure for obtaining recognition for **investment exchanges and clearing houses** is at Section 16.
    - The procedure for obtaining **official listing of securities** in the UK is at Section 17.
    - Regulation of **Lloyd's** (Section 18).
    - Regulation of **professions** such as accountants and solicitors when they carry on a regulated activity (Section 19).
    - Duties of authorised persons' **auditors and actuaries** (Section 20).

- **Insolvency** of authorised persons (Section 21).
- **Miscellaneous and supplemental provisions** (section 22).

## B - Glossary

The following abbreviations are used in this Guide:

Abbreviation	Meaning
APER	FSA Handbook: High Level Standards - Statements of Principle and Code of Practice for Approved Persons
AR	Appointed Representative
AUTH	FSA Handbook: Regulatory Process - Authorisation
BSD	A claim for breach of statutory duty under section 150 FSM Act
BCD	Banking Coordination Directive
CIS	Collective Investment Scheme
CIS	FSA Handbook: Specialist Sourcebooks - Collective Investment Schemes
COAF	FSA Handbook: Redress - Complaints against the FSA
COB	FSA Handbook: Business Standards - Conduct of Business
COMP	FSA Handbook: Redress - Compensation
COND	FSA Handbook: High Level Standards - Threshold Conditions
(CRED)	FSA Handbook: Specialist Sourcebooks - Credit unions (in force from 1 July 2002)
DEC	FSA Handbook: Regulatory Processes - Decision making
DISP	FSA Handbook: Redress - Dispute resolution: Complaints
DPB	Designated Professional Body
DPP	Director of Public Prosecution
EEA	European Economic Area
ENF	FSA Handbook: Regulatory Processes - Enforcement
EU	European Union
FIT	FSA Handbook: High Level Standards - The Fit and Proper test for Approved Persons
FN	Final Notice
FOS	Financial Ombudsman Service
FSA	Financial Services Authority
FSA 1986	Financial Services Act 1986
FSCS	Financial Services Compensation Scheme
FSM Act	Financial Services and Markets Act 2000
GEN	FSA Handbook: High Level Standards - General provisions
HMT	HM Treasury
HRA	Human Rights Act 1998
ICA	Insurance Companies Act 1986
ICVC	Investment company with variable capital (ie UK OEIC)
ID	Insider dealing
IPRU	FSA Handbook: Business Standards - 5 Interim Prudential sourcebooks

ISD	Investment Services Directive
IVA	Individual voluntary arrangement (an insolvency procedure)
LLD	FSA Handbook: Specialist Sourcebooks- Lloyd's
MA	Market abuse
MAR	FSA Handbook: Business Standards - Market conduct, including: Code of market conduct, Price stabilising rules, Inter-professional conduct and Endorsement of the Takeover Code
ML	Money laundering
ML	FSA Handbook: Business Standards - Money Laundering
(MORT)	FSA Handbook: Specialist Sourcebooks - (Later: Mortgages)
MPO	Miscellaneous Provisions Order
NoD	Notice of Determination
Non-RTC	Non Real Time Communication
OEIC	Open Ended Investment Company
OPS	Occupational Pension Scheme
PRIN	FSA Handbook: High Level Standards - Principles for Business
PROF	FSA Handbook: Specialist Sourcebooks - Professional firms
RAO	Regulated Activities Order
RCH	Recognised Clearing House
REC	FSA Handbook: Specialist Sourcebooks - Recognised Investment Exchanges and Recognised Clearing Houses
RIE	Recognised Investment Exchange
RTC	Real Time Communication
SAR	Substantial Acquisition Rules
Sec of S	Secretary of State
SHP	Stakeholder pension
SI	Statutory Instrument
SN	Supervisory Notice
SRO	Self Regulating Organisation under FSAct 1986
SUP	FSA Handbook: Regulatory Processes - Supervision
SYSC	FSA Handbook: High Level Standards - Senior Management Arrangements, Systems and Controls
TC	FSA Handbook: Business Standards - Training and Competence
Tesco Defence	The defence of taking all reasonable precautions and exercising all due diligence as set forth in the case of Tesco v Nattrass [1972 AC 153]
UK	United Kingdom
UTM	Unit Trust Manager
UTS	Unit Trust Scheme
(UKLA)	FSA Handbook: Specialist Sourcebooks - (Later: United Kingdom Listing Authority)

Tribunal	The Financial Services and Markets Tribunal
WN/DN	The procedure for issuing a warning notice followed by a decision notice set out in section 10.2.
+/-	With or without
➔	Leads to/resulting



## C - Location of Statutory Instruments and FSA Material

This section contains the following:

- A list of Statutory Instruments made/to be made under FSM Act, and where they are discussed in this Guide.
- A list of where the contents of the FSA Handbook are discussed in this Guide.
- A list of the FSA Consultation Papers and similar documents discussed in this Guide.

### Statutory Instruments

This section lists the SIs referred to in this Guide and states where they are discussed.

Those with SI numbers have been “made”; those without are still in draft.

Statutory Instrument	SI No	Guide
FSM Act 2000 -		
- Appointed Representatives	2001/1217	4.6.2
- Appointed Representatives (Amendment)	2001/2508	4.6.2
- Bankruptcy (FSM Act)	2001/3634	21.2.1
- Carrying on Regulated Activities by way of Business	2001/1177	2.2.3
- Collective Investment Schemes	2001/1062	12.1.1
- Collective Investment Schemes Constituted in other EEA States	2001/2383	12.5.1
- Commencement No 1	2001/516	D1
- Commencement No 2	2001/1282	D1
- Commencement No 3	2001/1820	D1
- Commencement No 4	2001/2364	D1
- Commencement No 5	2001/2632	D1
- Commencement No 6	2001/3436	D1
- Commencement No 7	2001/3538	D1
- Communications by Auditors	2001/2587	20.4.3
- Compensation Scheme: Electing Participants	2001/1783	13.2.4
- Competition Information (Specification of Enactment etc)	2001/1858	10.7.1
- Confidential Information (Bank of England) (Consequential Provisions)	2001/3648	10.7.2
- Consequential & Transitional Provisions (Miscellaneous)	2001/1821	D3.1
- Consequential & Transitional Provisions (Miscellaneous) (No 2)	2001/2659	D10.1
- Consequential Amendments & Repeals	2001/3649	22.4
- Consequential Amendments (Industrial Assurance)	2001/3647	22.9
- Consequential Amendments (No 2)	2001/3801	22.9
- Consequential Amendments (Pre-Commencement Modifications)	2001/2966	D10.6
- Consultation with Competent Authorities	2001/2509	7.8.3
- Control of Business Transfers (Requirements on Applicants)	2001/3625	15.6.1

- Control of Transfers of Business Done at Lloyd's	2001/3626	15.6.2
- Controllers (Exemption)	2001/2638	7.8.1
- Controllers Exemption (No 2)	2001/3338	7.8.2
- Designated Date for certain SROs	2000/1734	D10.5
- Designated Date for SFA	2001/2255	D10.5
- Designated Professional Bodies	2001/1226	19.2
- Disclosure of Confidential Information	2001/2188	10.7.2
- Disclosure of Confidential Information (Amendment)	2001/3437	10.7.2
- Disclosure of Confidential Information (Amendment) (No 2)	2001/3624	10.7.2
- Disclosure of Information by Prescribed Persons	2001/1857	9.4.3
- Dissolution of Board of Banking Supervision	2001/3582	D10.3
- Dissolution of IBRC	2001/1283	22.9
- EEA Passport Rights	2001/2511	4.6.3
- Exemption	2001/1201	4.6.1
- Exemption (Amendment)	2001/3623	4.6.1
- Financial Promotion	2001/1335	3.5.3
- Financial Promotion (Amendment)	2001/2633	3.5.3
- Financial Promotion Amendment (No 2)	2001/3800	3.5.3
- FSM Tribunal (Legal Assistance)	2001/3632	10.6.3
- FSM Tribunal (Legal Assistance Scheme – Costs)	2001/3633	10.6.4
- FSM Tribunal Rules	2001/2476	10.6.2
- Gaming Contracts	2001/2510	22.9
- Gibraltar	2001/3084	22.3
- Insolvency (Definition of “Insurer”)	2001/2634	21.2.3
- Insurers (Winding Up)	2001/3635	21.2.3
- Interim Permissions	2001/3374	D4.8
- Law Applicable to Contracts of Insurance	2001/2635	22.9
- Law Applicable to Contracts of Insurance (Amendment)	2001/3542	22.9
- Meaning of “Policy” and “Policyholder”	2001/2361	22.6, 9
- Miscellaneous Provisions	2001/3650	D4, D10.2
- Misleading Statements & Practices	2001/3645	10.5
- Mutual Societies	2001/2617	22.1
- OEIC Regulations	2001/1228	12.4
- Own Initiative Power (Overseas Regulators)	2001/2639	5.6.1
- Prescribed Markets & Qualifying Investments	2001/996	11.1
- Prescribed Markets and Qualifying Investments (Amendment)	2001/3681	11.1
- Professions (Non Exempt Activities)	2001/1227	19.3
- Promotion of CIS (Exemptions)	2001/1060	12.2.1

- Recognition Requirements for IE and CH	2001/995	16.2
- Regulated Activities	2001/544	2.1
- Regulated Activities (Amendment)	2001/3544	2.1
- Regulations relating to Money Laundering	2001/1819	10.5.5
- Rehabilitation of Offenders (Scotland)	2001/3640	D10.1
- Rights of Action	2001/2256	8.3.1
- Scope of Permission Notices	2001/3771	D4.4
- Service of Notices Regulations	2001/1420	1.6.4
- Transitional Provisions & Savings (Civil Remedies)	2001/2657	D7
- Transitional Provisions & Savings (Civil Remedies) (No. 2)	2001/3083	D7
- Transitional Provisions & Savings (Rules)	2001/1534	D3.2
- Transitional Provisions (Authorised Persons) etc	2001/2636	D4
- Transitional Provisions (Business Transfers)	2001/3639	D10.4
- Transitional Provisions (Controllers)	2001/2637	D6
- Transitional Provisions (Designated Dates for certain SROs)	2001/1734	D10.5
- Transitional Provisions (FS Compensation Scheme)	2001/2967	13.2.5
- Transitional Provisions (Information Requirements & Investigations)	2001/3646	D9
- Transitional Provisions (Ombudsman & Complaints)	2001/2326	D5.1
- Transitional Provisions (Partly Completed Procedures)	2001/3592	D8
- Transitional Provisions (Reviews of Pensions Business)	2001/2512	1.6.5
- Transitional Provisions, Repeals & Savings (FS Compensation Scheme)	2001/2967	13.2.5
- Treatment of Assets of Insurers on Winding Up	2001/2968	21.2.3
- Unfair Terms in Consumer Contracts Regulations	1999/2083	1.6.3
- Variation of Threshold Conditions	2001/2507	5.6.2

## Contents of the FSA Handbook

This section sets out where the contents of the FSA Handbook (ie rules, regulations, policies and procedures) are discussed in this Guide. The contents of the FSA Handbook are set out using FSA's terminology.

	<b>FSA Sourcebook or manual</b>	<b>Reference Code</b>	<b>Guide</b>
High Level Standards	Principles for Business	PRIN	8.5.1
	Senior Management Arrangements, Systems and Controls	SYSC	6.7.5
	Threshold Conditions	COND	4.6.4
	Statements of Principle and Code of Practice for Approved Persons	APER	6.7.6
	The Fit and Proper Test for Approved Persons	FIT	6.7.4
	General provisions	GEN	8.5.2
Business Standards	5 Interim Prudential sourcebooks	IPRU	8.5.3
	Conduct of Business	COB	8.5.6
	Market conduct, including: Code of market Conduct, Price stabilising rules, Inter-professional code and Endorsement of the Takeover Code	MAR	8.5.5 and 11.5.2
	Training and Competence	TC	8.5.9
	Money Laundering	ML	8.5.8
Regulatory Process	Authorisation	AUTH	4.6.4
	Supervision	SUP	9.4.2
	Enforcement	ENF	10.8.1
	Decision making	DEC	10.8.2
Redress	Dispute resolution: Complaints	DISP	14.5.1
	Compensation	COMP	13.2.1
	Complaints against the FSA	COAF	1.6.1
Specialist Sourcebooks	Collective Investment Schemes	CIS	12.10.1
	Credit Unions (in force from 1 July 2002)	CRED	
	Professional firms	PROF	19.7.2
	Lloyd's	LLD	18.5.1
	Later: Mortgages	MORT	8.5.10
	Recognised Investment Exchanges and Clearing Houses	REC	16.3.1
	(Later: United Kingdom Listing Authority)	(UKLA)	17

## FSA Consultation Papers and Policy Statements

This section lists and gives the location of the FSA Consultation Papers, discussion documents and similar referred to in this Guide. A "Policy Statement" is FSA's name for final policy plus applicable rules, and are listed on the proceeding page.

No	Name of Consultation Paper or Policy Statement	Guide
25	Enforcing the New Perimeter	2.6.1
26	Regulation of Approved Persons	6.7
29	Permission Regime	4.9
30	Professional Firms	19.7.1
31	Prudential Standards	8.5.3
35	Senior Management Arrangements, Systems and Controls	6.7
39	RIE/RCH Sourcebook	16.3
41	Interim Prudential Sourcebook: Friendly Societies and Insurers	8.5.13
43	Customer Classification	8.5.4
45	Conduct of Business	8.5.6, 7
46	Money Laundering	8.5.8
47	Inter-Professional Conduct	8.5.5
48	Lloyd's Sourcebook	18.5.1
49	Complaints Handling Arrangements:	14.5.1
51	Interim Prudential Sourcebook - Building Societies	8.5.3
52	Interim Prudential Sourcebook - Banks	8.5.3
53	Regulation of Approved Persons - Controlled Functions	6.7
54	Interim Prudential Sourcebook - Investment Business	8.5.13
55	Service Company Regime	8.5.12
56	Funding FSA's Activities Post N2	1.6.2
57	Conduct of Business Supplement	8.5.6
58	Compensation Scheme Rules	13.2.1
59	Code of Market Conduct	11.5.2
60	Training & Competence	8.5.9
62	CIS Sourcebook	12.10.1
63	Authorisation Manual	4.6.4
64	Supervision Manual	9.4.2
65	Enforcement Manual	10.8.1
66	Lloyd's Prudential	18.5
69	Exempt Professional Firms	19.7.2
70	Mortgage Regulation	2.2.10
71	General Provisions	8.5.2

73	Complaints Commissioner	1.6.1
74	Funding Financial Ombudsman Scheme	14.5.2
76	Supplement to Code of Market Conduct	11.5.2
79	Post-N2 Fee Raising	1.6.2
80	Reforming Polarisation	1.6.10
83	Inter-Professional Conduct	8.5.5
84	Interim Prudential Sourcebook: Friendly Societies & Insurers	8.5.3
85	CIS Sourcebook	12.10.1
86	Compensation Scheme Funding Rules	13.2.2
89	Grandfathering Concessions and Individual Guidance	3.4
90	Procedural Formalities for Handbook	8.4
91	Skilled persons	9.4.2
93	Complaints against FSA	D5.2, 1.6.1
97	Draft Integrated Prudential Sourcebook	8.5.3
98	Draft Mortgage Sourcebook	8.5.10
99	Complaints	D5.1, 14.5.1
101	Whistleblowing	6.9
104	Authorisation Manual: further consultation	2.2.11, 3.5.2, 8.4
108	Financial Services Compensation Scheme - Transitional Rules	13.2.5
109	Financial Services Compensation Scheme - Management Expenses Limit	13.2.2
110	Insurance Business & Friendly Society Transfers	15.6.2
115	Timetable for Integrated Prudential Sourcebook	8.5.3
117	Regulation of Electronic Money Issuers	1.6.8
Conduct of Business Sourcebook Transitional		8.5.7
Countdown to N2 - Grandfathering		D4.3
FSA's Approach to the Regulation of e-commerce June 2001		1.6.7
FSA's requirements on Outsourcing		8.5.11
Grandfathering - Firms, Individuals and Products: Policy Statement 12/2000		D4.9
Grandfathering - Waivers; Policy Statement 12/2000		3.3.4
Guidance/waivers to Firms: Policy Statement 9/1999		8.4.1
Handbook Notices 1&2		D2
High Level Standards for Firms and Individuals: Policy Statement 2/2001		6.7
Lead Supervision: FSA's New Approach June 1999		9.4.2
Principles for Business		8.5.1
Principles for Business - High Level Standards: Policy Statement 2/2001		8.5.1
Regulation of Approved Persons - Controlled Functions: Policy Statement 2/2001		6.7

Regulation of Electronic Money Issuers December 2001	1.6.8
Service Company Regime	8.5.12
Treating Customers Fairly after Point of Sale June 2001	1.6.9

## D - Commencement and Transitional Provisions

### Summary:

This section summarises the provisions which address the transition from the FSAct 1986, Insurance Companies and Banking Acts regime to the FSM Act 2000. It was originally intended to set out the transitional provisions in two "omnibus" statutory instruments (early drafts of which were summarised in the first draft of this section D). These have now been superseded by a number of separate statutory instruments, which provide as follows:

Commencement of FSM Act (1)

Commencement of FSA's Handbook (2)

- FSA's Rules (3)
- Grandfathering of Firms, Individuals & Products (4)
- Complaints (5)
- Change of Control (6)
- FSA's Civil & Criminal Powers (7)
- Pending Applications & Disciplinary Proceedings (8)
- Ongoing Investigations & Information Requests (9)
- Miscellaneous Transitional Provisions (10)

### Further transitional provisions are contained in this Guide as follows:

- RAO commencement (2.2.6)
- FPO transitionals (FPO Art 74) (3.5)
- EEA passport rights (4.6.3)
- Grandfathering firms, individuals and products (4.6.4)
- Conduct of Business (8.5.6)
- Compensation scheme (13.2.5)
- Auditors (20.4.4)

### 1. Commencement of FSM Act

Nearly all of the FSM Act has been commenced.

#### 1.1 Commencement Order No 1: SI 2001 No. 516

Parts of the FSM Act commenced (25th February 2001): principally powers to make subordinate legislation, orders and regulations.

#### 1.2 Commencement Order No 2: SI 2001 No. 1282

Parts of FSM Act commenced (30th April 2001): repealing existing legislation relating to insurance brokers.



### 1.3 Commencement Order No 3: SI 2001 No. 1820

Coming into force on 18th June 2001 were the following provisions:

- Constituting the FSA as the single financial services regulator.
- Giving the FSA the power to make rules.
- Establishing the compensation scheme.
- Establishing the Ombudsman scheme.

While these bodies did not acquire full powers until N2, they could now formally make rules and give guidance in preparation for that date.

### 1.4 Commencement Order No 4: SI 2001 No. 2364

Parts of FSM Act commenced (3rd July 2001):

From 30th July 2001, places Financial Services and Markets Tribunal under supervision of the Council on Tribunals.

From 19th July 2001, enables FSA to make complaints scheme and appoint investigator in accordance with paragraphs 7 and 8 of Schedule 1.

### 1.5 Commencement Order No 5: SI 2001 No. 2632

Parts of FSM Act commenced:

From 20<sup>th</sup> July 2001, provisions relating to insolvency (as noted in the Guide).

From 3<sup>rd</sup> September 2001, provisions relating to making of applications and granting of permissions for effect on N2 (as noted in the Guide).

### 1.6 Commencement Order No 6: SI 2001 No. 3436

From 19<sup>th</sup> October 2001, Section 402 commenced (power to institute proceedings for money laundering).

### 1.7 Commencement Order No 7: SI 2001 No. 3538

This brought into force **all** the provisions of FSM Act on 1<sup>st</sup> December 2001 which were not already enforced, subject only to the following:

- Section 104 comes into force for insurance business transfer schemes only
- Section 347 (1) and (2) – record of authorised persons - will be introduced as follows, and FSA is only required to maintain records from the stated date, although it may choose to do so earlier.
  - ex-RPB firms: 1 August 2002
  - EEA/Treaty firms: 1 May 2002
  - Approved persons: 1 December 2002
- Section 416(3)(b) and (c): winding up of the Policyholder Protection Board and Depositors Protection Board will come into effect of 2 March 2002.
- Part V Schedule 18 and Schedule 22: matters relating to Credit Unions and repeal of Credit Unions Act 1979 will come into force on 2 July 2002.

## 2. Commencement of FSA's Handbook

A large portion of the FSA Handbook was made at the FSA board meeting of 21st June 2001, and came into force on that date (see **Handbook Notice 1** - June 2001).

The Handbook Notice:

- Sets out which parts of the Handbook have been made (3).
- Summarises developments to each module, giving a brief history and the latest alterations (4).
- Sets out a number of significant recent changes to the Conduct of Business Rules (6).

The separate parts of the Handbook were commenced as follows:

- Certain parts of the Handbook came into force on 21st June 2001 in order to implement administrative provisions (but without imposing binding requirements). These included:
  - The Reader's Guide.
  - Glossary.
  - Most of General Provisions (GEN).
  - Chapter 9 of the Supervision Manual (SUP).
- Further parts of the Handbook were made on 19<sup>th</sup> July 2001 (see **Handbook Notice 2** – July 2001). They are:
- Volume 2 of the Interim Prudential sourcebook for Building Societies;
- The Interim Prudential sourcebook for Friendly Societies (IPRU (FSOC));
- Amendments to the Code of Market Conduct (MAR 1);
- Amendments to the Supervision manual (SUP) in order to bring in transitional provisions for grandfathering waivers and similar concessions and also for written guidance given before N2;
- The arrangements for handling complaints against the FSA, and the transitional arrangements for handling complaints against the FSA and the self-regulated organisations (COAF); and
- The provisions for application fees which are set out in chapters of the Authorisation manual (AUTH); the Collective Investment Schemes sourcebook (CIS) and the Regulated Investment Exchange and Recognised Clearing House sourcebook (REC).
- Parts coming into force on 3rd September 2001 (corresponding to those parts of the FSM Act commenced by Commencement Order 5) were materials to enable FSA to consider applications, including:
  - Authorisation manual (AUTH).
  - Threshold Conditions (COND).
  - Fit and Proper Test (FIT).
  - Supervision Manual Chapters 6, 8 and 10 (SUP).
  - Decision Making Manual (DEC).
  - Relevant parts of the Enforcement Manual (ENF).
- Most of the remainder of the Handbook came into force on 1st December 2001 (N2) including:
  - High level standards.

- Business standards.
- Regulatory process.
- Specialist sourcebooks.

### 3. FSA's Rules

#### 3.1 Application of FSA's rules

The definition of "consumers" in section 138, in addition to that contained in sub-section (7), shall include users of regulated services prior to N2, people who have rights derived from such use, or whose rights may be adversely affected by their agents' or trustees' use of such services. Section 138(8) and (9) FSM Act will therefore include the pre-N2 activities of authorised persons (**Consequential and Transitional Provisions (Miscellaneous) Order SI 2001 No 1821**).

#### 3.2 Power for FSA to make transitional rules

The **Transitional Provisions and Savings (Rules) Order (SI 2001 No 1534)** will come into force at the same time as section 138 (which confers rule making powers on FSA), and makes transitional provisions in relation to FSA's rule making powers. It enables FSA to designate existing rules and legislative provisions which will be repealed or lapse at N2 to continue thereafter as if made by FSA, together with associated modifications or waivers. FSA has used this power to issue transitional Conduct of Business Rules.

It also enables FSA to complete consultation for rules and other material undertaken prior to the FSM Act having received Royal Assent.

A "pre-commencement provision" is defined to mean an enactment, subordinate legislation, provision (such as Rule or Principle) or guidance which FSA wishes from N2 to apply to all or to a class of persons (and therefore not just to a single firm).

FSA may, prior to N2, designate such a provision in writing (4), in which case it shall be a "continued rule". FSA must modify a continued rule (5) to ensure that it has the same effect both before and after N2, and may narrow its application. A private investor who suffers loss because of a firm's breach of a continued rule will generally have an action for damages under section 150 FSM Act (6).

#### 3.3 Grandfathering of rule waivers and modifications

Where a waiver or modification of a designated pre-commencement provision is in operation in relation to a person immediately before N2, and that person is subject to the continued rule, then the modification or waiver shall have effect after N2 as if it were a direction under section 148(2) that the rule be waived or modified, subject to any pre-existing conditions (which will be deemed to have been imposed under section 148(5)), and without the usual requirement for publicity (8).

#### 3.4 CP89 – Grandfathering Concessions and Individual Guidance: April 2001

This amplified FSA's Briefing Note on Grandfathering of Waivers (December 2000). It detailed FSA's proposal to issue a transitional rule which will achieve:

- **Existing written waivers** and any attached conditions will be carried forward as amendments to the corresponding new rule, provided that it is sufficiently similar to the waived rule. Period of carry-forward: 12 months, after which firms must seek a fresh waiver. For implementation, see SUP TPs.
- **For building societies and banks**, waivers will be carried forward as amendments to general guidance in the Interim Prudential Sourcebooks. This will be effective for all purposes, including FSA enforcement action, and to protect against s150 FSM Act

claims. Period of carry-forward: until the Interim Prudential sourcebooks cease to apply, after which firms must seek a fresh waiver.

- **Individual guidance** will not be formally carried forward but will continue to remain relevant to a sufficiently similar rule in appropriate circumstances. SUP TP 6A requires the guidance to be written.

#### 4. Grandfathering of firms, products and individuals at N2 - the statutory framework and FSA's procedure

Under the **Transitional Provisions (Authorised Persons etc) Order (SI 2001 No 2636)**, (as amended by **the Miscellaneous Provisions Order (SI 2001 no. 3650)** articles 6-12) persons authorised or exempted under current legislation will, on N2, have Part IV permission to carry on activities which they could previously lawfully carry out. A person may only hold one Part IV permission, although this may encompass all regulated activities (article 24).

FSA's policy as set out in a Briefing Note of December 2000 is at 4.9.

##### 4.1 Grandfathered firms

Persons thus "grandfathered" are:

- Persons authorised under section 25 FSAct - **direct FSA authorisation** - (but not for business for which they are exempted, or are authorised under sections 24 or 24A FSAct - operators and trustees of recognised schemes; and ICVCs) (Article 3).
- Persons authorised under section 7 FSAct - **SRO firms** - (but subject to the same qualification) (Article 4).
- Persons authorised under section 15 FSAct by holding a certificate from a **designated professional body**, and who have given notice that they wish to have a Part IV permission (but not for business for which they are exempted) (Article 5).
- A section 43 **listed institution** (and thus an exempted person under the FSAct) will have an appropriate Part IV permission (Article 6).
- Lloyd's underwriting agents (Article 7).
- Lloyd's members' advisers who have lawfully advised on syndicate participation at Lloyd's prior to N2, provided they make application for a part IV permission and may continue after N2 pending authorisation (article 8).
- An **appointed representative** who is authorised on N2 will have permission to carry on regulated activities for which it was previously exempted (Article 9).
- A person authorised under the FSAct 1986 who carries on **investment business outside the United Kingdom** without contravening the ISD Regulations or FSA/SRO/RPB rules will have on N2 a Part IV permission for such business (Article 10). Similar provisions apply to **overseas banking business** (Article 12) and **overseas insurance business** (Article 17). These overseas provisions are relevant under section 418 FSM Act.
- Institutions authorised under the Banking Act for United Kingdom **banking business** plus previously exempt insurance business and dealing as principal in contractually based investments (MPO Article 6) (Article 11).
- Persons authorised under the Banking and Building Societies Acts will have Part IV permission to continue to carry on **non-banking listed activities** (as defined) on a branch or services basis in a member state subject to stated conditions (Article 13).
- **Insurers** authorised under the ICAct (Article 14), plus dealing as principal in contractually based investments (MPO Article 7).
- EC companies (as defined in the ICAct) which carry on **reinsurance business** through UK branches (15).

- EC companies (as defined in the ICAct) which carry on certain **investment business** in the United Kingdom (Article 16).
- **Friendly Societies** (Articles 18 to 20) and their overseas insurance business (Article 21), plus dealing as principal in contractually based investments (MPO Article 8).
- **Building societies** (Article 22) and their overseas banking business (Article 23) plus previously exempt insurance business plus dealing as principal in contractually based investments (MPO Article 9).
- An **EEA firm which has passported** into the United Kingdom in compliance with 2BCD or the ISD Regulations (Article 25), or in compliance with the ICAct and by carrying out direct insurance through a UK branch (Article 26) or providing insurance in the United Kingdom (Article 27) will be deemed to have satisfied the establishment or service conditions in Schedule 3 FSM Act and therefore qualify for authorisation under that schedule with corresponding permitted activities.
- **Treaty firms** authorised under section 31 FSAct (Article 29), a treaty firm carrying out reinsurance business through a United Kingdom branch (Article 30) and a treaty firm carrying on investment business in stated circumstances (Article 31) will be deemed to have given appropriate notice under Schedule 4 FSM Act.
- A United Kingdom firm which **established a branch or provided services** in a member state prior to N2 in accordance with 2BCD, the ISD, ICAct or Friendly Societies Act, will be treated as having satisfied the FSM Act's Schedule 3 requirements (Article 77).

## 4.2 Prohibitions and restrictions on firms will be carried forward

Prohibitions and restrictions imposed under the current regulatory regime will be carried forward after N2 under section 43 (Part IV permission, but subject to supplementary provisions (Article 54)), or section 196 (for Schedule 3 (passport) and Schedule 4 (treaty firm) permissions).

These include:

- Prohibitions/requirements under sections 65 to 68 FSAct (Articles 34 to 36).
- Prohibitions/requirements imposed by SROs and RPBs (Articles 35 and 36).
- Prohibitions/requirements imposed urgently by FSA under 2BCD/ISD (Article 37).
- Restrictions under section 12 Banking Act (Article 38) and directions under sections 19 and 20 Banking Act (Article 39).
- Directions (Article 40) and requirements (Article 41) under the ICAct; directions and requirements under schedule 2F ICA (Article 44); court orders under section 40A ICAct (Article 42).
- Requirements imposed on former Lloyd's underwriting members (Article 43).
- Conditions under the Friendly Societies Act (Article 45) and directions (Articles 46, 47 and 49) made under it and court orders under section 52A (Article 48).
- Conditions imposed and directions under the Building Societies Act (Articles 50 and 51).
- Prohibitions and restrictions under 2BCD and ISD (Articles 52 and 53).

## 4.3 FSA's procedure for grant of permissions to firms at N2

FSA is required to follow a pre-N2 procedure to clarify the scope of permissions arising from these transitional provisions. In **Countdown to N2: Grandfathering**, issued by FSA in July 2001, FSA set out how it planned to implement this procedure:

September 2001: FSA will send Scope of Permissions Notices and draft Controlled Functions lists to firms.

October: Target date for responses.

December: Formal deadline for finalising Scope Notices.

February 2002: FSA to have sent final Functions lists to firms.

- FSA must issue a scope of permission notice ("Notice") to each person holding a Part IV permission as a result of this SI, setting out that person's permitted activities together with any requirements under section 43 FSM Act. This does not include firms that passport into the United Kingdom. The Notice must go out as soon as reasonably practicable after the Order comes into force in mid-August, and (except for ex-RPB firms) FSA must use its best endeavours to send out these notices prior to N2 (Article 55).
- The Notice must give a period of at least 3 months for the recipient to notify FSA if it agrees, or why it disagrees. FSA may amend the Notice in the meantime (Article 56). FSA envisages that the Notice will allow a firm to carry out exactly the same activities post N2 as it was authorised for pre N2. FSA says that firms should check the Notice carefully, with legal advice if necessary (*Countdown* 2.5, 2.6). FSA expects that issues will be queried informally prior to formally disagreeing with the notice (2.8, 2.9).

FSA will use a series of "maps", which it will publish on its website, to "translate" current activities into their post N2 requirements (4.2). A firm's activities contained in the Notice should therefore correspond to its pre-N2 activities, save that neither waivers (5.1), outward passporting (6.2) nor AR activities (7.5) will be referred to.

- If a person disagrees or does not respond, FSA must give further notice and, if still dissatisfied, the person may refer the matter to the Tribunal (Article 58).
- Once settled by agreement (Articles 57 and 59), by failure to respond (Article 59) or by the Tribunal (Article 60), the Notice will be conclusive as to Part IV permission granted, and any section 43 requirements, applicable at N2.
- Section 20 FSM Act, which is concerned with an authorised person acting without the requisite permissions, is disapplied while a person carries on a regulated activity after N2 during this process (Article 62).

#### 4.4 Scope of Permission Notices (2001 No. 3771)

This Order enabled FSA to correct some Scope of Permission Notices by the issue of Correction Notices prior to N2. This Order is additional to, and amends, articles 29 and 30 of the Miscellaneous Provisions Order (5).

This Order lists 6 errors contained in FSA's Permission Notices (3) and sets out the revisions which FSA may make (4). They are as follows:

- Case 1: Firms authorised to deal as principal but where reference to contractually based investments was omitted from the Scope of Permission Notices.
- Case 2: PIA firms whose Scope of Permission Notice includes advising on investments should include advising on rights and interests in those investments.
- Case 3: Where a firm's Scope of Permission Notice gave permission to carry on a regulated activity in relation to a particular kind of investment, but wrongly gave

permission to advise on rights and interests in investments generally, rather than that particular investment.

- Case 4: IMRO/PIA firms allowed to carry out custody but who were wrongly prohibited from holding or controlling client money.
- Case 5: IMRO/PIA firms whose Statement of Permission allowed them to establish a collective investment scheme or stakeholder pension scheme, but wrongly purported to limit the permission to a specified kind of investment.
- Case 6: IMRO firms whose Statement of Permission included dealing as agent for stock lending, but wrongly excluded government and public securities from the scope of this Permission.

#### 4.5 FSA may require compulsory reapplication for permission

Within 2 years of N2, FSA may require a class of persons with Part IV permission to re-apply for permission (Article 63). Such a direction must state reasons and allow at least three months to reapply (Article 64).

#### 4.6 Grandfathering of collective investment schemes

The authorised or recognised status of collective investment schemes will be carried forward as if conferred under Part XVII.

- Authorised unit trust schemes (Article 65) subject to directions previously imposed (Article 69).
- Schemes constituted in other EEA states (Article 66), in designated countries and territories (Article 67) and individually registered schemes (Article 68) subject to directions previously imposed (Articles 69 to 71).

#### 4.7 Grandfathering of individuals - Approved persons

Where someone is working for an authorised person either directly or through its contractor prior to N2 in a post for which they will need to be approved after N2 under Part V FSM Act, then that person will generally be treated as approved for section 59 FSM Act (Article 72).

This includes persons approved under sections 60 and 61 ICACT but who had not taken up appointment prior to N2 (Articles 74 and 75) and partners in a banking firm in similar circumstances (Article 76).

But this does not apply to a person who has been served with a notice of objection under ISD Regulations, Banking Act, ICACT or FSACT 1986, or if their employment constituted contravention of an SRO rule. However, this exception does not apply where that person is merely subject to conditions (Article 73).

FSA sent all firms in September 2001 a draft list of individuals who were then registered with an SRO or who were already approved under FSM Act and, where known, their intended controlling functions. Firms were requested to complete and return this form by October. FSA issued formal lists shortly after N2 (**Countdown to N2: Grandfathering**, July 2001 section 8).

An individual disqualified under section 59 FSACT will be deemed prohibited under section 56 FSM Act (Article 79), but MPO Article 10 provides that information about the prohibition will only be divulged on express request.

#### 4.8 Interim Permissions (2001 No. 3374)

This Order confers interim permissions on persons who had applied to FSA for Part IV Permission prior to 31<sup>st</sup> October 2001 under sections 40 or 44 FSMA Act, and whose applications were pending on N2, subject to two provisos:

- That they were lawfully carrying on an activity prior to N2 which was regulated for the first time after N2 (3-7);
- That they were not subject to prohibitions such as a ban or a suspension (10).

This interim permission will last until the person withdraws its application with FSA's consent, the permission is granted or is determined by the Tribunal (8).

Schedule to the Order applies the FSM Act to individuals with transitional approval under the Authorised Persons Order to perform a controlled function for a person with interim permission. This transitional approval lasts until the interim permission lapses in accordance with (8), approval is granted or the matter is determined by the Tribunal (9).

## 4.9 Grandfathering Of Firms, Individuals and Products (FSA Briefing Note - December 2000)

Under the Treasury's Transitional Order, firms and individuals will not need new permissions or approvals after N2 where they already hold equivalent status under the FSA 1986:

- **Authorised firms**, including those authorised under the Financial Services, Banking and Insurance Companies Acts, together with firms which have passported in. These firms should be sent notification of FSA's intended permissions some three months before N2, together with any limitations or requirements which FSA intends to impose. FSA does, however, have reserve powers to require firms, or groups of firms, to apply for authorisation for up to two years from N2. FSA says that it could use this power where there was evidence of widespread failure by a class of firms to meet FSA's authorisation requirements (CP29 para 3.167).
- **Exempt persons**: they will remain exempt or otherwise be grandfathered with necessary permissions.
- **Approved persons**: They will be grandfathered whether or not they are currently individually registered.
- **Collective investments schemes**: will remain recognised.

But:

- **Professional firms**: will not be grandfathered, and will need authorisation where required.
- **Newly regulated activities** such as mortgage lending: will not be grandfathered, and will need authorisation where required.

## 5. Complaints

### 5.1 Complaints against firms

Under the Transitional Provisions (**Ombudsman Scheme and Complaints Scheme**) Order (SI 2001 No. 2326), complaints relating to pre-N2 acts or omissions which fall or would have fallen within the scope of the Banking, Building Societies or Insurance Ombudsman, or the IMRO, PIA, SFA or FSA complaints scheme (the "former schemes") will from N2 fall to be dealt with under the new Financial Ombudsman Scheme ("FOS"), subject to appropriate procedural modifications. In particular:

- Partly determined complaints will be handled by the new scheme (2).
- A complaint referred to the new scheme in relation to a pre-N2 act or omission which would have gone to a former scheme will generally fall within the compulsory jurisdiction (3).

FSA has issued **CP99 - Complaints Handling** (June 2001) which consults on amendments to the Complaints Sourcebook proposed in light of this SI, and contains amended rules. The



principal additions to the DISP rules set out in the December 2000 Policy Statement (see 14.5.2) address:

- **Relevant existing complaints.** These are partly determined complaints made to former schemes before N2, which will now be handled by FOS in accordance with the former schemes' procedures (subject to necessary amendments). This is set out in a new Appendix 1 to DISP, which amends the DISP rules for the purpose.
- **Relevant new complaints.** These are new complaints made to FOS after N2 but regarding pre-N2 business covered by a former scheme. These will be handled in accordance with the DISP rules, subject to certain amendments as contained in the revised rules.

## 5.2 Complaints against FSA

FSA may (from 19th July 2001) investigate pre-N2 complaints about either its functions, or those of an SRO, under the arrangements for FSA to investigate complaints relating to itself under FSM Act in Schedule 1 paragraphs 7 and 8: (SI Article 18).

CP93 (May 2001) proposes to extend the post-N2 regime to the following classes of pre-N2 complaints ("old complaints"):

- FSA's acts and omissions under FSA Act 1986.
- FSA's acts and omissions under Banking Act 1987, but only from 1 June 1998
- SROs' acts and omissions.

These old complaints will be investigated by the Complaints Commissioner (see 1.6.1 below) under a transitional complaints scheme (effectively the post-N2 scheme, but without the power to recommend compensation). However, if at N2 an existing commissioner is already investigating the complaint, then he will complete his work under the current scheme and not the FSM Act one.

## 6. Matters relating to change of control

The **Transitional Provisions (Controllers) Order (SI 2001 No. 2637)** makes transitional provisions in relation to persons required to notify significant shareholdings under Part XII FSM Act. It comes into force on N2.

- Where a person has **served notice of control** under the ISD Regulations, Banking Act, Insurance Companies Act or Friendly Societies Act (the "former legislation") and the acquisition has not been approved by N2, then that notice will be deemed to have been given under section 178(1) (article 3) with a period for consideration determined in accordance with article 4(2).
- An **outstanding request for information** or documentation under the former legislation will be treated as if made under section 183(2) (article 4 (1)).
- If before N2 a person **proposes to acquire an interest** by taking a step which, after N2, would oblige him to notify FSA under section 178(1) but has not taken that step, and was served prior to N2 with a notice by its regulator under the former legislation, then that person shall be treated after N2 as if he had served a section 178 notice and had received a section 184(1) approval notice or approval under section 184(2), and section 184(3) shall apply to them (article 5). Pre-commencement approval is also carried forward (Miscellaneous Provisions Order Articles 11-12).
- A **preliminary notice of objection** served under the former legislation to a notice of control where no notice of objection was served will cease to have effect on N2 (article 6).

- Where a person has **failed to notify a proposed acquisition of an interest** under the former legislation, FSA may (depending on the circumstances) exercise its powers in section 187(1) or (2) FSM Act (article 7).
- A regulator's **preliminary notice** under the former legislation following failure to notify shall be treated after N2 as a warning notice given under section 188(1) FSM Act (article 8).
- A regulator's **preliminary notice imposing conditions** under the Insurance Companies Act or Friendly Societies Act shall be treated after N2 as a warning notice under section 185(3) FSM Act (article 9).
- Any **conditions imposed** under the Insurance Companies Act or Friendly Societies Act before N2 shall after N2 be treated as imposed under section 185(1) FSM Act (article 10).
- A **notice of objection** to an existing controller served by a regulator prior to N2 shall, depending upon the circumstances, be treated after N2 as a warning notice given under section 188(1) FSM Act (article 11).
- FSA may exercise its **section 187(3) FSM Act powers** whether or not a controlling interest was acquired before or after N2 (article 12).
- A pre-N2 **direction** served under the former legislation in relation to acquisition of a controlling interest without consent will be treated as a restriction notice under section 189 FSM Act (subject to modifications) (article 13).
- If prior to N2 a person **was aware it became controller** of an ISD firm or a bank, and did not notify its regulator and a period of 14 days has not elapsed, section 191 (10) FSM Act shall apply (article 14). Similarly, section 190(1) FSM Act shall apply to failure to notify **cessation of control** (article 15).

## 7. FSA's civil and criminal powers

This **Transitional Provisions and Savings (Civil Remedies, Discipline, Criminal Offences (No. 2) Order 2001 No. 3083)** revokes and somewhat expands the original order (2001/2657). It addresses the powers of FSA in relation to pre-N2 conduct. It does not deal with what will happen to disciplinary proceedings and other applications ongoing at N2; this is covered by the Partly Completed Procedures Order – see paragraph 10.

### 7.1 Civil remedies

FSA may apply to the Court for an **injunction** (section 380(2)) or a **restitution order** (section 382(1) FSM Act) for pre-N2 contraventions of a number of FSM Act provisions, including unauthorised investment business; misleading statements and practices; breach of SRO, RPB, RIE and RCH rules; FSA Principles; and restrictions on taking deposits under the Banking Act (article 2).

FSA may require a firm formerly authorised by an SRO (an "SRO firm") which has contravened a pre-N2 requirement (such as under the conduct of business rules) to **make restitution** under section 384(5) FSM Act where that SRO had power to do so FSA must have regard to any relevant SRO statement (Article 3).

FSA may make an application under section 380(3) for an order **preventing the dissipation** of assets while investigating whether a bank has contravened a specified pre-N2 requirement (article 4).

The **unenforceability of agreements** under sections 26 - 28 FSM Act is extended to agreements in breach of the principal restriction contained in the FSAct or ICAAct (article 5).

## 7.2 Disciplinary powers

FSA may **publicly censure** under section 205 FSM Act a person authorised after N2 who was:

- Directly regulated by FSA, an authorised unit trust manager or trustee, an authorised insurer or a passported institution for pre-commencement breach of applicable FSAct provisions, provided FSA had not already done so (article 6).
- Immediately before N2 an SRO firm and who contravened its rules, provided the SRO could have exercised a corresponding power, which it has not done. FSA must have regard to any relevant SRO statement (article 7).

FSA may **impose a financial penalty** under section 206 FSM Act against a person authorised after N2 who was an SRO firm which contravened a rule, provided the SRO had a corresponding power which it has not exercised. Any penalty must have regard to the SRO's statements of penalties (article 8)

FSA may take **disciplinary action** under section 66 FSM Act against a **formerly registered individual** (under IMRO, PIA or SFA rules) who contravened an SRO requirement before N2 while performing what would be after N2 a controlled function. This is provided that the individual was so registered immediately before N2, and the SRO had that power which it has not exercised. This is further subject to any relevant time periods for taking such action where the individual ceased to be individually registered with the SRO. FSA must have regard to the SRO's penalty statements (article 9).

## 7.3 Formerly authorised deposit takers and building societies

FSA may give directions to a **formerly authorised bank** under sections 19 and 20 Banking Act and to **former building societies** under sections 43A and B Building Societies Act, neither of which holds FSM Act authorisation, with prior directions remaining in force (articles 10 and 11).

FSA may present a winding up petition under section 367 FSM Act against a former bank, or against any person who has contravened the deposit taking restriction (article 12).

## 7.4 Criminal offences

FSA may take criminal proceedings under sections 401 and 403 FSM Act for pre-N2 offences under the ICAAct, FSAct, Banking Act and subordinate legislation (article 13).

Under the Interpretation Act, the prosecution of a criminal offence committed under old law prior to repeal can continue after repeal, and therefore no additional provisions are needed in relation to criminal offences under the Banking, Insurance Companies and FSActs.

## 7.5 Information gathering and investigations

Sections 165, 166 and 167 FSM Act (power to require information, reports by skilled persons and appointment of persons to carry out general investigations) can be exercised against **former regulated persons** (articles 15 to 17). A "former regulated person" is someone authorised or exempted under the FSAct, or authorised under the Banking Act, ICAAct, Building Societies Act or EU legislation, but never under the FSM Act. Section 168 (appointment of persons to carry out general investigations) is altered to apply to pre-N2 contraventions (article 18).

## 7.6 Miscellaneous provisions

This addresses:

- **disqualification of auditors** under s345 FSM Act for failure to comply with pre-N2 duties (article 19);

- provision to FSA by an **RPB** of information relating to pre-N2 investment business (articles 20-21).

## 8. Transitional Provisions (Partly Completed Procedures) 2001 No. 3592

### 8.1 Applications under former legislation outstanding at N2 are generally carried forward:

- Applications for authorisation to be treated as section 40/44 application (3)
- Application to vary/cancel suspension or restriction to be treated under section 44/200 (4)

Any pending pre-N2 notice of "minded to refuse" an application for authorisation/vary suspension/limitation under FS Act, Banking Act or 2BCD/ISD Regulations lapses, and FSA must consider the matter anew under FSM Act (5-7).

- Request for surrender of authorisation to be treated as section 44 application (8)
- Section 52 procedure applicable to these section 40/44 applications is amended by article (9).

### 8.2 FSA's uncompleted pre-N2 own initiative proceedings

to withdraw, suspend or restrict authorisation under former legislation are to be treated as served under FSM Act as follows:

Pre-N2 Notice	To be treated as given under/as
Section 29 FSA Act	Section 53 FSM Act (10,11)
Section 33 FSA Act	Section 197 FSM Act (12, 13)
Section 13 Banking Act	Section 53 FSM Act (14-16)
Section 12/46 Insurance Companies Act	Proposal to impose requirement under Section 53 FSM Act (17-19)
2BCD/ISD Regulations	Section 197 FSM Act (20-23) or (for DGFT notices) section 203 FSM Act (24)

Uncompleted pre-N2 applications for authorisation and other regulatory proceedings relating to the authorisation of **Friendly Societies and Building Societies** are also to be treated as commenced under FSM Act, or the Building Societies Act as amended by it (26-38).

### 8.3 Pending applications for authorisations

of authorised unit trust schemes and recognised collective investment schemes are to be carried forward and treated as served under FSM Act as follows:

<b>Pre-N2 Application</b>	<b>To be treated as</b>
Application for authorisation of authorised unit trust scheme under Section 77 FSAct	Section 242 FSM Act (39)
Notice of proposed alteration/change of trustee under Section 82 FSAct	Section 251 FSM Act (40)
Notice of proposed change of manager of unit under Section 82 FSAct	Section 251 FSM Act (41)
Notice of intention to start marketing EEA scheme under Section 86 FSAct	Section 264 FSM Act (42)
Notice by scheme authorised in designated territory under Section 87 FSAct	Section 270 FSM Act (43)
Application by overseas scheme for individual recognition under Section 88 FSAct	Section 227 FSM Act (45)
FSA notice of revocation of authorisation of authorised unit trust scheme under Section 80 FSAct	Section 255 FSM Act warning notice (46)
Notice of cessation of recognition designated scheme under Section 89 FSAct	Section 280 FSM Act warning notice (47)
Notice of revocation of recognition of individual scheme under Section 89 FSAct	Section 280 FSM Act warning notice (48)

### 8.4 Other pending procedures

- Applications for individual approval by an SRO will be treated as made under Section 60 FSM Act (49).
- Notices under Sections 61 & 61 Insurance Companies Act for approval of an appointment, and for approval of a partner in a bank or investment firm, will also be treated as Section 60 FSM Act applications for approval (50-53).
- Pre-N2 FSAct 1986 disqualification directions and incomplete processes for making a public statement are addressed at (54,55).

### 8.5 Incomplete SRO Disciplinary Proceedings

- Applies to SRO firms and current or former registered individuals where disciplinary proceedings started but penalty not determined (56,57).
- FSA may before 1 June 2002 refer the incomplete proceedings to an Interim Tribunal to determine the appropriate action under FSM Act and remit to FSA to carry out (58) provided the SRO rules conferred similar powers, the penalty does not exceed the SRO's penalty and takes account of its relevant statements (60). The FSA procedure is set out at 61.
- FSA may instead take proceedings under the FSM Act in stated circumstances in substitution for the incomplete SRO disciplinary proceedings (64), but if the matter has already been referred to the Interim Tribunal only with the person's or the Interim Tribunal's consent (65).

- Issues of a firm's fitness and properness are to be considered in accordance with the Threshold Conditions for Authorisation, and for individuals in accordance with the FSM Act criteria (59).

Appeal lies from the Interim Tribunal to the Tribunal (62) with rules modified in accordance with the Schedule (63).

- FSA may issue a Decision Notice without a Warning Notice where the matter has been the subject of incomplete disciplinary proceedings, and the person had the opportunity to make representations to the SRO which, if made, FSA has taken into account (66,67). The Decision Notice may relate to public censure (68), fine (69), restitution (70), cancellation of Part IV permission (71), variation of permission or imposing a requirement (72), publishing a statement about an individual (73), fine of an individual (74) or withdrawal of approval of an individual (75) provided in each such case the SRO would have had this power.

## 8.6 Incomplete Appeals

- An appeal against disciplinary measures imposed by an SRO tribunal on a firm or individual (76) where an appeal was lodged pre-N2 but not determined: FSA must refer the appeal to the Interim Tribunal (77) subject to articles 59-61 (78).
- Where the right of appeal against an SRO tribunal penalty was not exercised and has not expired at N2, an appeal may be made to the Tribunal (79, 80).

## 8.7 SRO Intervention Measures

SRO Intervention Measures imposed on a firm which have been stayed before N2: there is no right of appeal (82). If not so stayed and an appeal is pending, or a right of appeal is exercisable, any appeal lapses and the firm may refer the matter to the Tribunal (83). The position for individuals is set out at (84).

Summary fines imposed pre-N2 where appealed, or an appeal is exercisable, can be referred to the Interim Tribunal (85).

## 8.8 Interim Tribunal

The duty of the President (86) and the constitution of the Interim Tribunal (with preference for the SRO panel which part-heard the matter immediately prior to N2) are set out at (87). The Interim Tribunal should follow the former SRO's procedure taking into account the pre-N2 proceedings (89). The validity of notices and time periods in affected disciplinary proceedings, and the rights of affected third parties, are set out at (90-95).

## 8.9 Partly completed exercise of EEA Rights

- For inwardly passporting firms seeking to establish a branch (96) or provide services (97), proper pre-N2 notices are to be treated as complying with Schedule 3 FSM Act.
- For EC reinsurers without prior FSM Act permission, a proper pre-N2 notice is to be treated as a Section 40 FSM Act application (98).
- Outwardly passporting UK firms which lodged a proper pre-N2 notice to establish a branch are to be treated as complying with Schedule 3 unless FSA gave notice of refusal which was not appealable after N2 (100). Pre-N2 consent notices are to be treated as Schedule 3 consent notices.
- Outwardly passporting UK insurer or friendly society which gave proper pre-N2 notice to provide services is to be treated as have given notice in accordance with Schedule

3, unless refused. Pre-N2 notice of consent to be treated as Schedule 3 consent notice (101).

## 8.10 Pending Appeals

Pending appeals to, and any rights of appeal extent at N2, in relation to the following tribunals shall remain effective, but modified as follows:

- Financial Services Tribunal (102-111)
- Banking Appeal Tribunal (112-117)
- Friendly Societies Act Tribunal (118-124)
- Building Societies Act Tribunal (125-131).

## 9. Information & Investigations - Transitional Provisions & Savings (Information Requirements and Investigations) 2001 No. 3646

This Order treats requirements to provide information under Banking Act, Financial Services Act, Insurance Companies Act and SRO Rules outstanding on N2 as requirements under Section 165/8 FSM Act (2). Section 174 (admissibility) and section 177 (offences, but subject to restrictions) apply after N2 to such information requests.

Similar provisions apply to outstanding information requests made by FSA (3).

Pending requirements to provide a report by a skilled person under the Banking and Insurance Companies Acts will be treated as requirements under Section 166 (4,5).

Investigators appointed under former legislation will have FSM Act powers as follows:

- Section 43A Insurance Companies Act – Section 167 (1) FSM Act as modified (6)
- Section 41 Banking Act – Section 167 (1) FSM Act as modified FSM Act as modified (7)
- Section 94 FSAAct – Section 284 (1) FSM Act as modified (8)
- Section 177 FSAAct – Section 168(3) FSM Act as modified (9)

so that investigations in progress of N2 are to be treated as appointed under these FSM Act sections with appropriate modifications.

The investigating authority must give notice of the FSM Act provision under which it is now deemed to have been appointed to the person being investigated, unless this is likely to frustrate the investigation (10).

A direction by the investigating authority under section 170(7) may provide that the investigator need not duplicate pre-N2 steps (10).

The repeal of sections 94, 105, 106 and 177 FSAAct or section 42 Banking Act will not affect ongoing investigatory process (11-13).

## 10. Miscellaneous Transitional Provisions

### 10.1 The Consequential and Transitional Provisions (Miscellaneous) No. 2 Order (SI 2001 No. 2659)

makes consequential and transitional provisions in accordance with Commencement Order No. 5 and fully comes into force on 3rd September 2001.

- Section 165 FSM Act (**FSA's information gathering powers**) is modified to enable FSA to exercise its powers before N2 in respect of a person who will be subject to section 165 after N2 (article 2). FSA explains in **Countdown to N2**:

**Grandfathering** (July 2001, para 2.14) that from 3rd September 2001 firms seeking authorisation for the first time, or to vary an existing authorisation, can apply to either an existing regulator, or to FSA.

- A number of detailed **transitional modifications** were made, which applied until N2 (article 3).
- FSA may require a **Recognised Professional Body** to furnish it with stated information (article 4).
- Certain exceptions are made to the **Rehabilitation of Offenders** Act 1974, so that spent convictions will remain relevant up to N2, in relation to:
  - Applications for Part IV permissions for banking activities; and
  - Applications relating to authorised and recognised collective investment schemes (articles 5 and 6).
- Rehabilitation of Offenders in Scotland is addressed by the **Savings, Miscellaneous and Consequential Provisions (Rehabilitation of Offenders) (Scotland) Order (2001 No. 3640)**.
- Alterations are made to the **Disclosure of Confidential Information Regulations** in relation to the period to N2 (article 7).
- FSA may **authorise an OEIC** prior to N2, but with effect from N2 when the OEICS Regulations come into force (article 9).

## 10.2 Miscellaneous Provisions 2001 No. 3650

This Order makes the following amendments:

- **CIS Order** (2001 No. 1062) (2). This amendment is noted at paragraph 12.1.1 of this Guide.
- **Professions (Non-Exempt Activities)** (2001 No.1227) (3). This amendment is noted at paragraph 19.3 of this Guide.
- **Financial Promotion** (2001 No. 1335) (4,5). This amendment is noted at paragraph 3.5.3 of this Guide.
- Transitional Provisions (**Authorised Persons**) (2001 No. 2636) (6-10). This amendment is noted at paragraph D4 of this Guide.
- **Section 367** FSM Act is amended so that default under a pre-N2 agreement will constitute a person being unable to pay its debts (14,15).

Exemptions from the **Rehabilitation of Offenders** Act which applied to the pre-N2 regime will continue to have effect in relation to ongoing FS Act and Banking Act proceedings (16).

Members of the FSAct **Financial Services Tribunal** remain disqualified from political office (17).

Duties of **auditors** to communicate matters to FSA under the Financial Services, Banking, Insurance Companies, Building Societies and Friendly Societies Act remain in force in respect of pre-N2 events (18).

FSA must make a scheme for the **transfer to it of such of the SROs'** property, rights and liabilities as it considers appropriate (21).

**Liabilities of SROs** arising from pre-N2 acts or omissions are to be treated as FSA's liabilities (22), and FSA substituted for them in any ongoing legal proceedings (23).

Pre-N2 proceedings for Financial Service and Banking Act **injunctions** concluded after N2 may be granted in terms of FSM Act (23).

Repeal of relevant legislation does not effect the continuing **statutory immunity** from damages of any pre-N2 regulatory (24).



Paragraph 17 Schedule 1 **fees** may be levied for functions performed in relation to former legislation (25); there are particular provisions for the Insurance Companies Act fees (26,27).

Inaccurate pre-N2 **Permissions Notices** shall take effect as corrected:

- Where FSA has corrected the Scope of Permissions granted under grandfathering categories 6-9 in the Authorised Persons Order (29)
- Error in scope of permission notice for PIA firms, where FSA has sent out correction notices (30).

### 10.3 Dissolution of Board of Banking Supervision (Transitional Provisions) 2001 No. 3582

This Order provides for the dissolution of the Board, and for it to prepare a final report.

### 10.4 Transitional Provisions and Savings (Business Transfers) (2001 No. 3639)

Applications pending at N2 for the transfer of an insurers' long term or general business under Schedule 2C Insurance Companies Act may continue after N2, subject to amendment (1-9).

An order or approval under Schedule 2C is to be treated as a Section 111(1) FSM Act order (7).

### 10.5 Transitional Provisions (Designated Dates for Certain SROs) (2000 No. 1734)

Schedule 21 paragraphs 1 and 2: 25 July 2000 was the designated date for PIA and IMRO; under **the Designated Date for SFA Order (2001 No. 2255)** the designated date for SFA was 13 July 2001. In each case this prevents revocation of the SRO's recognised status.

### 10.6 Consequential Amendments (Pre-Commencement Modifications) (2001 No. 2966)

This makes modifications to the Consumer Credit Act, Companies Act and certain other statutes and statutory instruments to the Consumer Credit Act, Companies Act and certain other statutes and statutory instruments consequent upon FSM Act provisions brought in under the 5<sup>th</sup> Commencement Order. They principally relate to grant of applications and permissions and the operation of the Tribunal. These modifications ceased to have effect on N2, 1<sup>st</sup> December 2001.

## E - Analysis of FSM Act

### 1. Financial Services Authority Sections 1 - 18, 404; Schedule 1

#### Summary:

This section describes FSA's constitution, duties, powers and to whom (and how) it is answerable as follows:

- Constitution (1.1)
- Duties (1.2)
- Powers of FSA (1.3)
- Answerable to whom? (1.4)
- Public record (1.5)

It also contains discussion of:

- Complaints against FSA – COAF (1.6.1)
- CP79 - Post-N2 Fee Raising Arrangements (1.6.2)
- Unfair Terms in Consumer Contracts Regulations (1.6.3)
- Service of Notices Regulations (1.6.4)
- Transitional Provisions (Reviews of Pensions Business) (1.6.5)
- Consequential and Transitional Provisions (Miscellaneous) Order (1.6.6)
- FSA's Approach to the Regulation to e-Commerce (June 2001) (1.6.7)
- Regulation of Electronic Money Issuers (CP 117-December 2001) (1.6.8)
- Treating Customers fairly after Point of Sale (1.6.9)

#### 1.1 Constitution

**Treasury appoints** chairman and governing body (Sch 1 para 2).

Majority of **governing body** to be non-executive (Sch 1 para 3).

**Non-executive committee functions** include monitoring:

- whether FSA is acting in the most efficient and economical way in using its resources in discharging its functions in accordance with the decisions of the governing body (Sch 1 para 4 (3)(a));
- whether FSA's internal financial controls secure the proper conduct of its financial affairs (Sch 1 para 4(3)(b)); and
- and to determine the remuneration of the governing body's chairman and executive members (Sch 1 para 4(3)(c)).

**Governing body** makes rules, issues codes, statements, directions and guidance (Sch 1 para 5).

FSA must follow principles of **good corporate governance** (s7).

**Independent investigator** for complaints against FSA (not Sch 1 para 5 powers) who may recommend remedy/compensation and may publish report (Sch 1 paras 7-8). FSA must consult on complaints scheme. See 1.6.1.

**Annual report** and **public meeting** (Sch 1 paras 10-12).

Power to **levy fees** to meet expenses, repay borrowings and maintain reserves in accordance with rules. Fees not take account of penalties (Sch 1 paras 17-18).

Not Crown servants (Sch 1 para 13) and **no liability in damages** bar bad faith/HRA (Sch 1 para 19).

## 1.2 Duties

When **discharging general functions**, meaning:

- Making rules.
- Issuing codes.
- Giving general guidance.
- Determining general policy and principles ('general functions') (s2(4)).

**FSA must act**, so far as reasonably possible, **compatibly with regulatory objectives** (s2(1)) which are:

- Maintaining confidence in the financial system (s3).
- Promoting public understanding of the financial system - benefits and risks(s4).
- Securing appropriate degree of consumer protection (s5):
  - consumers should take responsibility for decisions.
- Reduction of financial crime (s6):
  - firms must take appropriate measures to prevent and monitor (= fraud, dishonesty, market misconduct, handling proceeds - world-wide).

and in discharging the general functions, **FSA must have regard to 7 items**, (s2(3)):

- Efficient use of resources.
- Responsibility of firm's management.
- Burden of regulation should be proportionate to its benefits.
- Facilitating innovation.
- Maintaining UK competitiveness.
- Minimising adverse effect on competition.
- Facilitating competition between regulated firms.

**FSA must have regard to representations of Practitioner Panel and Consumer Panel** as to whether general policies and practices are consistent with general duties under section 2 and notify Panel in writing if disagrees (ss 8-11).

FSA bound by **duty of confidence** (s348).

FSA must **co-operate** with:

- other regulators;
- others re financial crime;

including sharing information (as allowed by Part XXIII, s354).

## 1.3 Powers of FSA

This section **identifies the principal powers** conferred upon FSA by the FSM Act.

Certain powers under the FSM Act are **reserved to the Treasury** including:

- Making financial promotion rules (s21).
- Specifying regulated activities (s22).
- Defining persons exempt from the general prohibition (s38).
- Making regulations for authorised OEICs (s262).
- Designating professional bodies (s326).

**Principal powers granted to FSA are as follows:**

- To grant, vary and cancel **permissions** (ss 42, 44 and 45). A person holding permission is an authorised person under the FSM Act (s31).
- To **approve individuals** to perform controlled functions (s59); to issue principles and codes for their conduct (s64) and to take action against them for misconduct (s66). FSA may also withdraw approval (s63) and make a prohibition order against an individual (s56).
- The right to be heard in court on a **banking or insurance transfer** (s110).
- To impose a penalty or public statement for **market abuse** (s123) together with additional enforcement powers (ss 381 and 383-386). Seeking injunctions and restitution orders for market abuse (ss 380 and 382) is a power shared with the Treasury.
- To **make rules** (ss 138-147). This is a particularly significant power which enables FSA to make rules for the conduct of wide range of activities, including:
  - conduct of business rules,
  - client money rules,
  - financial promotion rules,
  - money laundering rules.
- To require an authorised person to **provide information**, documents or an expert's report (ss 165-166). These are powers commonly exercised by FSA as part of its routine monitoring activities.
- To perform **investigations** (ss 167-168). This is a power shared with the Treasury.
- To regulate the acquisition, increase and continuation of **control** over UK authorised persons (ss 178-192).
- To take **disciplinary action** against an authorised person by issue of a decision notice (s208). The authorised person may refer the subject matter of the disciplinary notice to the Financial Services & Markets Tribunal (s133).
- To establish a **compensation scheme** (s213).
- To make or approve rules for the **Financial Ombudsman Scheme** (ss 225-234).
- To authorise **unit trust schemes** (s242); FSA may make rules for the regulation of authorised unit trust schemes (ss 247-248), must approve certain alterations (s251), and may revoke authorisation and intervene (ss 257-258).
- To **recognise overseas CISs** (s264), schemes from designated territories (s270) and individual schemes (s272).
- To **recognise investment exchanges and clearing houses** (s290) in accordance with regulations made by the Treasury (s286).
- To keep under review the desirability of **regulating Lloyd's** in accordance with Part XIX of the FSM Act (ss 314-324).

- To keep under review the desirability of exercising its powers over the **designated professional bodies** in accordance with part XX of the FSM Act (ss 325-333).
- To maintain a **public record** of authorised persons, schemes, prohibited individuals and approved persons (s347(1)).
- To initiate or participate in **insolvency proceedings** in accordance with Part XXIV of the FSM Act (ss 355-379).
- To **cooperate with other regulators** and other persons concerned with preventing or detecting financial crime (s354).
- To institute **criminal proceedings** under the FSM Act, subject to restrictions imposed by the Treasury (s401). This power is shared with the Treasury and can also be exercised by or with consent of the DPP (s401(2)(b)). FSA may also institute proceedings, subject to restrictions imposed by the Treasury, for insider dealing and money laundering (s402).
- Finally, under section 404, if the Treasury considers that there is evidence that there has been **widespread or regular failure** to comply with rules, and private persons may suffer compensatable loss, the Treasury may authorise FSA to establish and operate a scheme for investigating the situation and compensating investors. This provision is curious for three reasons:
  - it does not form part of the original scheme for the FSM Act, but was added by virtue of a minority opposition amendment shortly before the third reading,
  - it does not empower FSA to do anything that it could not do already,
  - it requires a positive resolution statutory instrument in order to be implemented (s429).

It has been implemented for the pensions review - see 1.6.5.

## 1.4 Answerable to whom?

Treasury may appoint **independent person to review FSA's** use of resources (ss 12-13).

Treasury may also appoint (and control) **an enquiry into FSA** in two cases:

- Serious failure under regulatory system causing grave risk to financial system or consumers.
- Serious failure under listing system causing significant damage to shareholders (ss 14-18).

FSA is also answerable to:

- Governing body.
- Non-executive committee.
- Parliament (through annual report).
- Public (through annual meeting).
- Courts (through judicial review/injunction applications).
- Practitioner and Consumer Panels.
- Complaints investigator (CP73-see 1.6.1 below).
- Competition scrutiny (ss 159 - 164).
- Certain decisions of FSA can be referred to the Tribunal. (These are listed at 10.6.1 below.)

- **Required to consult** on a number of areas, including:
  - codes for individuals (s65),
  - penalties for individuals (s70),
  - market abuse penalty policy (s125),
  - issuing new or varied rules (s155),
  - FSM Act penalties (s211),
  - extension of FSM Act to Lloyd's underwriting (s319),
  - reapplication of general prohibition to professional firms (s330),
  - procedures for the issue of warning notices, decision notices and supervisory notices (s396),
  - scheme for investigating complaints against FSA (Sch 1 para 7),
  - application of penalties for the benefit of authorised persons (Sch 1 para 16).

## 1.5 Public record

FSA must maintain public record of:

- Authorised persons (plus services provided).
- Schemes.
- Prohibited individuals.
- Approved persons etc (to include name of relevant authorised person/contractor (s347(1))).

This is described at paragraph 3.155 in RP29 ("The Permission Regime" - Response Paper).

## 1.6 Key statements on policy and implementation

- (a) CP1 - Consumer Involvement (October 1997).
- (b) CP2 - Practitioner Involvement (October 1997).
- (c) Meeting our Responsibilities (August 1998).
- (d) A Short Guide to Own Preparations for the New Regulatory Regime (January 2000).
- (e) A New Regulator for the New Millennium (February 2000).
- (f) Building the New Regulator - Progress Report 1 (December 2000).

In relation to particular functions:

### 1.6.1 Complaints against FSA (CP73 - November 2000; CP93 - May 2001)

A key element of the investor protection regime remains the requirement that authorised firms must investigate and resolve complaints made against them by investors. FSA is placed under a corresponding requirement in relation to complaints made against it, and is required to appoint an independent investigator to conduct investigations against it in accordance with a complaints scheme (Sch 1 para 7). The following description is taken from the FSM Act, and includes FSA's proposed procedures set out in Consultation Paper 73 *Investigating of Complaints against FSA* (November 2000) as amended by CP93 (May 2001) (the "COAF" rules).

For transitional provisions, see paragraph 5 at Section D at the front of this Guide.

FSA's **states its policy** as follows:

*“FSA will seek to maintain high standards in all its dealings with consumers, regulated firms and others. If it fails to meet these standards, those directly and adversely affected should be entitled to see a thorough and impartial enquiry into what went wrong, and to be told what the FSA will do to put things right.” (CP73, para 2.2)*

In particular, it is clear from the following provisions that FSA will seek to handle complaints made against it to the same standard as it requires regulated firms to handle the complaints which they receive.

#### **The complaints scheme has the following features:**

- Provides for the investigation of complaints “arising in connection with” the exercise or non exercise of any of FSA’s non-legislative functions (Sch 1 para 7 (1)(a)). This encompasses misadministration in the shape of mistakes and lack of care, unreasonable delay, unprofessional behaviour, and lack of integrity (COAF 1.4). A person cannot complain about FSA’s legislative functions, such as the making of a rule or failure to issue guidance, although he could complain about the exercise of enforcement or disciplinary powers, or refusal to admit a firm.
- FSA points out in CP93 (paras 5.7 to 5.11) that while misadministration (such as bias or unreasonable delay) will fall within the scheme, dissatisfaction with the quality of FSA’s regulatory judgment will not. Nonetheless, FSA points out that it must always act fairly, and have good reason to act, and that key decisions will often be made by the independent Regulatory Decisions Committee (see 10.8.2 below). FSA states that:
  - If a firm is dissatisfied that FSA is acting correctly, it should put this view, together with its reasons, to the staff in question.
  - If the firm is dissatisfied with FSA’s response, it may escalate the matter to more senior staff or, ultimately to the Director of the FSA Division who will deal with the matter personally.
- Implicitly, a complaint can be made by an investor, a firm or a person otherwise affected by FSA’s action or inactivity.
- Complaints should be investigated quickly (Sch 1 para 7 (2)).
- FSA must publicly consult on the proposed scheme and, once made, on any alterations or replacements of it; must take any representations into account and must publish them together with its response (Sch 1 para 7(5)-(9) and (14)). FSA’s initial consultation is contained in CP73, as amended by CP93.
- FSA must publish details of the scheme (Sch 1 para 7(10)-(11)).

#### **The Complaints Commissioner:**

- Must be independent of FSA (Sch 1 para 7(1)(b)). In appointing the Commissioner, who will hold office for 3 years, FSA will be advised by an independent panel (COAF 1.3).
- Must conduct investigations into complaints falling within the remit of the complaints scheme (Sch 1 para 7(1)(a)).
- Requires Treasury approval for his appointment or dismissal (Sch 1 para 7(3)).
- Must be appointed under terms which FSA considers are reasonably designed to secure that he acts independently of FSA, and that his investigations will not favour FSA (Sch 1 para 7(4)).
- Together with his agent under (Sch 1 para 8(8)), is not liable in damages in respect of these functions (Sch 1 para 19(2)).

## What is excluded?

FSA is not obliged to investigate the complaint in accordance with the complaints scheme:

- If it relates to employee or contractual disputes, or to its legislative functions (COAF 1.4.2). COAF 1.4.3 also gives the examples of complaints expressing dissatisfaction with FSA's policies or proper exercise of discretion.
- If FSA reasonably considers it will be more appropriately dealt with in another way, such as a reference to the Financial Services and Markets Tribunal or by instituting legal proceedings (Sch 1 para 8(1), COAF 1.4.3). FSA is therefore given wide discretion initially to exclude from the Investigator's remit complaints:
  - which arise out of warning notice/disciplinary notice/supervision notice procedures (see 10.2 below), for which the appropriate remedy may be to refer the matter to the Tribunal. This will principally affect applicants for authorisation or approval and disciplinary issues relating to firms and approved individuals,
  - which could be dealt with by legal proceedings, for example judicial review of administrative action against FSA, or an intermediate customer's or market counterparty's action against a firm in default. Again, this is likely to affect firms and individually approved persons.
- A complaint relating to ongoing FSA action - for instance, disciplinary or admission proceedings - will not usually be investigated until the complainant has exhausted relevant remedies (COAF 1.4.4).

**Procedure for handling complaints against FSA** will be as follows (Sch 1 para 8):

- (i) A complaint should be made against FSA, which will seek to acknowledge it within 5 working days (COAF 1.5.1). It should normally be made within 12 months of becoming aware of the circumstances giving rise to the complaint (COAF 1.4.6), but need only be in writing if made by a firm (COAF 1.4.5).
- (ii) FSA will investigate the complaint (Sch 1 para 8(10)). This will be carried out by a senior and independent (in the sense of not previously involved) member of FSA's staff who will seek to resolve the matter within 8 weeks by, if appropriate, an apology, recommending rectification or an ex-gratia payment (COAF 1.5.2-6).
- (iii) If dissatisfied, the complainant may refer the matter to the Commissioner (Sch 1 para 8(2)(a)). The Commissioner will investigate personally or by his agent (Sch 1 para 8(8)) who may not be an officer or employee of FSA (Sch 1 para 8(9)). FSA must cooperate with him. However, reference to the Commissioner will not normally stop FSA taking or continuing with the action which is the subject of the complaint (COAF 1.5.10 - 1.5.14).
- (iv) Also, if FSA decides not to investigate a complaint, it must notify the Commissioner who may nonetheless proceed to investigate it (Sch 1 para 8(3)-(4), COAF 1.5.7).
- (v) When investigating a complaint, the Commissioner:
  - Must have the means to conduct a full investigation.
  - Must report the result of the investigation to FSA and the complainant.
  - May publish all or any part of his report which he considers ought to be brought to the attention of the public (Sch 1 para 8(2)(b), COAF 1.5.17 - 1.5.19).
- (vi) The Commissioner may recommend that FSA does either or both of:
  - Compensate the complainant.
  - Remedy the matter complained of (Sch 1 para 8(5), COAF 1.5.20).
- (vii) If the Commissioner reports that a complaint is well founded or has criticised FSA, then FSA must inform both him and the complainant of steps which it proposes to take in



response (Sch 1 para 8(6)). The Commissioner may require FSA to publish all or part of that response (Sch 1 para 8(7), COAF 1.5.21-22).

Before the Commissioner recommends a compensatory payment, the draft Scheme (COAF 1.5.23) requires him to have regard to FSA's statutory objectives and general duties. If, having done so, he still recommends compensation, then FSA will give proper consideration to the recommendation and, in deciding whether to make such payment, will have regard to:

- Its statutory objectives and general duties.
- The gravity of the misadministration.
- Whether the matter complained of was an operational or administrative matter or a policy issue, with the latter being less deserving of compensation.
- The impact of the cost of the proposed compensatory payment on firms and, ultimately, consumers.

In other words, FSA may accept the Commissioner's recommendation in the case of serious misadministration in the operational sphere where a limited class of persons, or a single person, has suffered significant direct loss. FSA may choose to compensate in the following two cases (CP73 para 3.25):

- a firm suffers loss because FSA wrongly deletes it from the public register of authorised firms;
- a customer suffers loss because, on the basis of information received from FSA, he entrusts funds to an unauthorised firm in circumstances where it should have been clear to FSA that those funds would be at risk;

but not in the case of customers (or other firms) suffering loss because of the failure of a firm.

### 1.6.2 CP79 - Post N2 Fee Raising Arrangements (December 2000)

CP56 (June 2000) sets out the general framework for funding FSA's activities post N2, based on:

- Periodic fees (to fund most statutory functions).
- Application fees, which are non refundable. The amount of application costs borne by an applicant (rather than existing fee payers) will be determined in accordance with its complexity (CP79 para 8).

FSA proposes fee blocks, based on categories of business with different application and periodic fees, and proposes to allocate its annual funding requirement ("AFR") across them in accordance with FSA's activities in respect of those fee blocks. For authorised firms, fees will not be calculated in accordance with the specific risk of the firm (CP79 paras 3.7 - 3.12) but will, instead, be based upon their category of Part IV permission. FSA is considering the imposition of fees for demand led activities, such as providing guidance under section 157 FSM Act (CP79 para 9).

FSA sees the benefit of levying fees on a fee block basis as follows (CP79 para 4.2):

- FSA's AFR will be closely correlated to the collective risk posed by the fee block's members to FSA's statutory objectives.
- All fee-payers within any given block will pay fees on the same basis.
- It minimises cross subsidies, for example the current subsidy between product providers and IFAs (CP79 paras 5.20-5.28).

Disciplinary penalties imposed under section 206 FSM Act or under section 123 FSM Act (market abuse) which relate to activities carried on in a particular fee block will be allocated to that fee block to reduce its fees (CP79 paras 5.29-5.32). Penalties under section 100 FSM Act will be allocated to the UK Listing Authority fee block. Penalties on persons neither authorised nor approved will be applied for the benefit of all authorised persons.

Legal assistance for individuals subject to market abuse proceedings will be charged across all authorised persons.

FSA discusses proposals for tariffing each fee block in accordance with various "size of business" measures. These include:

- Deposit takers: modified eligible liabilities.
- Insurers: premium income.
- Fund managers: fund under management.
- Dealers as principal: position risk requirement.
- Execution only traders: fee income.
- Dealers, arrangers, brokers and advisers: number of Approved Persons.

Fees will be discounted for firms which passport in (CP79 para 7.20) and will be calculated by reference to legal entity rather than to corporate group (CP79 para 7.24). There will be penalties for late payment (CP79 para 10.19).

### **1.6.3 Unfair Terms in Consumer Contracts Regulations (SI 1999/2083)**

FSA has been constituted a qualifying body under these regulations (as amended by SI 2001/1186 reg 2(b) which came into force on 1st May 2001). This will empower it to pursue complaints from consumers about clauses in financial services contracts and products. FSA has stated (FSA Plan & Budget 2001/2002 para 33) that it will be consulting in relation to how it will approach exercise of this power.

FSA's policy for seeking injunctions under these Regulations is set out at ENF Section 6.10.

### **1.6.4 Service of Notices Regulations (2001 No. 1420)**

This sets out methods by which FSM Act authorities may give notices and directions, and establishes the effective date of receipt of documents served on them from N2.

Relevant document: one made under FSM Act (bar Parts IX and XXIV)

Relevant authority: FSA, Secretary of State, DGFT, Investigator, Ombudsman, Scheme Manager/Operator

- how relevant authority may serve relevant document (2), (11)
- who is the appropriate person to be served with a relevant document by relevant authority (3)
- what is proper address for service by relevant authority (4)
- relevant authority may only serve by fax/e-mail with prior written consent (5)
- when service of a relevant document by a relevant authority is deemed effective (6)
- how a relevant document may be given to a relevant authority (7-10).

### **1.6.5 Transitional Provisions (Reviews of Pensions Business) (2001 No. 2512)**

In force 6 August 2001.

This order empowers FSA to designate the pre-existing pensions review as a review for purposes of Section 404. This applies to reviews of:

- personal pensions sold between 29 April 1988 and 30 June 1994
- FSAVCs sold between 29 April 1988 and 15 August 1999

which are to be treated as Section 404 schemes. FSA may therefore use FSM Act powers, and failure to fulfil pension review requirements is to be treated as breach of FSA rule made under FSM Act.

### 1.6.6 Consequential and Transitional Provisions (Miscellaneous) Order SI 2001 No. 1821

Consequential upon Commencement Order No 3, from 18th June 2001 the Chairman and governing body of FSA are deemed to have been appointed under Schedule 1 paragraph 2(3).

### 1.6.7 FSA's Approach to the Regulation to e-Commerce (June 2001)

FSA welcomes the way that e-commerce will promote competition, offers a potential for cost-savings and for a significantly increased choice for customers. However, the key challenge to FSA is to address the risks posed by e-commerce (1.1, 1.2).

FSA has adopted a position of **technological neutrality**: it will not discriminate on the basis of delivery channel and is alert to differences in risk (1.5, 3). FSA acknowledges the importance of its approach being consistent with its statutory objectives, for example to differentiate between different delivery channels only if they have different risk characteristics (3.12).

FSA's concerns are as follows:

- Firms must possess **adequate IT systems and controls**. FSA views this as a responsibility of senior management.
- Customers must have **access to appropriate information** about obtaining financial services by e-commerce channels, while retaining responsibility to protect themselves.
- **Regulations must be adapted to e-commerce** (1.8). FSA refers to aggregation, which is where a customer's bank/broker/other information is detailed on a single page, and is not regulated as such. However, FSA expects appropriate legal due diligence to have been carried out by a firm offering this service, and confidentiality to be observed. FSA also refers to the fact that the issue of digital certificates supporting electronic signatures is not regulated, and firms should therefore consider how much reliance they should place on such certificates (1.16).

FSA is also alert to the **international context** (Annex B) and refers in particular to:

- The e-commerce Directive, which permits a firm to provide a service across the EEA subject to the "country of origin" approach to the pre-contractual, internet and e-mail phases of a contract (4.4).
- International customers needing adequate advice and protection (4.10).
- Legal requirements should only be imposed when necessary, and for this reason FSA supports the development of the **"directed at"** test for marketing material (4.12). FSA refers to a series of tests relevant to non – EEA authorised persons wishing to avoid making financial promotions in the United Kingdom, which are as follows:
  - The website must say that a communication is not directed at UK persons, and must not be acted upon by UK persons;
  - It must not make reference to such a communication in any other communication directed at a UK person, or make the one communication directly accessible from the other;
  - It must have systems and controls in place to prevent it doing business with UK customers (4.13).

FSA has identified 17 key **e-commerce risks** (5.5) and these include:

- Availability problems with e-commerce leading to customer loss;
- Significant crime via e-commerce delivery channels;

- Risks to FSA maintaining its statutory objectives because it is not attuned to e-commerce (Annex C).

FSA recognises that it could help firms to achieve **adequate IT risk management** by:

- Ensuring that senior management focuses on it;
- Clarifying FSA's expectations;
- Incentivising good risk management;
- Disseminating good practice (6.5).

FSA's existing work in this field is summarised in Annex A.

FSA expects firms to work towards **improved customer security** (7.16 to 7.23), identifies 6 risks relevant to customers (8.7) and sets out what information it considers is required to address these risks.

FSA identifies a number of areas where it **may need to review its approach** and these include:

- Aggregation (9.2);
- E-signatures (9.16);
- Trust Services (9.43);
- Money Laundering (9.28);
- Use of e-signatures.

### 1.6.8 Regulation of Electronic Money Issuers (CP 117- December 2001)

When the EU directives on E-money (2000/28/EC; 2000/46/EC) are implemented into UK law on 27<sup>th</sup> April 2002, the issue of E-money will be regulated under the FSM Act (this change will be implemented by statutory instrument). Issuers of E-money will, from that date, require to hold appropriate authorisation from FSA with the permitted activity of issuing of E-money. Existing issuers of E-money will be "grandfathered" for a period of six months.

E-money is defined as monetary value represented by a claim on the issuer which is stored on an electronic device and accepted by third parties as a means of payment. "Third parties" is significant as phone and canteen cards which are only accepted by the issuer do not constitute E-money.

E-money may be downloaded from an automatic teller machine or the internet and carried on a number of electronic devices. It can be used by inserting a card into a terminal or over the internet. E-money is meant to be used in the place of currency for making E-payments for small amounts, for example over the internet or on public transport. It can perform the same functions as physical cash.

CP117 sets out FSA's proposed approach, mainly in relation to proposed prudential rules. FSA sees the following as the principal areas of risk in relation to E-money:

- how a non-bank E-money issuer will invest funds received;
- the activities of such issuers;
- operational risk; and
- technical risk;

which FSA seeks to address by the following:

#### **Prudential requirements**

- an E-money issuer may not be an individual, and may not have holdings in unrelated undertakings;
- there will be a minimum base capital requirement of €1 million (ELM 2.3);
- own funds must be 2% or more of outstanding E-money liabilities (ELM 2.5);
- E-money issuers must have high quality liquid assets of at least their outstanding E-money liabilities in order to meet redemptions (ELM 3);
- there are limits on foreign exchange exposure (ELM 3.4), interest rate risks (ELM 3.6) and large exposures (ELM 3.5);
- an E-money issuer may not carry on unrelated activities (ELM 4.4). It may not grant credit, pay interest, issue at a discount or redeem at an uplift. There are restrictions on investment in derivatives (4.3);
- consolidated financial supervision rules will apply to an E-money issuer which is a member of a group (7).

### **Management, systems and controls (ELM 5)**

E-money issuers must have appropriate systems and controls in accordance with FSA's APER and SYSC rules.

### **Other areas**

- appropriate disclosure must be made to customers in relation to a number of matters including fees, liability for loss, redemption and expiry;
- an individual purse limit should not generally exceed £250, unless customers are protected against loss and the issuer maintains detailed records (ELM 6.9);
- holdings are to be redeemable on demand (ELM 6.3 – 7);
- E-money issuers must observe money laundering requirements;
- certain small E-money issuers can seek exemption for the requirement to be authorised (ELM 8).

### **Other applicable FSA rules**

A number of FSA's other rules will be applicable to E-money issuers, principally when carrying out the regulated activity of issuing E-money. They are as follows:

- Principals for Business, in relation to Prudential regulation;
- Threshold Conditions;
- Statements of Principle and the Fit and Proper test for Approved Persons;
- Senior Management Systems and Controls;
- Complaints;
- Authorisation, Supervision (in part), Enforcement and Discipline;

but not Conduct of business, Training and Competence or Compensation.

### 1.6.9 Treating customers fairly after point of sale – Discussion Paper June 2001

The existing regime for financial products aimed at retail consumers is particularly focused on quality of disclosure and advice prior to sale. However, FSA's objective of consumer protection does not end there, and FSA is considering how retail customers should be treated fairly after point of sale.

FSA considers that "**fairness**" represents a series of values including (3.4, Appendix A):

- honesty and integrity;
- disclosure of relevant information in an understandable way;
- fulfilling legitimate expectations;
- consistency of action;
- reasonableness;
- competence and diligence.

FSA explains that some **initiatives are already underway**, including:

- FSA's with-profits review;
- re-projections on mortgage endowments;
- the ABI's Raising Standards initiative;
- CAT standards;
- other FSA initiatives, listed at Section 5.

However, **FSA proposes further work** to address each of the following five areas (1.15) where it considers that unfairness can arise:

- some products/information **are difficult for customers to understand** (4.16). FSA will seek to address this by:
  - promoting plain English by use of its financial promotion/Unfair Contract Terms powers
  - considering whether some products are unsuitable for mass retail distribution.
- customers are **not kept appropriately informed after point of sale** (4.30). FSA will address this by considering what information should be provided to customers on an on-going basis.
- **expectations created at point of sale** may not be met (4.33). FSA will address this through use of its financial promotion powers to reduce unrealistic expectations.
- customers are **discouraged from changing products/providers** (4.36). FSA will seek to reduce this by reviewing unfair barriers to mobility, such as front-end charges and low surrender values by using the COB unfair terms rules and its Unfair Contract Terms powers. It will also seek to promote understanding of the choices available.
- **complaints are not always dealt with fairly** (4.44). FSA will seek to address this by use of the DISP rules, and in particular by identifying trends gathered from its monitoring of firms and from the FOS.

### 1.6.10 Further Reform of Polarisation

#### Further Reform to Polarisation – FSA's Consultation Paper 121 (January 2002)

##### (a) FSA's reform

Under the current polarisation regime, an adviser who makes a personal recommendation of a packaged product (life assurance, personal pensions, unit trust and similar authorised schemes and ISAs) to a retail customer must either be:

- independent and advise on all products across the market; or
- represent one company (and its marketing group) only.
- First announced in November 2000, FSA is continuing to reform polarisation:
- stakeholder pensions and directly offered financial products were removed from this restriction in time for introduction of the stakeholder pension regime in April 2001;
- FSA's latest Consultation Paper now proposes to abolish polarisation altogether.

This change will be of great significance to firms which advise retail customers on packaged products.

**(b) FSA's reasoning**

FSA says that, if polarisation did not already exist, it would find it difficult to justify polarisation under the new FSMA regime because it does not deliver sufficient consumer benefits (CP 121 paragraphs 1.3-1.6).

- In particular, FSA considers that polarisation may actually disadvantage consumers because:
- Many consumers do not understand the difference between tied and independent advice;
- A tied adviser may have an incomplete product range and thus customers serviced by tied agents may only be offered limited products;
- Polarisation has not resulted in tied firms competing with each other to produce value for money products.
- Furthermore, FSA has identified what it describes as a number of "market failings" as follows:
- The remuneration system for tied advisers and IFAs gives an incentive to sell a product which may not always be suitable for the consumer (3.32-3.43);
- Polarisation has not delivered good value for many consumers (3.55-3.60);
- Too few consumers are making adequate provision for retirement (3.50-3.54);
- Combining the cost of advice and the cost of the product hinders consumer understanding of the role and cost of advice (3.3 –3.11).

**(c) FSA's proposal**

FSA therefore proposes that polarisation is abolished.

FSA considers that the abolition of polarisation will lead to wider consumer choice and increased competition, albeit at the potential risk of possible consumer confusion. In order to address these issues FSA considers that the abolition of polarisation should be accompanied by an appropriate "infrastructure", to include the following elements:

- The current polarisation rules have achieved **clarity of responsibility** by requiring firms to act for themselves or as agents for a customer. FSA wants this degree of clarity and the resulting lines of responsibility to be maintained.
- A firm should only be allowed to **call itself "independent"** where it acts exclusively for its customers (and does not represent a product provider) and is remunerated on a fee basis (4.30). An IFA who does not fulfil these criteria must operate under another name. Indirect benefit rules will be revised (4.37).

- Product providers will be allowed to invest in IFA firms who may then sell that provider's products without being subject to a **"better than best"** rule, although clear disclosure will be required (4.44).
- **Introducers** to IFAs may remain unregulated (4.48). However, adviser firms and introducers to non-IFAs who are currently Appointed Representatives may only introduce to/arrange for **single firms**, although that firm may itself choose to be a multiple distributor firm and adopt the products of other providers as well as continuing to offer its own products (4.52). Multi-tie distributors (introducers or advisers) will need to be authorised by FSA, and may not be Appointed Representatives (4.56).
- Responsibility for complaints should be clear (3.48,49) and amendments to DISP are proposed (4.54).
- FSA additionally refers to a number of complementary initiatives, including:
- Enhanced **disclosure** to consumers of the type of advice and remuneration of the adviser (5.2-11).
- Improving **access to advice** for lower income customers. The current regulatory regime has made it increasingly uneconomical to provide financial advice to those on lower incomes, who are therefore not encouraged to save for retirement (3.54). FSA recognises that the cost of training and of advisers may deter firms from servicing low income customers. It therefore canvasses the possibility of allowing advisers with a lower level of training to advise on a limited range of products, such as stakeholder pensions, CAT products, and other straightforward products (5.23).

**(d) When will this happen?**

FSA is just making proposals at this stage and the consultation period lasts until April 2002. However, given FSA's obvious commitment to abolishing polarisation, this will probably happen around June – September 2002.

**(e) The consequences of abolition**

With polarisation removed, the market for packaged products will be likely to segment into:

- **Provider firms which continue to offer only their own products** and may distribute through tied, independent and direct channels, including appointed representatives;
- **Provider firms which choose to increase their range of products** by adopting products from other provider firms. They may also distribute through tied, independent and direct channels. A provider firm which adopts another provider's product will need to fulfil the requirements summarised at section 6.
- **Distributor firms** which introduce or advise on the products of a range of different providers. They may not remain as appointed representative firms and must, instead, seek direct authorisation from FSA. This may be relatively unattractive because of the costs associated with direct authorisation: the need to establish systems and controls and to maintain the requisite level of capital.
- **Independent advisers** providing independent advice on a fee basis; and
- **Other advisers** who provide independent advice on a commission basis, but who may not be called 'independent'.

**(f) How can a Provider adopt a product?**

A provider firm which wishes to adopt and distribute the product of another provider will need to do the following:

- **Have an appropriate distribution structure**  
The company in the product provider's group that adopts the third party's product



- (i) must be FSA authorised with appropriate permissions to arrange and advise;
- (ii) but cannot itself be a product provider because of the requirements (in IPRU (INS) 1.3 (1) and in CIS 6.5 and 16.5) that an insurer or manager of a collective investment scheme does not carry on unrelated business;
- (iii) will need to enter into section 39 Appointed Representative agreements with the group's sales force to enable them to distribute the new product.

- **Have an appropriate adoption agreement**

The agreement between the adopting company and the third party provider should include appropriate provisions such as the following:

- (iv) **Appointment of firm adopting product** - outline of services to be provided e.g. marketing product, soliciting applications, collecting application forms;
- (v) **Scope of authority of firm adopting product** - no power to enter into contract on behalf of product provider, no negotiation of product terms or issuing of illustrations;
- (vi) **Obligations of product provider** - product administration, compliance with applicable regulatory requirements (both for administration and documentation produced), assistance with training;
- (vii) **Marketing obligations of firm adopting product** - responsibility of firm adopting product for ensuring compliance with applicable regulatory requirements;
- (viii) **Access to premises/co-operation with FSA** - access to premises for other party and FSA for purposes of compliance with FSA requirements, co-operation with instructions by other party and FSA for compliance with regulatory requirements;
- (ix) **Commission** - payment of commission and maintenance of records to determine commission payable;
- (x) **Performance Standards** - each party to comply with specified performance standards as relate to product administration or marketing;
- (xi) **Branding and Literature** - grant of licences to use other party's logos and brand names for purposes of Agreement, provisions regarding the branding of mutual documentation and use of such documentation;
- (xii) **Informal committee** - agree setting up of informal committee with representatives of both parties to discuss issues, agree performance standards, review customer complaints, co-ordinate public relations, review effectiveness of training, review sales volumes etc;
- (xiii) **Customer access/solicitation of customers** - agree customer ownership and solicitation of customers;
- (xiv) **Termination** and other standard clauses.

**(g) How will this impact firms?**

The following summary assumes that all of FSA's proposals will be implemented.

Independent Adviser Firm	Product Provider
<ul style="list-style-type: none"> <li>• Currently IFA firm or network;</li> <li>• Will no longer be <b>clearly distinguished</b> from tied advisers;</li> <li>• Can <b>continue to operate as at present</b> by representing only their customer and advising from a range of product providers;</li> <li>• However, may only call themselves "<b>independent</b>" if they charge on a fee basis in accordance with FSA's requirements. This fee may be subject to <b>VAT unless a product is sold</b>. Any commission received must be rebated to the customer, although it seems that an independent adviser may retain renewal commission in relation to contracts which antedate the new arrangements;</li> <li>• May choose to become a <b>distributor firm</b>.</li> </ul>	<ul style="list-style-type: none"> <li>• Currently product provider and its appointed representatives;</li> <li>• Can <b>continue to operate as at present</b>, distributing only its own products. However, there will be a number of alternatives which are as follows:</li> <li>• Distribute through <b>multi-tied introducers/advisers</b>, who will need FSA authorisation.</li> <li>• <b>Invest</b> in an independent adviser firm. Because the "better than best" rule will be disappplied, the independent firm will not be restricted from selling its shareholder's products, although it must, of course, only advise a customer to acquire a product when suitable for him;</li> <li>• Seek to penetrate the "<b>financially excluded</b>" market with lower trained advisers selling straightforward products. This may be attractive to Industrial Branch offices;</li> </ul>
Tied Adviser	
<ul style="list-style-type: none"> <li>• Currently will be an individual member of a product provider's direct sales force, or an appointed representative firm;</li> <li>• Can <b>remain tied</b> to a single product provider as at present, and will continue to be exempt as an appointed representative;</li> <li>• If its product provider <b>adopts other firms' products</b>, it can introduce and advise on them as well;</li> <li>• If it agrees to introduce to or advise on products <b>for more than one firm</b>, it must cease to be an appointed representative and will need FSA authorisation.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Add to its product range</b> by adopting products of other product providers, as can be done at present for stakeholder pensions. In order to do this the adopted product must be taken by a group company which is neither an insurer nor a unit trust manager and a detailed distribution agreement will be required;</li> <li>• If it permits its appointed representatives to introduce or advise on non-group products as well as its own, then they must <b>become authorised by FSA</b>.</li> </ul>

## 2. General Prohibition - Part II sections 19, 22-24, 26-29

### Summary:

A person may not carry on a regulated activity unless authorised or exempt. "Carrying on a regulated activity in the UK" has a complex definition, while the specified activities and investments are contained in the Regulated Activities Order ("RAO"). This section discusses:

- The general prohibition (2.1)
- The meaning of "carrying on a regulated activity in the UK" (2.2) which includes
  - Carried on by way of business (2.2.3)
  - In the UK (2.2.4)
  - Specified Investments in RAO (2.2.7)
  - Specified activities in RAO (2.2.8)
  - General Exclusions in RAO (2.2.9)
- Regulation of investments not previously regulated under FSAct 1986 (2.2.10)
- Guidance on RAO Article 54 (2.2.11)
- Offences (2.3)
- Enforceability of agreements in breach of the general prohibition (2.4)
- Enforcing the New Perimeter – CP25 (2.6).

### 2.1 General prohibition (s19)

May not carry on regulated activity in UK (or purport to do so) unless authorised/exempt (s19).

#### Regulated activity =

- Activity specified by Treasury relating to investment specified by Treasury - requires positive resolution SI for 1st RAO and subsequent extensions (s429(8)). Specified in **FSM Act 2000 (Regulated Activities) Order 2001/544** as amended by the **Regulated Activities (Amendment) Order 2001/3544** (see 2.2.2).
- Carried on by way of business (s22) - Treasury may define (s419) by SI requiring positive resolution (s429). Defined in **FSM Act 2000 (Carrying on Regulated Activities by way of Business) Order 2001/1177** (see 2.2.3).

### 2.2 Carrying on regulated activity in UK

#### 2.2.1 General prohibition (s19 FSM Act)

May not carry on regulated activity in UK unless authorised or exempted.

- **Carry on:** this phrase has a connotation of repetition or continuity.
- **Regulated activity:** see 2.2.2
- **By way of business:** see 2.2.3.
- **In the UK:** see 2.2.4.
- **Or purport to do so:** see 2.2.5.

#### 2.2.2 Regulated activity (s22 FSM Act)

= (i) specified investment - in RAO: see 2.2.7.

+ (ii) specified activity - in RAO: see 2.2.8.

+ (iii) carried on by way of business: see 2.2.3.

For collective investment scheme ("CIS") and stakeholder pension ("SHP"), only (i) and (ii) are required (RAO para 4(2)).

### 2.2.3 Carried on by way of business

The Business Order (see 2.1) defines "by way of business" as follows:

- **For deposit taking:** holding out as accepting deposits on a day to day basis and not only on particular and separate occasions.
- **For investment business:** when a person carries on the business of (in summary) engaging in any of the following activities in relation to investments:
  - dealing,
  - arranging,
  - managing,
  - providing custody,
  - sending dematerialised instructions,
  - operating a CIS or SHP,
  - advising,
  - agreeing to do any of the foregoing.
- A person managing the assets of an OPS is regarded as doing it by way of business, subject to stated exceptions.

"**Business**" remains undefined but a person is likely to carry on an activity by way of business when:

- He intends to make a profit or to avoid a loss.
- He is a market participant or provider rather than a market customer.
- He engages in the activity in question more than intermittently.

See AUTH 2.3 for FSA's view.

### 2.2.4 In the UK

This element is likely to focus on where the activity takes place, and not where the contract is made. So, for example, the following activities are likely to be viewed as taking place in the UK in the following circumstances:

- Dealing: either party is in the UK.
- Arranging: either party is in the UK.
- Managing: activity is in the UK.
- Advising: either party is in the UK.

Plus 4 cases in s418 where a person is to be regarded as carrying on a regulated activity in the UK where:

- They passport out from the UK (s418(2)-(3)).
- The regulated activity is managed in or carried out from the UK (s418(4)-(5)). AUTH 2.4 gives FSA's view.

### 2.2.5 Or purport to do so

This would be where the activity is a pretence, or resembles a regulated activity even though it is not.

### 2.2.6 Commencement of RAO

Comes into force on N2; for funeral plan contracts ("FPC") on 1st January 2002; for regulated mortgage contracts ("RMC") originally intended to be on N2 plus 9 months (but now postponed).

### 2.2.7 Specified investments in RAO

Definitions:

- Securities = investments in Articles 76-82
- Contractually based investments ("CBI") = investments in Articles:
  - 75, if long term life assurance (subject to the two stated qualifications),
  - 83-85 ("Derivatives"),
- funeral plan contracts.

See AUTH 2.5-2.9 for FSA's view of RAO.

Article	Investment	How altered from FSA 1986
74	Deposits **	
75	Contracts of insurance **	CBI if long term life assurance which is neither: <ul style="list-style-type: none"><li>• reinsurance; nor</li><li>• term assurance with stated characteristics.</li></ul>
76	Shares *	Definition/exclusions extended to certain comparable EEA companies (Articles 76(2)(b) and (3)(d)).
77	Debentures *	A bill of exchange accepted by a banker is no longer excluded from definition of debenture (Article 77 (2)(b)).
78	Government securities *	Securities of Scottish, Welsh and Northern Irish Assemblies together with certain supra-national organisations now included (Article 78(1)(b)-(d) and (g)(ii)).
79	Warrants	
80	Certificates *	Definition recast to make clear that securities subject of certificate must be in issue (Article 80(1)(a) and (b)).
81	CIS units	
82	SHP rights **	
83	Options	

Article	Investment	How altered from FSA 1986
84	Futures *	Contract for delivery within 7 days, where parties do not intend this, no longer excluded (Article 84(4)).
85	Contracts for differences*	Deposit with interest calculated under index or other factor no longer a contract for differences (Article 85(2)(b)).
86	Lloyd's syndicate capacity/membership **	
87	Funeral plan contracts ("FPC") ** - CBI	
88	Regulated Mortgage Contracts ("RMC")**	
89	Rights/interests in investments - security/CBI	

\* Definition altered from Schedule 1 FSAct 1986

\*\* Investment not previously regulated under FSAct 1986 - see 2.2.10 below

## 2.2.8 Specified Activities in RAO, together with applicable exclusions

- Note: Investment Firm ("IF") may not rely on exclusion in Article 15 or on general exclusions in Articles 68-70. The definition of Investment Firm is summarised below in section 2.2.9.
- The General Exclusions in Articles 66-72 are set out in section 2.2.9.

Activity	Which specified investments ?	Specific Exclusions	General exclusions						
			Tees* (Art66)	Prof* (Art67)	G/S (Art68)	Grp* (Art69)	Coy* (Art70)	ESS (Art71)	OSP* (Art72)
14 - <b>Dealing as principal</b> Securities, CBI (not FPC) How altered from FSAct 1986: - Article 15 - disapplied for bare trustees - Article 17 - narrowed so may not accept as agent - Article 18 - definition of "company" altered  - Article 19 - new, replaces "permitted person" regime		15 - Not hold out* (IF may not rely) 16 - Unauthorised person dealing in CBI 17 - Accepting debenture * 18 - Company issuing own shares * 19 - Hedging with derivatives ** Plus general exclusions	✓		✓	✓	✓	✓	✓
21 - <b>Dealing as agent</b> Securities, CBI (not FPC)  How altered from FSAct 1986: - Article 22 new - intended to exempt professions - Article 23 - new - replaces "permitted person" regime		22 - Unauthorised person dealing through authorised person ** 23 - Hedging with derivatives **  Plus general exclusions		✓*	✓	✓	✓	✓	✓
25 - <b>Making arrangements *</b> Securities, CBI (including FPC), Lloyd's syndicate capacity/ membership  How altered from FSAct 1986: - Article 27 - new excluding communications providers - Article 29 new - intended to exempt professions - Article 32 - narrows exclusion, so that provision of finance must be sole purpose of arrangement		26 - Not bring about a deal 27 - communications providers ** 28 - Arranger is party 29 - Unauthorised person arranges through authorised person ** 30 - Lending on insurance policies * 31 - Accepting a debenture 32 - Providing finance * 33 - Introducing 34 - Issuing shares * 35 - ISRO  Plus general exclusions	✓	✓	✓	✓	✓	✓	✓
37 - <b>Managing</b> Securities, CBI (including FPC) How altered from FSAct 1986: - Managing is now defined to require the exercise of discretion. Non-discretionary managing will now count as dealing as agent and advising. - Article 38, which excludes certain managers appointed		38 - Attorneys ** Plus general exclusions	✓		✓				✓

Activity	Which specified investments ?	Specific Exclusions	General exclusions						
			Tees* (Art66)	Prof* (Art67)	G/S (Art68)	Grp* (Art69)	Coy* (Art70)	ESS (Art71)	OSP* (Art72)
under a power of attorney, and who act on third party instructions, is new									
40 - <b>Custody</b>	Securities, CBI (including FPC)	41 - Third party accepts responsibility 42 - Introducing 43 - Other exclusions Plus general exclusions	✓	✓	✓	✓		✓	✓
44 - <b>Sending</b>	Securities	46 - Participating issuers 47 - Settlement banks 48 - Take over offers 49 - Providing a network **							
<b>Dematerialised instructions ("DMI") for another</b> How altered from FSAct 1986: - References to CGO settlement deleted - Article 38, which excludes sending a DMI as a necessary part of operating a network, is new			✓		✓				✓
51 - <b>Establishing, operating or winding up a CIS</b>	Any property	None							
52 - <b>Establishing, operating or winding up a SHP **</b>	Any property	None							
53 - <b>Advising</b> *	Securities, CBI (including FPC)	54 - Advice in periodical ** For FSA guidance see AUTH App 1.22-1.28	✓	✓	✓	✓	✓		✓
How altered from FSAct 1986: - Advising is now defined to include advising an investor, a potential investor or (new) that person's agent. - Article 54, which excludes advice given in periodicals, is extended to any service providing regularly updated information but is also narrowed so that it does not apply to periodicals/services whose principal purpose is (new elements underlined) - to give regulated advice; - to lead <u>or enable</u> people to buy or <u>sell</u> investments. See 2..2.11.									
64 - <b>Agreeing</b>	Any specified	General exclusion							✓



Activity	Which specified investments ?	Specific Exclusions	General exclusions						
			Tees* (Art66)	Prof* (Art67)	G/S (Art68)	Grp* (Art69)	Coy* (Art70)	ESS (Art71)	OSP* (Art72)
<b>to carry on a specified activity*</b>	investment other than deposit, insurance, CIS or SHP								
How altered from FSA 1986: - Offering is no longer a regulated activity									

### 2.2.9 General exclusions in RAO

General Exclusions		Relevant to	
66	Trustees, nominees and personal representatives  How altered from FSAct 1986: Article 66(7) clarifies availability of exclusion.	14 25 37 40 45 53	Dealing as principal Arranging Managing Custody Sending DMI Advising
67	Activities carried on in course of profession or non-investment business  How altered from FSAct 1986: - Extended to dealing as agent. - Article 67(1)(b) clarifies availability of exclusion; intended to exclude need for precautionary authorisation.	21 25 40 53	Dealing as agent Arranging Custody Advising
68	Activities carried on in connection with sale of goods/supply of services  How altered from FSAct 1986: Article 68(3) altered (apparently in error) but with result that supplier can be agent of either party.  Investment Firm is defined (Article 4 (4)-(5)) as: <ul style="list-style-type: none"> <li>A person whose regular occupation or business is the provision of core investment services to third parties on a professional basis.</li> <li>Core investment services are listed in section A of the Annex to the Investment Services Directive as (in summary) dealing, arranging, managing or underwriting transactions in transferable securities, CIS units, money market instruments, financial</li> </ul>	14 21 25 37 40 53	Dealing as principal Dealing as agent Arranging Managing Custody Advising  Investment Firm may not rely on Article 68 (see definition in left hand column).

General Exclusions		Relevant to	
	<p>futures, FRAs, interest rate, currency and equity swaps, and options on these investments.</p> <ul style="list-style-type: none"> <li>• Subject to stated exclusions, including: <ul style="list-style-type: none"> <li>- Insurers.</li> <li>- Firms which provide investment services exclusively for group companies.</li> <li>- certain professionals and brokers.</li> </ul> </li> </ul>		
69	<p>Groups and joint enterprises</p> <p>How altered from FSAct 1986: Articles 69(1)-(4) restrict exclusions by requiring that other party acts as principal.</p>	14 Dealing as principal 21 Dealing as agent 25 Arranging 37 Managing 40 Custody 41 Sending DMI 53 Advising  Investment Firm may not rely on Article 69.	
70	<p>Sale of body corporate</p> <p>How altered from FSAct 1986: exclusion greatly widened to apply to any transaction which may reasonably be regarded as acquisition of day to day control of affairs of body corporate.</p>	14 Dealing as principal 21 Dealing as agent 25 Arranging 53 Advising  Investment Firm may not rely on Article 70	
71	<p>Employee share schemes</p> <p>Not altered from FSAct 1986.</p>	14 Dealing as principal 21 Dealing as agent 25 Arranging 40 Custody	
72	<p>Overseas persons</p> <p>Definition = a person who carries on a specified activity (paras 14-53 or 64) but not from, nor offered from, a permanent place of business maintained by him in UK (RAO Article 3 - definitions).</p> <p>How altered from FSAct 1986: exclusion restricted so that overseas person may no longer enter into transaction as agent for unauthorised person in UK</p>	14 Dealing as principal 21 Dealing as agent 25 Arranging 53 Advising 64 Agreeing to: <ul style="list-style-type: none"> <li>• Arrange</li> <li>• Manage</li> <li>• Provide custody</li> </ul>	

General Exclusions	Relevant to
(Article 72(2)(b)(i)).	<ul style="list-style-type: none"> <li>• Send DMI</li> </ul>

## 2.2.10 Regulation of investments not previously regulated under FSAct 1986

### (a) Deposits

**Regulated activity:** accepting deposits (RAO Article 5).

**Exclusions:** RAO Articles 6 - 9.

**How regulated:** deposit takers regulated prudentially and not for conduct of business.

### (b) Contracts of insurance, other than long term

**Regulated activity:** effecting and carrying out contracts of insurance (RAO Article 10).

**Exclusions:** RAO Articles 11 and 12.

**How regulated:** insurers regulated prudentially. The Government announced on 12 December 2001 that FSA would regulate general insurance brokers, and will consult on rules and timetable. In the meantime, intermediaries of general insurance (and most insurers) may join, and be regulated by, General Insurance Standards Council ("GISC") for marketing activities. Also, when applicable, COB 6.8.

### (c) Stakeholder pensions (RAO Article 82)

**How regulated:** Providers must be regulated (see Article 52 at 2.2.8). Marketing is regulated as for a packaged product. For Conduct of Business rules, see 8.5.6, 7 below.

### (c) Lloyd's

**Regulated activities:**

- (i) Advising on syndicate participation at Lloyd's (RAO Article 56).
- (ii) Making arrangements (RAO Article 25) in relation to the underwriting capacity of a Lloyd's syndicate or a person's membership of a Lloyd's syndicate (RAO article 86).
- (iii) Managing the underwriting capacity of a Lloyd's syndicate (RAO Article 57).
- (iv) Lloyd's arranging deals in contracts of insurance written at Lloyd's (RAO Article 58).

**Exclusions:** For making arrangements only, see under Specified Activities - section 2.2.8 - at Article 25.

**How regulated:** Lloyd's itself will be regulated under the Lloyd's Sourcebook - see section 18. The application of the Conduct of Business Sourcebook to those regulated activities is set out at Chapter 12 below (see section 8.5.9(a)).

### (d) Funeral plan contracts ("FPC")

**Regulated activities:**

- (i) Arranging (RAO Article 25).
- (ii) Advising (RAO Article 53).

(iii) Entering into FPC as provider (RAO Article 59).

**Exclusions:**

FPCs covered by insurance or trust arrangements (RAO Article 60). FSA considers it likely that most FPCs will be structured to fall within this exclusion (Plan & Budget 2001/2).

For arranging/advising, see under Specified Activities at Articles 25 and 53.

**How regulated:** provision subject to prudential regulation; marketing subject to applicable conduct of business rules.

**(e) Regulated mortgage contracts ("RMC")**

In summary, a RMC is a loan which, at the time it is entered into, has stated characteristics. They are that it is a loan to an individual or trustee secured by a first legal mortgage on UK land, at least 40% of which is to be used as the borrower's, trust beneficiary's or relative's dwelling.

**Regulated activities:**

- (i) Entering into RMC as lender (RAO Article 61).
- (ii) Administering a RMC.
- (iii) The Government announced on 12<sup>th</sup> December 2001 that FSA would regulate mortgage advice, and will consult on rules and timetable.

**Exclusions:**

Unauthorised person arranging for authorised person to administer RMC (RAO Article 62) or administering RMC under contract with authorised person (RAO Article 63).

- **How regulated:** see 8.5.10 below.

**(b) Long term care contracts ("LTC")**

The Government is currently considering whether to include LTC contracts within the scope of the FSM Act in order to impose conduct of business requirements.

## 2.2.11 Guidance on Article 54 (AUTH 7 - CP 104).

Article 54 RAO sets out when **periodicals and news services** will not be carrying on the regulated activity of giving investment advice. A person can, if in doubt, apply for a certificate, although this is not needed to benefit from the exclusion (AUTH 7.2, 7.5).

- guidance is given on when a person is carrying on the business of advising on investments (AUTH 7.3.4).
- the person who controls editorial content may require authorisation (AUTH 7.3.9).
- the exclusion applies only if the principal purpose of the publication/service is not to advise on investments, nor to lead/enable people to deal. In judging this, FSA will look at overall impression over a period of time (AUTH 7.4).
- procedure for application for, and granting of, a certificate is set out at AUTH 7.6. A certificate remains in force indefinitely, but is subject to FSA's ongoing monitoring.

## 2.3 Offences

Contravention of general prohibition (s23):

- "Tesco" - defence.

False claim to be authorised or exempt (s24):

- "Tesco" - defence.

## 2.4 Enforceability

Agreement made when carrying on regulated activity in breach of the general prohibition or made by an authorised person through an unauthorised person unenforceable against counterparty who may recover money/compensation (ss 26-27).

- Court will determine amount (s28).
- Court may allow enforcement (reasonable belief for s26; authorised person not know of third party's contravention for s27).
- Special provisions for deposit taking (s29).

This does not apply to certain EEA firms (Sch 3 para 16).

## 2.5 Miscellaneous

An ISRO approved under paragraph 25B Schedule 1 FSA Act is approved under article 35 RAO (**Transitional Provisions (Authorised Persons etc) Order (SI 2001 No. 2636)** Article 80).

## 2.6 Key statements of policy and implementation

### 2.6.1 CP25 - Enforcing The New Perimeter (July 1999)

This explains how FSA will use its enforcement powers to deal with unauthorised persons who have breached either the general prohibition or the financial promotion requirements. In considering whether to use its powers, FSA will seek to protect consumers from dealing with unregulated businesses which are:

- possibly incompetently managed;
- financially unsound, or
- fraudulent.

CP25 describes FSA's stance on using its criminal and civil powers, and the power to prohibit individuals, as set out in the then FSM Bill. See also ENF paragraph 2.8.

### 3. Financial Promotion - Part II sections 21, 25, 30

#### Summary:

The investment advertisement/cold calling regime is replaced by a new “financial promotion” regime which regulates invitations and inducements to engage in investment activity. This section covers the following areas:

- Basic provision (3.1)
- Disapplication of basic provision (3.2)
- Contravention of basic provision (3.2)
- Unenforceability (3.4)
- FSA’s guidance on financial promotion (3.5.1)
- COB sourcebook – rules on financial promotion (3.5.2)
- An analysis of the Financial Promotion Exemptions Order (as amended) 3.5.3

#### 3.1 Basic provision

No communication of invitation or inducement in the course of business (as defined by Treasury order (s21(4) - see 2.2.3) to engage in investment activity unless you are authorised or authorised person has approved it (s21(1)-(2)).

**Investment Activity** = making or effecting agreement whereby either party falls within RAO (“controlled activity”), or exercising RAO investment rights (“controlled investment”) (s21(8)).

If communication originates from outside the UK, restriction only applies if capable of having effect in UK (s21(3)). Treasury order may repeal this (s21(7)).

#### 3.2 Disapplication of basic provision

Treasury may make order to disapply s21, including financial promotion rules (s21(5)-(6)). For **FSM Act 2000 (Financial Promotion) Order 2001**, see 3.5.3. Any person may make a financial promotion under this Order without infringing the basic provision (3.1).

#### 3.3 Contravention of basic provision

Contravention of the basic provision is an offence (s25) for which there are two defences:

- Reasonable belief that prepared/approved by authorised person.
- ‘Tesco’ - defence.

#### 3.4 Unenforceability

Controlled agreement (agreement where either party engages in controlled activity) made in consequence of unlawful communication (s30):

- Is unenforceable against customer (who may recover money/compensation).
- Court may enforce having regard to prescribed issues:
  - whether maker seeking enforcement reasonably believed not making unlawful communication (s30(6)),
  - whether third party seeking enforcement knew agreement entered into in consequence of unlawful communication (s30(7)).

## 3.5 Key statements on policy and implementation

### 3.5.1 Guidance on Financial Promotion (CP104 - Appendix 1)

FSA has prepared the following draft guidance in the form of questions and answers.

#### 1. Definitions

A **real time financial promotion** involves interaction, and can be interrupted (1.10).

A **non-real time financial promotion** is enduring. Broadcasts can be either.

A financial promotion is **solicited** where it is restricted to investments contemplated by the investor, so if the investor requests a visit to discuss X then advice on Y may be **unsolicited**. FSA also makes the point that answering a question at the presentation might amount to an unsolicited real time communication all persons other than the questioner.

#### 2. Am I making a communication or causing it to be made? (1.6)

A person makes a communication when imparting information to a recipient, or is responsible for its physical transmission on behalf of another. A communication is therefore made by its author, the person who causes it to be made, and anyone who passes it on.

It requires an active step to make/cause a communication to be made, examples include:

- Sending a prospectus to an investor;
- Advertising;
- Advising;
- Publishing;
- People who supply to the intermediary;
- Distributors (hence the exclusion at Article 18 FPO for conduits);
- Making a website page (1.20);
- Creating a hypertext link.

However, leaving a document on a train or being overheard will not be a communication.

#### 3. Is it an invitation or inducement? (1.4)

An **invitation** invites someone to enter/offer to enter into an investment activity, such as a direct offer advertisement or a prospectus with an application form. An offer will include an invitation to treat.

An **inducement** involves a degree of incitement/promotion, a step in the chain which leads directly or indirectly to a person engaging in investment activity, such as a brochure with contact details. While this depends upon circumstances and actual/perceived intention, FSA considers that it requires more than presenting purely factual information without any inducement. For example, supplying the execution draft of a share purchase agreement will not be an inducement, nor will general profile raising (such as including a logo on an umbrella).

#### 4. Does the invitation of inducement relate to an investment activity? (1.7)

A person may not be carrying on a regulated activity as set out in the Regulated Activities Order but may still be making a financial promotion in relation to a controlled investment because exclusions in the RAO do not apply.

#### 5. Is it being made in the course of business? (1.5)

This is more than simply carrying on business, and requires a commercial intent on the part of the communicator, although this is easily fulfilled. Examples are given of a company selling its subsidiary, communicating to its employees in relation to PHI policies, or promoting an employee share scheme. Furthermore, activities carried out with regularity may be in the course of business, and the example is given of an individual investing in shares. Overall, FSA considers that this test is fulfilled once there is regularity and a commercial purpose (1.32).

**6. If the financial promotion originates outside the UK, is it capable of having an effect in the UK? (1.8)**

The answer is "yes" if:

- It is an invitation or inducement to someone in the United Kingdom to engage in an investment activity;
- It is capable of resulting in this. An example would be a financial promotion between two foreign nationals to deal in a London Stock Exchange listed investment, although this specific example would not be a financial promotion because of FPO Article 12.

**7. Is it exempt?**

- Reference should be made to FPO to determine this.

**8. The consequences of a financial promotion are:**

- For authorised persons, COB applies (although an FP may be exempt under COB 3.2.5).
- For unauthorised persons, a non-real time financial promotion may be specifically approved by an authorised person (1.9). However, real time financial promotions may not be approved.

**3.5.2 COB Sourcebook (see 8.5.9(c))**

This applies to persons authorised by FSA which make or approve a financial promotion.

- Detailed contents rules similar to those of the SROs.
- Overall requirement: must be fair and not misleading.

**3.5.3 Financial Promotion Exemptions Order ("FSM Act 2000 (Financial Promotion) Order 2001/1335") as amended by Financial Promotion (Amendment) Order 2001/2633; Miscellaneous Provisions Order 2001/3650 Articles 4 and 5; and Financial Promotion (Amendment No.2) Order 2001/3800 ("FPO")**

**(i) Definitions**

**Communication** = communication, in course of business, of invitation or inducement to engage in investment activity; or causing such communication to be made. A communication is:

- Made to another person if addressed (verbally or legibly) to particular person(s) (eg letter, telephone call).
- Directed to persons when addressed generally (eg TV or website).

**Controlled activities** = same as RAO but most exclusions (eg dealing as principal) do not apply. They are contained in Schedule 1 to the FPO and are:

- (1) Accepting deposits.
- (2) Effecting and carrying out contracts of insurance.
- (3) Dealing in securities and contractually based investments (other than FPCs) as principal or agent.
- (4) Arranging deals in investments.
- (5) Discretionary management of investments.
- (6) Safeguarding and administering investments.



- (7) Advising on investments.
- (8) Advising on syndicate participation at Lloyd's.
- (9) Entering as provider into a funeral plan contract.
- (10) Providing qualifying (ie mortgage) credit as lender.
- (11) Agreeing to carry on an activity in (3)-(10).

**Controlled investments** = same as RAO.

**Recipient** = person to whom communication is made or, for non-RTC directed at persons generally, person who reads or hears it.

**Real time communication** ("RTC") = communication is made during personal visit, telephone conversation or other interactive dialogue.

**Non-RTC** = anything else, including letter, e-mail, website, broadcast, publication; see FPO paragraph 7(5) for indications.

An RTC is **solicited** when made in course of personal visit/call/interactive dialogue initiated or expressly requested by the recipient (FPO para 8). Note caveats in FPO paragraph 8(3). Otherwise it is **unsolicited**. Close relatives and joint participants are covered by recipient's solicitation (FPO para 8(4)).

Where FPO requires an indication to be contained in a communication, it must be **clear and prominent** (FPO para 9).

FSA provides guidance on some of these exemptions in AUTH App 1 (paragraphs 1.12 – 1.19).

(ii)

**Exemptions for all controlled activities:**

- (a) A communication (but not an unsolicited RTC) made (from inside or outside the UK) **to persons outside the UK** (FPO para 12).
- (b) A communication (but not an unsolicited RTC) directed (from inside or outside the UK) only **to persons outside the UK**. This is subject to qualifications (FPO para 12).
- (c) An unsolicited RTC falling within (a) or (b) only if **made from a place outside the UK** for non-UK business (FPO para 12(3)).
- (d) **Customer's communication** to provider of controlled activity, seeking information about provider's products and services, or the products or services themselves (FPO para 13).
- (e) Non-RTCs or solicited RTCs which **follow up** a prior exempt communication (FPO para 14).
- (f) An RTC made for the **introduction** of the recipient to an authorised or exempted person (FPO 15).
- (g) A non-RTC/solicited RTC made by an **exempt** person and an unsolicited RTC made by an appointed representative which its principal could compliantly have made (FPO para 16).
- (h) A **generic** promotion (FPO para 17).
- (i) A communication made or directed by a **mere conduit** in course of a communications business (FPO para 18).
- (j) A communication made or directed at **investment professionals**, meaning authorised and exempt persons, persons carrying on the controlled activity for business, local and national governments (FPO para 19).

- (k) A non-RTC written by a **journalist** in a general periodical/broadcast (FPO para 20 as substituted by the No. 2 Amendment Order).
  - (l) **Company Directors** and others who promote their company in the course of a broadcast (FPO para 20A)
- (iii) **Exemptions for deposits and non long term life insurance:**
- (a) **Deposits:** non-RTC (subject to detailed conditions) (FPO para 22) and RTC (FPO para 23).
  - (b) **Insurance** which is not a regulated long term life assurance: non-RTC (subject to detailed conditions) (FPO para 24) and RTC (FPO para 26).
  - (c) **Reinsurance and large risks:** non-RTC (subject to detailed conditions) (FPO para 25).
- (iv) **Exemptions for controlled activities other than accepting deposits and for regulated long term life assurance:**

Note: Qualifying contracts of insurance (= **long term life**): no FPO exemption applies to communication inviting/inducing person to enter unless made by authorised/exempt EEA/designated territory person (FPO para 10).

**Bespoke communications:**

- (a) One off non-RTC/solicited RTC other than for regulated mortgages: a **bespoke communication** which takes into account recipient's circumstances (FPO para 28).
- (b) One-off unsolicited RTC where the communicator reasonably believes that the **recipient understands the relevant risks** and would expect to be contacted in relation to the relevant investment activity (FPO para 28A).

**Media related communications:**

- (a) Communications to **placers of promotional material** (FPO para 38).
- (b) Communications to **information disseminators** (FPO para 47).
- (c) Advertisements sent to **advertisers** (FPO para 57).

**Communications to particular persons:**

- (a) Communications between actual or potential participators in **joint enterprises** (as defined) (FPO para 39).
- (b) Communications within **corporate groups** (FPO para 45).
- (c) Communications offering **regulated mortgages** to corporations (FPO para 46).
- (d) Non-RTC/solicited RTC of (in)direct **investment in unlisted company** to individual with current certificate from accountant/employer as having certain income/assets (FPO para 48).
- (e) Communications to **substantial corporations** etc (FPO para 49).
- (f) Communications to investor certified by authorised person to be **sufficiently knowledgeable** in respect of such investments (FPO para 50).

- (g) Non-RTC/solicited RTC to **associations of persons** falling within (FPO paras 48-51).
- (h) Non-RTC/solicited RTC to **common interest group of company** in relation to its shares/debentures (FPO para 52).
- (i) Communications by **settlers or trustees** to trustees (FPO para 53) or by or to beneficiaries (FPO para 54) on trust business.
- (j) Any RTC by a **member of a profession** to his client about an excluded activity incidental to his professional services (FPO para 55).

#### By particular persons:

- (a) Non-RTC/solicited RTC made by:
  - **Governments and central banks** (FPO para 33).
  - **Industrial and provident societies** (FPO para 34).
  - **Nationals of non-UK EEA states** in course of carrying on a lawful controlled activity in that state which conforms to FSA's financial promotion rules (FPO para 36).
- (b) Non-RTC/solicited RTC by **non-OEIC corporation** regarding certain bearer instruments (FPO para 41) and promotions to existing holders (FPO para 42).
- (c) Non-RTC/solicited RTC by **non-OEIC corporation** to members and creditors (FPO para 43).
- (d) Non-RTC/solicited RTC made by supplier (as defined) of **goods/services** to non-individual customer (FPO para 61).
- (e) Non-RTC/solicited RTC by **non-OEIC company** relating to its group securities already admitted to certain markets (FPO para 69).
- (f) Non RTC by **members of a profession** who carry out Part XX activities and are not authorised under FSM Act provided the firm states that it is not authorised, but can provide a limited range of investment services in addition to professional services (FPO para 55A).

#### Relating to CISs:

- (a) Non-RTC/solicited RTC by **operators of RCISs** to UK participants (FPO para 40).
- (b) Non-RTC/solicited RTC by **OEIC** to its members and creditors (FPO para 44).

#### Relating to investment markets:

- (a) Non-RTC/solicited RTC by specified **financial markets** about their facilities (FPO para 37).
- (b) Non-RTC/solicited RTC relating to debt or securities traded on a **specified market** and required or permitted by its rules (FPO para 67).
- (c) Non-RTC/solicited RTC in connection with admission to certain **EEA markets** (FPO para 68).
- (d) Non-RTC/solicited RTC to which FSM Act **listing rules** apply (FPO para 70).
- (e) Non-RTC in **listing particulars/prospectuses** (FPO paras 71-73).

**Relating to bodies corporate:**

- (a) Non-OEIC corporation's publication of **report and accounts**, subject to conditions (FPO para 59).
- (b) Certain communications relating to participation in **employee share schemes** (FPO para 60).
- (c) Communications relating to certain **sales of bodies corporate** (FPO para 62 as amended by 2001/2633 by addition of "or on behalf of").
- (d) Communications relating to certain **takeovers** of private companies (FPO paras 63-66).
- (e) Broadcast promotions by **company directors** - see 2 (l) above.

**Overseas persons:**

- (a) Person who deals in securities or derivatives, arranges deals, manages, advises or provides custody outside the UK, and **not from permanent place of business he maintains in the UK** may make:
  - Solicited RTC from outside the UK in course of carrying on his non-UK business (FPO para 30).
  - Non-RTC and unsolicited RTC to certain existing customers (FPO paras 31-32).
  - Unsolicited RTCs to specified "knowledgeable" recipients (FPO para 33).

**Miscellaneous:**

- (a) Communications required/authorised **by other enactment** (but not for regulated mortgages) (FPO para 29).
- (b) Communications consequent upon an **Ombudsman's report** (FPO para 56).
- (c) Non-RTC/solicited RTC relating to shares issued by a **management company** in conjunction with acquisition of interest in property run by that company (FPO para 58).

**Transitional period** (FPO para 74): a communication which is:

- approved by an authorised person under s57 FSAct 1986; or
- approved by an authorised person under FSM Act and which is compliant with financial promotion rules;

before N2, may be made within one month of N2 without infringing the financial promotion restriction contained in section 21(1) FSM Act - see 3.1 above.

#### 4. Authorisation and Exemption - Part III sections 31-39; Part XIII sections 193-204

##### **Summary:**

This section describes:

- Who is an authorised person under FSM Act (4.1)
- Who is an exempted person under FSM Act (4.2)
- Exemption Orders (4.6.1)
- AR Regulations (4.6.2)
- EEA Passport Rights (4.3)
- Passport in
- Statutory provisions (4.3.1)
- Procedure (4.6.3)
- AUTH 5 (4.6.4)
- SUP 14 (4.6.6)
- Passport Out
- Statutory provisions (4.3.2)
- Procedure (4.6.3)
- SUP 13 (4.6.5)
- Treaty rights – statutory provisions (4.4)
- FSA powers of investigation against EEA/Treaty firms (4.5)
- FSA's Authorisation Manual (4.6.4)
- Applying for Part IV permission
- Threshold Conditions
- Passporting in from EEA

#### 4.1 Authorised persons (s31)

The following are authorised persons:

- Persons with Part IV permission (until cancelled (s33)). This will be the normal way for a UK firm to obtain authorisation – see section 5 of this Guide.
- EEA firms (Sch 3) (until ceases (s34)).
- Treaty firms (Sch 4) (until ceases (s35)).
- Operator, trustee, depository of recognised CIS (Sch 5 para 1) (until cancelled (s36)).
- Authorised OEIC (Sch 5 para 2).

## 4.2 Exempted persons

Exempted persons are:

- Persons exempted in Treasury Order (s38) (which may require positive resolution SI (s429 (5))) - see 4.6.1.
- Appointed representatives (s39) - see 4.6.2.
- A person with a Part IV permission cannot also be exempted.

## 4.3 EEA Passport Rights (Schedule 3)

### 4.3.1 Passport in:

- EEA firm seeking to establish branch in the UK under Single Market Directives is authorised once satisfies establishment conditions.
- EEA firm seeking to provide services in the UK under Single Market Directives is authorised once satisfies service conditions (Sch 3 para 12).

Single Market Directives = 1BCD, 2BCD, Insurance Directives, ISD (1)-(4).

No fee chargeable (Sch 1 para 18).

Guidance for an incoming EEA firm in relation to:

- variation of passport rights;
- ending its automatic authorisation;

is contained in SUP14.

#### **EEA firm =**

Investment firm (ISD), credit institution (1BCD), financial institution (2BCD), direct insurer (IDs) (Sch 3 para 5).

#### **Establishment Conditions (Sch 3 para 13):**

- Home regulator sends appropriate consent notice to FSA.
- FSA notifies firm or 2 months elapse from its receipt of consent notice.

FSA must prepare for supervision and notify firm of applicable host rules.

#### **Service conditions (Sch 3 para 14):**

- Firm notifies home regulator.
- If investment firm/insurer, home regulator notifies FSA.

FSA must prepare for supervision and notify firm of applicable host rules.

Once authorised under (Sch 3 para 12), gains applicable permissions (Sch 3 para 15).

EEA firm which does not passport in: agreements are not unenforceable (ie ss 27-29 not apply) (Sch 3 para 16).

Regulations may modify applicability of FSM Act to EEA firms (Sch 3 para 17).

### 4.3.2 Passport out:

**To establish a branch** (Sch 3 para 19):

- (i) Firm gives FSA notice of intention.
- (ii) FSA gives consent notice to host regulator. Limited grounds for refusal - WN/DN procedure applies.

- (iii) Host gives notification of applicable host rules or 2 months elapse from (ii).

**To provide services** (Sch 3 para 20):

- (i) Firm gives FSA notice of intention.
- (ii) FSA must notify host.
- (iii) Applications under Insurance Directives: if FSA refuses to notify host, firm may refer to Tribunal. Also, firm may not provide services until received formal notice (amended by **Financial Services (EEA Passport Rights) Regulations 2001 No. 1376**).

No fee for Sch 1 paras 19 or 20 (Sch 1 para 18).

Treasury may make regulations governing passporting out activities, including application of FSM Act (Sch 3 para 22).

Rules and guidance relating to a UK firm passporting out are contained in SUP13. A firm wishing to establish a branch, or to provide services, will be required to notify FSA.

An Annex, not yet issued, will summarise the application of the FSA Handbook to such business.

Offence for unauthorised UK firm to establish branch/provide services in EEA (Sch 3 para 21):

- Tesco - defence.

#### 4.4 Treaty Rights (Schedule 4)

A treaty firm (a non-UK EEA firm) is authorised to establish a branch or provide services in UK with applicable permissions (Sch 4 paras 2 and 4) provided:

- Home state authorisation is held for regulated activity.
- Home state laws offer equivalent protection/satisfy directive (Treasury certificate conclusive).
- No EEA right (ie not single market directive business) (Sch 4 para 3).
- Must give FSA 7 days prior notice providing prescribed information (Sch 4 para 5) or offence (Sch 4 para 6) (Tesco defence).

#### 4.5 FSA Intervention

FSA may intervene against incoming EEA/Treaty firm (Part XIII ss 193-204):

- Similar to Part IV imposition of requirement (s196).
- If has/likely to contravene FSA host requirement.
- If has knowingly/recklessly given false/misleading information to FSA.
- To protect customers (s194(1)).
- FSA may also exercise power of intervention to help overseas regulator (s195) and may inject incoming EEA insurer (s198).
- Proceed by supervisory notice (s197(3)) unless urgent. FSA must heed representations (s197(6)). Firm may refer to Tribunal (s197(8)).

Where single market directive so provides, then (s199):

- FSA must notify EEA firm of breach of FSA's requirement (s199(3)).
- If fails to comply, FSA must notify home regulator (s199(4)).

- FSA may (unless urgent (s199(6)) only intervene if home regulator fails/takes inadequate steps (s199(5)).

FSA may rescind/vary requirement imposed on intervention on own initiative or on application by firm (s200(1)).

Refusal of application → WN/DN procedure (s200(4)-(5)).

Contravention of FSA requirement imposed on intervention not offence/nor make transaction void, but may be actionable as for BSD - see 8.3.

FSA's policy for intervention against incoming firms is contained in ENF section 4.4, and is stated to be similar to the exercise of FSA's own initiative powers to vary a firm's permission - see 5.6.2 below. FSA's policy in relation to section 198 injunctions is set out at ENF section 6.8.

## 4.6 Key statements of policy and implementation

### 4.6.1 Exemption Order

The **FSM Act (Exemption) Order 2001/1201** exempts named persons, or categories of persons, such as:

- Bank of England;
- a local authority;
- enterprise schemes;

for stated activities.

#### **Exemption (Amendment) 2001 No.3623**

This Order amends the FSM Act in relation to:

- Northern Irish Credit Unions (2-4);
- Northern Irish insolvency practitioners (5);
- Scottish and Northern Irish Housing Associations (7);
- Wholesale electricity trading arrangements (8).

### 4.6.2 Appointed Representative Regulations

The **FSM Act 2000 (Appointed Representatives) Regulations 2001/1217** as amended by **Appointed Representatives Amendment Regulations 2001/2508** provides that ARs are exempted for business relating to:

- Arranging deals in securities or contractually based investments, provided the receipt and transmission of an investor's order in relation to an ISD instrument is carried out solely for the account of another investment firm.
- Arranging custody by another.
- Advising on investments.
- Or agreeing to do so.

AR contracts must restrict, or enable principal to restrict, other counterparties whom AR may represent.

Rules relating to appointment of an appointed representative ("AR") appear in SUP Chapter 12. These include:

- An AR may be a "full" AR, who may give investment advice, or an "introducer" AR who may only effect introductions and distribute advertisements (SUP para 12.2).



- A firm must, before appointing a full AR, be satisfied that it is fit and proper, and an introducer AR is suitable (SUP para 12.4). These are ongoing obligations (SUP para 12.6).
- The contract appointing the AR must contain prescribed terms (SUP para 12.5).
- There are rules on notification (SUP para 12.7) and termination (SUP para 12.8).

### 4.6.3 Passport Rights (2001 No. 2511)

#### **Passporting In**

Information which an inwardly passporting firm's regulator must provide to FSA is specified in relation to:

- A branch (2) – paragraph 13 (1)(iii) (3) Schedule 3
- Services (3) – paragraph 14 (1)(b) Schedule 3

#### **Passporting Out**

The procedure to follow where information provided or the nature of passported activities changes is specified for a branch (4,6); and for services (5,7).

The procedure for cancellation of authorisation when a person ceases to carry on a regulated activity in the United Kingdom is contained at (8,9).

In section 60 FSM Act, "authorised person concerned" will include an EEA firm for which FSA has received a paragraph 13/14 Schedule 3 notice (10).

The procedure to follow where a UK firm which has passported out changes information provided or its activities is set out as follows:

- Changes to branch details (11, 13-15, 18)
- Changes to services details (12,16,17,18)

Where a firm's notice of intention under paragraphs 19 or 20 Schedule 3 includes activities which are not regulated under FSM Act, then they are deemed to be authorised under FSM Act for the purposes of passporting, provided UK law does not prevent them being carried on in the EEA state in question (19).

#### **Transitionals**

Articles 20 and 21 contain transitional provisions for procedures partly completed at N2, such as applications for passporting in or out and outstanding notices, all of which are (subject to detailed points) deemed to have been made in accordance with the provisions of FSM Act.

### 4.6.4 Authorisation Manual – CP63 (August); Policy Statement (May 2001)

#### **Introduction**

The Authorisation Manual sets out how FSA will exercise its statutory powers in four circumstances:

- Grant of Part IV permissions;
- Grant of individual approval under section 59 FSM Act submitted with a Part IV application;
- Authorisation of inward passporting firms;

- Refusals to grant a Part IV permission or individual approval, or grant of restricted approval.

The Authorisation Manual comprises eight chapters, setting out how FSA will exercise its statutory powers. Most provisions are preceded by a “**G**”, which indicates that it has the status of guidance under section 157 FSM Act. It is therefore not substantive and may not be relied upon as a “safe harbour” although, given the inherently discretionary nature of the application process, this is not a particular concern. A few provisions are marked in bold and prefaced with a “**D**”, which indicates that these are procedural directions made by FSA under sections 51 or 60 FSM Act.

The policy which underlies the Authorisation Manual was set out in the *New Regulator for the New Millennium* document published in January 2000. FSA states that it is moving towards a regime which:

- is founded on a risk based approach to the regulation of all financial business which integrates and simplifies the difficult approaches adopted by the current regulators;
- switches resources from reactive post-event action towards front-end intervention; and
- uses the full range of tools available to FSA under the new legislation, including customer education.

The regulatory tools include vetting at entry level, which aims to allow only firms and individuals who satisfy the necessary criteria (including honesty, competence and financial soundness) to engage in regulated activity. FSA considers that experience in the United Kingdom and elsewhere shows that regulatory objectives are more likely to be achieved by setting and enforcing standards for entry, rather than having to deal with major problems later.

### **Preliminary sections**

An introductory Chapter (1):

- Explains the application of the Manual (AUTH 1.1 - as described in the Introduction above).
- Describes the steps which an applicant for authorisation should take when considering authorisation, and offers an overview of the application procedure (AUTH 1.6).

Chapter 2 - “Authorisation and Regulated Activities” - summarises the requirement for authorisation under the FSM Act. It gives FSA's view of the regulated investments, activities, exclusions and exemptions, together with a flow diagram.

Chapters 1 and 2 will be helpful for new-entrant applicants, particularly for overseas firms wishing to understand the key elements of the process. They are, however, simplistic - perhaps misleadingly so - and are unlikely to provide definitive assistance other than in the simplest cases. Nonetheless they are a welcome attempt at clarity and transparency.

### **Applying for Part IV permission**

Chapter 3 describes how FSA will review applications for Part IV permissions, and therefore implement the following statutory powers:

- (i) To be an authorised person under the FSM Act, a firm must generally hold appropriate permission(s) under Part IV (s40).
- (ii) Authorised persons under the FSM Act, aside from persons holding a Part IV permission, are set out in section 31 as follows:
  - EEA firms (Sch 3);
  - Treaty firms (Sch 4);
  - The operator, trustee, depository of recognised CIS (Sch 5);
  - An authorised OEIC (Sch 5).

all of whose requirements are addressed in the Manual, although CISs, and OEICs are dealt with in greater detail in the CIS Sourcebook (see 12.10.2).

(iii) In granting permission, FSA:

- Must specify the firm's permitted activities (s42(6));
- May have regard to connected persons (s49);
- May incorporate limitations or restrict the permissions granted (s42(7));
- May impose positive or negative requirements (s43).

(iv) FSA may vary or cancel a Part IV permission on its own initiative (s45). Grounds for taking this action are:

- Failing to satisfy Threshold Conditions;
- 12 months or longer inactivity;
- Desirable to protect consumers.

Chapter 3 describes how FSA may impose limitations on permissions granted, such as the kind of clients with whom a firm may deal or requirements, such as not to hold client money (AUTH 3.6, 3.7). The examples given reflect the existing authorisation procedure, although there is no doubt that FSA can go further than at present.

FSA's categories of activities for which it may grant permission mirror the Regulated Activities Order but with a number of separate categories for investments or activities which are felt to require special consideration because of their particular risk profile. They are (AUTH 3.4, 3.5):

- Advising on pension transfers or opt outs,
- Operating an unregulated collective investment scheme;
- Custody;
- Commodity derivatives;
- Spread bets;
- Rolling spot FX.

Within the Manual, FSA makes a formal direction under section 51 FSM Act by setting out its procedure for granting or varying permission (AUTH 3.9). This includes:

- Making the application (3.9.3);
- Third party reports (3.9.16);
- FSA having regard to connected persons (3.9.22);
- Commencing regulated activities (3.9.25);
- Timing (3.9.30);
- Withdrawal (3.9.32).

There are sections (AUTH 3.11 – 3.20) dealing with specific obligations for a number of particular categories including:

- Partnerships and unincorporated associations;
- Insurers;
- Controllers of client money;
- PEP and ISA managers;
- Group restructurings;
- Non EU/Treaty incoming firms;

- Passporting out.

### Threshold Conditions

Threshold conditions are relevant to the following:

- grant, maintenance and variation of Part IV permission (COND 1.2.2);
- exercise of FSA's own initiative powers under s45 (COND 1.2.3);
- approval of acquisition/increase in control (ss185(2)), 186(3)) (COND 1.2.4).

They are set out in Schedule 6 to FSM Act and referred to at AUTH 3.6. Together with Guidance, they appear in COND (Policy Statement: Regulatory Process Manuals May 2001). In summary, they are as follows:

- **Legal status:** relevant for insurers and deposit takers (COND 2.1).
- **Location of offices:** implementing the Post-BCCI Directive, UK incorporated companies must have both head office and registered office in the United Kingdom (COND 2.2).
- **Close links:** if an applicant has close links (as defined) with another person, FSA must be satisfied that these close links will not hinder FSA's effective supervision. The Guidance offered explains the complex definitions, in particular "parent undertaking" and "subsidiary undertaking" (COND 2.3).
- **A firm must have adequate resources:** the Guidance indicates that this encompasses both financial and human resources, and emphasises the importance of a start up having a rigorously tested business plan (COND 2.4).
- **Suitability:** an applicant must satisfy FSA that it is fit and proper (COND 2.5). The Guidance explains that this Condition is principally relevant to a prospective firm, because suitability of persons performing controlled functions will be addressed separately. FSA is likely to look for confirmation that the firm will conduct business with skill and integrity, and that it will have competent management. Particular guidance is offered on these two concepts.

### Authorisation Fees

Are dealt with in Chapter 4.

### Passporting in from the EEA (Chapter 5 - Policy Statement October 2001)

Paragraphs 19 and 20 of Schedule 3 FSM Act set out the requirements for an authorised firm that wishes to passport into an EEA state, to which Chapter 5 adds little.

It principally applies to an EEA firm seeking to passport into the United Kingdom, to a Treaty Firm that wishes to exercise single market rights for financial services which are not covered by a Single Market Directive, and to UCITS firms. It addresses:

- Guidance and notice requirements for passporting in (5.1);
- Operating as a branch (5.4);
- Providing services (5.5);
- Applicable FSA rules (5.6 and App 3);
- Top up permissions (5.7).

Further obligations are imposed on incoming firms in SUP 14 (see 4.6.5).

A UK law firm passporting out is dealt with at SUP 13 (see 4.6.5).

### Approved persons

Chapter 6 provides brief guidance on controlled functions.

### Determining Applications

Chapter 8 summarises as how applications will be handled, but refers to the Decision Making Manual (DEC) for full details.

It describes internal staff procedures, and how an independent Regulatory Decisions Committee will take decisions involving refusal or proposed refusal of application for a Part IV Permission, associated applications for individual approval, or for grant of a Part IV Permission subject to limitations or requirements. The Regulatory Decisions Committee will direct FSA to issue a Warning Notice if it imposes a restriction or refuses an application, and will be responsible for hearing representations in response.

### **Conclusion**

Taken together, the contents of the Manual point to a rigorous pre-authorisation examination of applicants for authorisation. However, the current SROs' application procedures are by no means lax, and it is suggested that much of what is set out in the Manual is largely reflective of what is already taking place.

#### **4.6.5 Procedure for UK Firms Passporting Out – SUP 13**

This deals with:

- Establishment of branch (13.3) and changes to details (13.6)
- Provision of services (13.4) and changes to details (13.7)
- Provision of notices (13.5) and changes to details (13.8)
- Application of FSA Handbook (13.9)
- Record keeping (13.11).

#### **4.6.6 Procedure for Incoming EEA Firms – SUP 14**

- Informing FSA of changes (14.2 - 14.4);
- Cancelling qualifications for authorisation (14.6).

## 5. Permission to carry on regulated activities - Part II section 20; Part IV sections 40-55

### Summary:

A person with a Part IV permission is an authorised person under FSM Act, and this will be the normal way for a UK firm to obtain authorisation. This section summarises

- Requirement for permission (5.1)
- Threshold conditions which must be fulfilled before grant of permission (5.2)
- FSA's powers on granting permission (5.3)
- FSA's powers to vary or cancel permission (5.4)
- FSA's procedure on granting/varying permission (5.5)
- FSA's policy for varying or cancelling permission on its initiative (5.6.3 4)

### 5.1 Requirement for permission

A person with a Part IV permission is an authorised person (s31) for the purpose of section 19 (general prohibition).

However, section 20 states that an authorised person who carries on a regulated activity otherwise than in accordance with a Part IV permission (or as FSM Act otherwise permits) will contravene FSA's requirements. In other words, a person must not only hold a Part IV permission, but also one which extends to his regulated activities. Section 20 provides that breach:

- Is not an offence;
- Does not make a transaction void or unenforceable;
- But does give rise to an action for BSD –see section 8.3 (s20(2), (3)).

Additionally, a person who breaches s20 will be liable to discipline (s205).

EEA firms cannot apply for permission if fall within Schedule 3 (s40(3)).

### 5.2 Threshold conditions

Subject to FSA's duty to take steps to protect consumers, threshold conditions (Schedule 6, which Treasury may alter - and has altered: see 5.6.2) are paramount when giving permission/varying requirement (s41). They are:

- Legal status (Sch 6 para 1);
- Location of offices (Sch 6 para 2);
- Close links (Sch 6 para 3) (plus s49 - may include consulting home regulator);
- Adequate resources (Sch 6 para 4);
- Suitability (Sch 6 para 5).

But they have limited application to EEA/Treaty firms seeking (additional) permission (Sch 6 paras 6-7).

### 5.3 Granting permission

In granting permission (s42) FSA:

- Must specify permitted activities (s42(6);

- May have regard to connected persons (s49) and must consult home regulator if connected with EEA firm;
- May incorporate limitations/grant wider or narrower description of regulated activity (s42(7)) → WN/DN procedure (s52(6)).
- May impose positive or negative requirements (s43) → WN/DN procedure (s52(6)).

## 5.4 Cancelling or varying permission

**FSA may vary or cancel permission at firm's request** (s44). FSA may have regard to connected persons (s49) and must consult home regulator if giving, cancelling or varying permission of person connected with EEA firm.

**FSA may vary or cancel permission on FSA's own initiative** (s45) or at request of overseas regulator (s47 - see 5.6). Section 50 is relevant to additional permissions held by EEA/Treaty firms. For cancellation: WN/DN procedure (s54). For variation: FSA proceeds by supervisory notice (s53(4)). Grounds under s45/47 are:

- Failing to satisfy threshold conditions;
- 12 months or longer inactivity;
- Protection of consumers;
- For FSA's policy, see 5.6.3,4.

FSA may impose or vary requirement on change of control (s46).

**Where a firm wishes to vary or cancel** its Part IV permission, it must follow the procedure contained in SUP para 6.

## 5.5 Procedure on granting or varying permission

Grant or variation of permission may include "assets requirement" (= freezing) (s48):

Procedure to grant/vary permission:

- As FSA directs (s51);
- FSA must determine within 6 months of complete application (s52);
- Proposal to refuse: WN/DN procedure (s52(7)).

## 5.6 Key statements on policy and implementation

### 5.6.1 Own Initiative Power (Overseas Regulators) (2001 No. 2639)

This specifies the kind of overseas regulator at whose request, or for purposes of assisting whom, FSA may exercise the own initiative power to vary/cancel Part IV permission. They are:

- a regulator who exercises functions corresponding to FSA or under the Companies Act or in relation to insider dealing is prescribed for Section 47(1)(b);
- a host state regulator and the Swiss authorities in relation to direct non-life insurance are prescribed for Section 47(3)(b);
- provisions of community legislation and state rules which implement it for host state regulators; and provisions of the Swiss agreement and Swiss rules which implement it for the Swiss authorities are prescribed for Section 47(3)(c).

## 5.6.2 Variation of Threshold Conditions (2001 No. 2507)

Varies Schedule 6 threshold conditions as follows:

- limited liability partnership may not effect or carry out contracts of insurance (2);
- an insurer with its head office outside the EEA must satisfy additional threshold conditions ((3) (1));
- regime for Swiss general insurance companies is altered ((3) (2)).

## 5.6.3 Enforcement Cancelling Permission (CP65a; ENF Section 5)

FSA states that it will cancel a firm's permission under section 45 (when all authorised business has come to an end) or, when it has very serious concerns.

## 5.6.4 Varying Permission On FSA's Initiative (CP65A; ENF Section 3.5; SUP Section 7.3)

### Enforcement

FSA will take this action only if necessary to secure compliance where it cannot rely on the firm to take effective action, and also in context of supervisory activities - see SUP section 7.3.

FSA considers that a firm is primarily responsible for achieving compliance, and will take formal enforcement action affecting a firm's business only if necessary to achieve compliance.

Examples of where FSA may vary permission include (ENF 3.5.3):

- where risks are not fully captured by FSA's rules;
- where a firm is involved in new products or selling practices not captured by the rules;
- where there has been a change in a firm's strategy, controllers or practices which gives rise to uncertainty or particular risks, and the firm has failed to respond to FSA's request for action, or
- where FSA has serious concerns over the firm (ENF 3.5.8).

FSA may vary with immediate effect in urgent cases - ENF sections 3.5.12, 13 set out the criteria. FSA's approach under section 47 (request of overseas regulator) is at ENF section 3.5.14. Publicity: see ENF section 3.7.

### Supervision

FSA may vary a firm's permission on FSA's initiative where risks arising from the firm's management or controls, or involvement in new products, are not fully addressed by FSA's rules (SUP para 7). Doing so will subject the firm to a formal requirement, whereas issuing individual guidance to that firm will not.

## 5.7 Transitional provisions

FSA's transitional provisions for grant of permission at N2 are set out at paragraph 4.3 of Section D at the start of this Guide.



## 6. Approval for individual staff - Part V sections 56-71

### Summary:

Individuals (and also bodies corporate) performing specified functions must be individually approved (= registered) by FSA and observe principles and codes. They are liable to discipline. This section discusses:

- Duty on authorised persons to ensure that persons performing controlled functions are approved by FSA (6.1)
- Applying for approval (6.2)
- FSA withdrawing approval (6.3)
- FSA's power to make a prohibition order (6.4)
- FSA's power to issue principles & codes (6.5)
- FSA's power to discipline (6.6)
- FSA's policy and procedures (6.7):
  - Introduction (6.7.1)
  - Summary (6.7.2)
  - Requirement for individual approval (6.7.3)
  - Fitness & Properness (6.7.4)
  - Senior Management Requirements (6.7.5)
  - Principles for Approved Persons (6.7.6)
  - FSA's policy on enforcement (6.7.7)
  - Fulfilling FSA's requirements (6.7.8)
- Transitional Provisions
- Whistleblowing (CP101 July 2001) (6.9)

### 6.1 Duty on authorised persons

Authorised person must take reasonable care to ensure no person performs a controlled function (defined in rules - see 6.7 below) (s59):

- under arrangement entered into by it (s59(1));
- under arrangement entered into by its contractor (s59(2));
- including employment/services (s59(10));

unless FSA approves that performance (s59). This regime may not apply to EEA firms (s59(8)). Breach actionable as for BSD (s71 - see 8.3).

### 6.2 Application for approval

An application for approval is made by authorised person as FSA directs (s60) - no fee if successful (Sch 1 para 18).

FSA must be satisfied that the person for approval is fit and proper (s61):

- Having regard to qualification, training and competence (s61(2));
- Period of 3 months to consider (s61(3));
- Refusal: WN/DN procedure (s62).

An application for approval should be made in accordance with SUP Chapter 10, including applications for notifications of:

- Initial approval (including 10 years' employment history). The sponsoring firm must confirm the individual's fitness and properness and take up references.
- Performance of an additional controlled function.
- Ceasing to perform a controlled function.
- Changes to a person's details.

### 6.3 Withdrawing approval

FSA may withdraw approval if considers approved person is not fit and proper (s63)

- WN/DN procedure.

### 6.4 Prohibition order

FSA may make prohibition order against individual performing all or any functions (s56(2)-(3)):

- Test: not fit and proper (s56(1)).
- Offence for individual to breach (Tesco - defence) (s56(4)-(5)).
- Authorised person must take reasonable care not to use prohibited person (s56(6)). (Breach actionable as if BSD (s71)).
- Can be varied or revoked (s56(7)).
- Including exempt and professions (s56(8)).
- WN/DN procedure (ss 57-58) for making/refusal to vary or revoke prohibition order.

### 6.5 Principles and codes

FSA may issue principles and codes (s64) for approved persons' conduct:

- Approved person may rely on code (s64(7)).
- Consultation procedure applies (s65).
- Is a rule making function (s64(11)(b)).

### 6.6 Misconduct – FSA's power to discipline an approved person

Misconduct = approved person who:

- Fails to comply with principle.
- Knowingly concerned in authorised person's contravention of requirement imposed on it under FSM Act (s66(2)).

If appropriate for FSA to take action (s66(1)(b)):

- penalty/statement (s66(3)).

FSA must act within 2 years of knowledge of misconduct (s66(4)-(5)).

- WN/DN procedure (s67).

FSA must issue policy on penalties (s69):

- consultation procedure (s70).

## 6.7 Key statements on policy and implementation

### 6.7.1 High Level Standards For Firms and Individuals And Regulation Of Approved Persons - Controlled Functions (Policy Statements February 2001) plus FIT, SYSC, APER and relevant parts of ENF and SUP.

#### Introduction

FSA has expanded the pre-N2 individual registration regime to impose higher standards on senior managers. Holding senior management responsible for a firm's compliance is one of the FSA's key objectives. Intended to help prevent another Barings or Morgan Grenfell, Part V of the FSM Act and FSA's February 2001 policy statements on "High Level Standards for firms and individuals" and on "The Regulation of Approved Persons: Controlled Functions" outline a new system of senior management responsibility. The "High Level Standards" policy statement consolidates FSA's earlier Consultation Papers 26, 35 and 53, and its June 2000 policy statement. This new regime represents one of the most significant changes to be introduced by the FSM Act, and imposes a standard of personal accountability which is considerably higher and more exacting than previously.

These requirements, which are contained in FSA's Handbook at FIT, APER, SYSC and in parts of SUP and ENF are as follows:

### 6.7.2 New Individual Approval Regime - Summary

The key elements are:

- (i) Senior management at director and designated level and staff dealing with assets and customers must be **individually approved**. This is similar to the pre-N2 individual registration regime but is extended to a wider class of persons.
- (ii) Individually approved personnel (both senior managers and staff dealing with assets and customers):
  - Must be and remain **fit and proper**, which includes being compliant.
  - Must observe **new regulations** which apply to individuals (rather than the firm). These include Statements of Principle and a Code of Conduct which call for compliance with FSA's regulations.
  - Are subject to **discipline** by FSA, including fines.
- (iii) The Principles and Code of Conduct for **senior management** require that a firm is run in a careful and controlled fashion. Senior management are held responsible for its compliant operation, and will be liable to discipline for breach of these Principles. FSA will not, of course, discipline senior management for every breach, but has made it clear that it will be prepared to take disciplinary action where a breach is deliberate or - a more likely occurrence - where an individual falls below the required standard by failing to take reasonable care and skill.

There are four additional features of this regime, which are as follows:

- The individual approval regime applies to UK firms and (with some variations) to non-EEA branches. For incoming EFTA and EEA firms, individual approval will only extend to functions subject to UK conduct of business regulation, which is likely to include certain senior and significant managers, together with dealing with customers and money laundering (SUP paras 10.1.6-10.1.15).
- The requirement to obtain individual approval applies to arrangements for the performance of controlled functions both by the firm itself, and by another firm as its contractor (SUP para 10.3).

- A firm may change the responsibilities of an approved person within a particular controlled function without requiring further approval (Guidance in draft SUP handbook).
- Recognising the requirement to cover for absences owing to illness or holidays, an individual may perform any significant influence functions for up to 12 weeks within any 52 week period without requiring to be individually approved (SUP para 10.5.5).

### 6.7.3 Who Will Require Individual Approval?

These categories are:

#### **Significant influence functions (SUP para 10.5)**

This category takes in:

- **Governing functions (SUP para 10.6):** Companies Act directors, Chief Executives and equivalent.  
The governing functions (other than non-executive directors) include:
  - systems and controls functions,
  - significant management functions,
 where that person also performs such additional function.
- **Required functions (SUP para 10.7):** which are appointed actuary, money laundering reporting officer and the head of compliance, who will be at director or senior executive level. In addition, the executive responsible for the “apportionment and oversight function”, in other words establishing the apportionment of significant responsibilities among directors and senior managers required by the SYSC rules - see 6.7.5 below.
- **Systems and controls functions (SUP para 10.8):** If not already performed by individuals registered under “governing functions” this will include:
  - Head of Finance,
  - Head of Risk,
  - Head of Internal Audit.
- **Significant management functions (SUP para 10.9)** If not already registered under “governing functions” or “systems and controls functions”, the following senior managers of significant business units will require individual approval. FSA expects that only firms of the largest size and complexity are likely to have individuals who have substantial autonomy of action, and who can exercise significant influence over the conduct of the firm’s affairs and who will not fall into one of the other categories. These individuals are:
  - senior manager with responsibility for investment or business services, such as head of equities trading, head of back office, head of sales or head of retail banking, together with senior regional managers;
  - senior manager in charge of non-life underwriting;
  - senior manager responsible for financial resources such as the group treasurer;
  - senior manager responsible for operations, such as head of settlements or head of claims.
- **Customer functions (SUP para 10.10)**  
Falling in this category are the following:
  - Customer adviser (SUP para 10.10.7).

- Customer trader (dealer or arranger) for or with private or intermediate customers (SUP para 10.10.16).
- Investment discretionary manager (SUP para 10.10.20).

Note:

- (i) These functions are not concerned with banking or general insurance.
- (ii) Introducers and execution only dealers do not require individual approval.
- (iii) Overseas based advisers may spend up to 30 days each year advising UK customers under supervision without the need for individual approval.

Application procedures and notification requirements are at SUP paras 10.13.

#### 6.7.4 Fitness and Properness for all Approved Persons

An approved person must be and remain fit and proper under the criteria contained in FIT. These are principally:

- Honesty, integrity and reputation (FIT para 2.1). This criteria includes consideration of whether the individual has breached any rules or Principles of FSA or its predecessors, complaints received, and willingness to comply.
- Competence and capability (FIT para 2.2).
- Financial soundness (FIT para 2.3).

#### 6.7.5 Senior Management Requirements

FSA's requirements for Senior Management are contained in the Senior Management Arrangements, Systems and Controls ("SYSC") rules and apply to:

- All firms, but are amended for incoming EEA, Treaty and UCITS firms (SYSC rule 1.1.1 and Appendix 1).
- Regulated activities, dealing as principal and ancillary activities in relation to designated involvement business (SYSC rule 1.1.3) and to approval of a financial promotion for an unauthorised person (SYSC rule 1.1.4).
- Non-regulated activities in a prudential context, and take account of group activities (SYSC rule 1.1.5).
- Activities carried out by the firm/its AR from an establishment it maintains in the UK, but worldwide in a prudential context to a UK or overseas (not EEA, Treaty or UCITS) firm (SYSC rules 1.1.7-1.1.10).

Breach of a rule in SYSC does not give rise to a claim for damages under s150 FSM Act.

Key provisions are that a firm must take reasonable care to:

- Maintain a clear and appropriate apportionment of significant responsibilities among its directors and senior managers (SYSC rule 2.1.1) and these arrangements must be recorded (SYSC rule 2.2.1).
- Establish and maintain appropriate systems and controls for its business (SYSC rule 3.1.1).
- Establish and maintain an effective compliance system (SYSC rule 3.2.6) under the responsibility of a director or senior manager (SYSC rule 3.2.8).

Guidance is provided at SYSC rule 3.2 in relation to matters including:

- Creation of reporting lines (SYSC rule 3.2.2).
- Selecting and monitoring delegates (SYSC rules 3.2.3-3.2.4).

- Segregation of functions (SYSC rule 3.2.5).
- Compliance function (SYSC rules 3.2.7-3.2.9).
- Management information (SYSC rules 3.2.11-3.2.12).
- Assessing employees' suitability (SYSC rules 3.2.13-3.2.14).

### 6.7.6 Principles and Code for all Approved Persons

FSA's statements of Principle for all Approved (ie individually registered) Persons appear in FSA's Approved Persons ("APER") rules and apply to approved persons (APER prin 1.1) who perform a controlled function for which they have been approved (APER prin 1.2).

Principles 1-4 apply to all approved persons; Principles 5-7 additionally apply to those who perform senior management functions.

FSA's Code of Practice for Approved Persons helps to determine whether an approved person's conduct conforms to the Principles (APER prin 3.1) and tends to establish whether or not the conduct was compliant. In determining whether an approved person has breached a Principle, FSA will consider both the particular context and circumstances, and also whether there is personal culpability - ie deliberate misconduct or where the person falls below reasonable standards. FSA emphasises that personal culpability is necessary to establish a breach of a Principle, and there is no presumption that a rule breach is evidence of an individual having failed to take reasonable care.

In considering potential breaches of Principles 5-7, FSA will additionally take into account:

- Whether the person exercised reasonable care when considering available information.
- Whether he reached and acted upon a reasonable conclusion in light of his responsibility and the complexity of the business (APER prin 3.3).

The Statement of Principle are:

**1. *An approved person must act with integrity in carrying out his controlled function.***

The Code of Practice at APER principle 4.1 gives examples of deliberate dishonesty as breaching this Principle.

**2. *An approved person must act with due skill, care and diligence in carrying out his controlled function.***

The Code of Practice at APER principle 4.2 gives examples of non-compliance with rules as breaching this Principle.

**3. *An approved person must observe proper standards of market conduct in carrying out his controlled function.***

The Code of Practice at APER principle 4.3 refers to the standards of compliance contained in the Code on Inter-Professional Conduct and Code of Market Conduct.

**4. *An approved person must deal with the FSA and with other regulators in an open and co-operative way and must disclose appropriately any information of which the FSA would reasonably expect notice.***

The Code of Practice at APER principle 4.4 gives examples.

**5. *An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function is organised so that it can be controlled effectively.***

In other words, a similar manager must ensure that the part of the business for which he is responsible is organised so that it can be properly controlled.

The Code of Conduct at APER principle 4.5 explains that this calls for:

- Responsibilities should be apportioned to suitable individuals.
- Creation of a control matrix.
- Establishment of appropriate reporting lines.
- Satisfaction on objective grounds that individuals to whom tasks are delegated are competent.
- Being regularly held to account.

**6. *An approved person performing a significant influence function must exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his controlled function.***

In other words, a senior manager must ensure that he manages skilfully that part of the firm's business for which he is responsible.

The Code of Conduct at APER principle 4.6 explains that this calls for:

- Clear understanding of key processes within that business area.
- Supervision of delegates.

**7. *An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function complies with the regulatory requirements imposed on that business.***

In other words, a senior manager must take reasonable steps to ensure that the part of the firm's business for which he is responsible is compliant.

The Code of Conduct at APER principle 4.7 explains that this calls for:

- Maintenance of an adequate compliance function.
- Adequate systems of control.
- Performance of monitoring.
- Investigation of potential breaches.
- Appropriate remedial action.

### 6.7.7 FSA's Policy on Enforcement against Approved Persons

- **Withdrawal of approval (ENF section 7.5)**

FSA will withdraw approval only if the individual is no longer fit and proper. This section sets out FSA's criteria, which reflect that test.

- **Prohibition order (ENF section 8.4, 8.5)**

FSA will only make such an order where the approved person presents a risk that cannot be addressed by withdrawing approval. FSA views this as a serious penalty and will only make it in the most serious cases, or where the individual is not an approved person. FSA's criteria for considering an application to vary or revoke a prohibition order are at ENF section 8.9.

- **Discipline for individually approved persons (ENF sections 11-13)**

A firm is primarily responsible for ensuring compliance with its regulatory obligations and therefore the main focus for discipline will be the firm. However, it may be appropriate:

- not to discipline a firm for an approved person's actions where it took all reasonable steps to prevent the breach,

- to act against firm *and* approved person where the firm had inadequate systems and the individual took advantage of them for misconduct. (11.5.1,2).

FSA will only discipline an individual for personal culpability, meaning where the behaviour was deliberate or fell below a reasonable standard. FSA will also not discipline for vicarious liability.

FSA will not discipline an approved person performing a significant influence function just because a breach occurred in his area. FSA will only discipline if his conduct fell below a reasonable standard (ENF section 11.5.6).

Other factors to be considered when deciding whether to discipline an individual include:

- did the individual's conduct comply with the Principles (see section 6.7.6 above)?
- Was the individual responsible for the conduct of the firm that breached the requirements?
- Was he knowingly concerned in the breach?

Discipline is more fully discussed at section 10.1 of this Guide.

### 6.7.8 Fulfilling FSA's Requirements

FSA expects firms to establish a control environment, and is looking to senior management to take the lead in ensuring that the firm's procedures are robust. In its policy statement FSA referred to firms undertaking systems reviews before N2 and says:

*"the reviews envisaged ... are comprehensive reviews covering compliance with all of the elements of the Senior Management arrangements, systems and control provisions set out in CP35, including apportionment of responsibilities (including recording such arrangements), organisation (including reporting lines, control of delegation, outsourcing and segregation of duties), compliance and risk management. As such these reviews would encompass a review of the systems and controls necessary for senior managers to comply with Principles 5 to 7".*

We consider that one suitable approach to fulfilling FSA's requirements is as follows:

- (i) For each of the firm's principal routines, such as new business processing, unit dealing or equity trading, each stage of the operation should be tracked, and the following identified:
  - Regulatory requirements.
  - Key areas of vulnerability.
  - Information needed to monitor these areas.
- (i) Controls can then, as needed, be established to ensure that the right information is promptly sent to the right level of management, such as (to continue these examples) data relating to rejected fact finds, aged reconciliation's or failed trades. Management will be able to use the information derived from this control matrix to monitor each routine, and ensure that any necessary remedial action is implemented before problems get out of hand.
- (ii) Steps can then be taken to complete FSA's requisite control environment. These include ensuring that procedures are sufficiently documented, reporting lines are clear, staff are properly trained and supervised and there is adequate compliance monitoring.

An example of such a business analysis is set out in the next section. The example taken relates to unit trust management, but its principles can be applied to any other area of regulated activity.

One advantage of this approach is that a firm can be satisfied that it has identified its principal areas of vulnerability, ensured that each of these is properly monitored and "owned" by a responsible senior manager, and thus achieved a key element in FSA's control environment.



The benefit from the senior manager's point of view is that his areas of responsibility have been defined, an appropriate reporting structure has been put in place, and he is thereby enabled to discharge his regulatory responsibility.

We believe that there are two additional reasons why this approach merits further consideration. First, it is reasonably straightforward and implementable by the firm itself with limited outside guidance. It does not require extensive external consultancy nor a radical restructuring of current working methods. It is also sufficiently adaptable to be applied in the future to new and amended products and procedures.

Secondly, we have reviewed the facts that underlie a number of enforcement and disciplinary cases which we have recently handled. In every one of these cases we consider that, had the firm implemented this kind of control matrix, management would have detected and prevented serious rule breaches. By preventing these occurrences in the first place, the firm would have achieved significant savings in terms of remedial costs and management time as well as avoiding the enforcement or disciplinary action.

### **Example Of Business Analysis**

1. A firm should review each area of its regulated business, and for this purpose we take the example of unit trust management.
2. This business should then be divided into notional workflows each comprising discrete areas of this business. Care should be taken to ensure that work flows "join together". For example, unit trust management will divide into a number of workflows such as:
  - (i) Marketing.
  - (ii) New business processing.
  - (iii) Dealing.
  - (iv) Pricing.
  - (v) Investment
  - (vi) Redemption.
3. Each work flow should then be examined in relation to:
  - (i) Do the firm's procedures accurately describe the work?
  - (ii) Do the firm's procedures fully reflect FSA's requirements?
  - (iii) Do the firm's procedures fully reflect its own requirements?
  - (iv) Do the firm's procedures properly address key risk areas such as (depending on the workflow):
    - Cash handling in accordance with client money regulations.
    - Box maintenance.
    - Prompt execution.
  - (v) For each key risk area:
    - Does the firm have a clearly defined operational procedure which staff understand?
    - What is the key data which will indicate, daily or over a period of time, whether the firm is meeting the requirement? (This could be data on aged reconciliation's, failed trades or pricing statistics.)
    - Is there a clear mechanism in place for this data to be kept and monitored as necessary?
    - Is this data regularly and effectively made available to management with the ability to assess it and the authority to

address any problems? (It should be made available daily, weekly, or monthly as required.)

- Are clear records kept of this data?
- Does Compliance adequately monitor this area?

4. Having established an appropriate procedure, the firm should ensure that:

The overall process is “owned” by a suitable individual.

Proper reporting lines are in place.

That individual is held regularly to account.

The process “owner” reports to a senior manager.

## 6.8 Transitional provisions

The transitional provisions relating to approved persons are discussed at paragraph 4.7 at Section D at the beginning of this Guide.

## 6.9 Whistleblowing - CP101 (July 2001)

“Whistleblowing” is the name given to an unsanctioned disclosure - such as a tip off - made by a member of staff in relation to his employer’s suspected failure to comply with legal obligations in any part of the world. Under the Public Interest Disclosure Act 1988 (“PIDA”), employees (and certain other staff) are protected if they make such a disclosure in good faith to their employer or to certain bodies such as FSA.

FSA has issued draft guidance on whistleblowing which:

- Encourages firms to adopt appropriate internal procedures. Responding constructively to such disclosures will help firms to achieve an effective risk management system, and enable senior management to address an issue before it gets out of hand. FSA states that it will expect to be kept informed when appropriate.
- Sets out how it will institute arrangements to receive and action such disclosures which it receives directly. FSA emphasises, though, that such direct approaches are less likely to happen where a firm itself has appropriate procedures in place to address these disclosures.
- Explains that it will be seriously concerned if a firm acts to the detriment of an employee who makes a disclosure protected under PIDA.

## 7. Control over Authorised Persons - Part XII sections 178-192

### Summary:

FSA must be given prior notice of, and approve, certain change of control events in relation to a UK authorised person. This section covers:

- Requirement to notify FSA (7.1)
- Definitions (7.2)
- Statutory Provisions (7.3)
- FSA giving conditional approval or objecting (7.4)
- FSA freezing for contravention (7.5)
- Offences (7.6)
- Powers of Treasury (7.7)
- Exemptions Orders (7.8.1, 2)
- FSA's Practice and Policy (7.8.4)

### 7.1 Requirement to notify FSA

Must give notice to FSA if propose to take step which would result in **acquiring control/additional kind of control/increase in control** over UK authorised person (ss 178(1) and 182):

- If subsequently become aware, must notify within 14 days (s191(10)).
- Must also give notice within 14 days of becoming aware that have acquired control without taking such step (s178(2)).
- If fail to give notice, FSA may approve/give WN ((s187)(1)-(2)).

Controller must notify FSA of proposal to **reduce/cease control** over UK authorised person (s190(1)):

- If subsequently become aware, must notify within 14 days (s191(10)).
- If took no step, must give notice within 14 days of becoming aware of such reduction/cessation (s190(2)).

### 7.2 Definitions

**Control** = holding shares/entitlement to exercise voting power in UK **authorised person** ("A")/**parent** ("P") (s179(4)).

**Acquiring control** = +/- associates.

Holds or can control exercise of 10%+ shares in A or P.

Can exercise significant influence over A or P (s179).

**Increasing control** = % of shares/voting power held in P or A increases by given steps (s180).

**Reducing control** = % of shares/voting power in P or A reduces by given steps (s181).

### 7.3 Procedure

FSA must within 3 months approve notice of control or give WN (s183). FSA must consult with prescribed competent authorities - see 7.8.3.

Once FSA approves, acquisition of control must be made within FSA's specified period (s184(3)).

## 7.4 Conditional approval/FSA objection

FSA's approval may be subject to conditions having regard to threshold conditions - WN/DN procedure (s185). Firm may seek variation.

FSA may object to acquisition of control by WN if believes (s186):

- acquirer not fit and proper;
- interests of consumers threatened;

having regard to threshold conditions, but must point out what step to (not to) take which → approval (s186(4)).

FSA may object to existing control by WN if becomes aware (s187(3)):

- Controller not fit and proper.
- Interests of consumers threatened.
- Section 185 condition breached.

## 7.5 Freezing for contravention

FSA may direct that shares acquired/held in contravention of ss 186/187 DN or FSA's approval condition (s189):

- Are frozen (s189(2)).
- Seek court order for sale ((s189(3)).

## 7.6 Offences

- Failure to comply with duty to notify (ss 178 and 190) (defence of ignorance (s190(9)) (s191(1)-(2)).
- Carry out proposal while awaiting FSA's consent/after WN (s191(3)-(4)).
- Acquire control despite ss 186/187 DN (most serious) (s191(5)).

## 7.7 Treasury powers

HMT may make order for notification exemptions/amend Part XII (s192) – see 7.8.1,2.

## 7.8 Key statements on policy and implementation

### 7.8.1 Controllers (Exemption) (2001 No. 2638)

No obligation to notify FSA of change in control in relation to friendly society to which single markets directive does not apply.

### 7.8.2 Controllers Exemption (No. 2) 2001 No. 3338

This Order exempts those who acquire control, an additional kind of control, or an increase in a relevant kind of control, over an authorised building society from the Part XII obligation to notify FSA of change of control within specified percentages.

### 7.8.3 Consultation with Competent Authorities (2001 No. 2509)

Specifies consultation with EEA home state regulators which FSA must carry out when performing Part XII functions. Prescribed under Section 183 (2) and 188 (2).

#### **7.8.4 FSA's Practice and Policy**

This is contained at SUP Chapter 11.

### **7.9 Transitional provisions**

See paragraph 6 of Section D at the start of this Guide.

## 8. Rules and Guidance - Part X sections 138 - 164

### **Summary:**

FSA has power to make a wide range of rules. This section summarises:

- FSA's power to make rules (8.1)
- FSA's power to disapply or modify a rule (8.2)
- Consequences of contravening a rule (8.3)
- FSA's duty to consult and power to issue guidance (8.4)

It also summarises the following FSA rules and similar:

- Principles and Business (8.5.1)
- General Provisions, which apply to the entire Handbook (8.5.2)
- Prudential Regulation

- FSA's approach to Prudential standards
- Interim Sourcebooks
- Draft integrated Prudential Sourcebook
- And its timetable for implementation

- Customer Classification (8.5.4)
- Rules on Interprofessional Conduct (8.5.5)
- Conduct of business sourcebooks (8.5.6)

- And Transitional Arrangements (8.5.7)

- Money Laundering (8.5.8)
- Mortgage Regulation (8.5.10)
- Outsourcing (8.5.11)
- Service company regime 8.5.12)

Other rules are discussed at the sections of this Guide listed at Section D.

### 8.1 Rules made by FSA

- FSA has the following powers to make rules. FSA has made the rules listed at Section C of this Guide. FSA calls the rules which relate to different aspects "Sourcebooks" and the Sourcebooks collectively are called the FSA "Handbook".
- General rules = rules made by FSA applicable to authorised persons (marked by a \*):
  - for regulated or unregulated activities (s138(1)),
  - to protect consumers, who may be indirect (s138 (7)-(9)) and unconnected persons (s138(4)),
  - may take into account group activities (s138(5)).
- FSA may also make:
  - client money rules (s139),
  - restriction on UTM other activity rules (s140),

- \*insurance business rules (ss 141-142),
  - endorsing City Code/SAR rules (s143),
  - \*price stabilising rules (s144),
  - \*financial promotion rules (s145),
  - \*ML rules (s146),
  - \*rules imposing duty of confidence on authorised firms (s147),
  - \*rules requiring appointment of, and imposing duties on, auditors and actuaries (s340).
- FSA may also make rules relating to CISs (ss 247-248), Ombudsman funding (s234), Ombudsman compulsory jurisdiction (Sch 17 para 12), RIE/CH rules (ss 293 and 295) and Exempt Regulated Activity rules (s332).
  - The definition of “consumers” in section 138, in addition to that contained in sub-section (7), shall include users of regulated services prior to N2, people who have rights derived from such use, or whose rights may be adversely affected by their agents’ or trustees’ use of such services. Section 138(8) and (9) FSM Act will therefore include the pre-N2 activities of authorised persons **(Consequential and Transitional Provisions (Miscellaneous) Order SI 2001 No. 1821)**.

## 8.2 Disapplication or modification of a rule

On application/with consent of an authorised person, FSA may direct disapplication or modification of a \*rule, but only if:

- compliance unduly burdensome/not achieve purpose of rules; and
- no undue risk to consumers.

Decision must be published unless prejudicial (although FSA will also take into account if breach of the rule is actionable for BSD).

FSA may impose conditions/vary/revoke direction (s148).

The **procedure** for applying for a rule waiver is contained in SUP Chapter 8. A firm should write to its supervision team providing a clear explanation and sufficient information for FSA to evaluate the request.

The procedure that a firm must follow when seeking a rule waiver is contained at SUP para 8.3.3. FSA’s procedure is at SUP para 8.3.5. FSA may

- Grant the application.
- Modify a rule rather than direct that it is not to apply.
- Impose conditions to accompany a waiver.
- Limit the time for a waiver to apply.
- Refuse the application, in which case it will give reasons.
- Publish general details of the waiver (SUP para 8.6)
- Vary or revoke a waiver, usually on notice (SUP para 8.8).

A firm may rely on a waiver (SUP para 8.4.1) but a firm should:

- remain alert that a subsequent rule change may invalidate a waiver (SUP para 8.4.2).
- promptly notify FSA of altered circumstances relevant to a waiver (SUP para 8.5.1).

FSA will generally publish a waiver (SUP para 8.6). This is because a waiver will affect the legal rights of third parties, and FSA must publish waivers so that the extent of parties’ rights are clear (PS para 29). FSA will only possibly not publish a waiver where doing this would lead to

premature disclosure of “proprietary” information to commercial rivals, or disclosure of a firm's intellectual property, and even then FSA may publish on a no-names basis.

## 8.3 Contravention

A rule may provide that contravention does not give rise to the usual consequences. These are that it exposes a firm to claim for BSD/FSA discipline/requirement to compensate investors for consequent loss. Instead, the rule may state that observance or contravention tends to establish compliance/contravention of another rule (s149(1)-(3)).

Contravention of a rule:

- Is not a criminal offence and does not make void the transaction to which it relates (s151).
- But it may result in an authorised person being liable to a private person (meaning to be prescribed) who suffers loss because of the contravention as for BSD (s150). This will not apply for breach of listing or financial rules. For rights of action, see 8.3.1.

### 8.3.1 Rights of Action (2001 No. 2256)

This Order sets out circumstances when contravention of certain FSM Act provisions are actionable by a person who suffers loss as a result.

#### **Private Person =**

Individual (unless suffers loss when carrying on regulated activity, or would be but for overseas person exclusion) but includes individual at Lloyd's carrying on Article 10 activity (effecting/carrying out contract of insurance).

Plus any other person who does not suffer loss when carrying on business of any kind (but under no circumstances a government, local authority or international organisation) (3).

#### **Fiduciary =**

A person acting in fiduciary/representative capacity on behalf of a private person, which action cannot otherwise be brought and where remedy is exclusively for his benefit.

These circumstances are as follows:

**Authorised person acting outwith permission** is prescribed by Section 20(3) and hence actionable provided:

- not relate to contravention of financial resource requirement (FRR);
- action brought at suit of private person;
- or by a fiduciary (4).

**Employment of unapproved or prohibited person** to perform a controlled function is prescribed by Section 71(3) and therefore contravention of Section 56(6) or 59(1) or (2) is actionable:

- by private person;
- non private person acting as a fiduciary or representative capacity (5).

**Contravention of FSA rules by an authorised person** is prescribed by Section 150 and is therefore actionable by:

- private person (s150(5));
- non private person (s150(3)) if



- rule prohibits authorised person seeking to exclude/restrict duty or liability; or
- rule is against dealing with the benefit of unpublished price sensitive information;
- it is acting as a fiduciary (6).

**Contravention by an incoming firm** of a requirement imposed by FSA under Part XIII (other than in relation to FRR) is prescribed by Section 202(2) and actionable by

- private person;
- fiduciary (7).

## 8.4 Consultation and guidance

### Consultation

FSA must consult on new/varied rules (s155).

FSA has consulted in relation to each item in its Handbook. As some consultation took place before the relevant parts of the FSM Act were passed, and may therefore have been technically deficient, it has reconsulted in **CP90 – Procedural Formalities for the Handbook – May 2001**.

### Guidance

FSA may give guidance (information and advice) on FSM Act, rules and functions, or may assist others to give this (s157(1)-(2)). FSA must first consult on guidance to regulated persons (s157(3)). "General Guidance" means guidance:

- In written or legible form;
- Intended to have continuing effect;
- Given to persons/regulated persons/a class of regulated persons (ie not to a single person) (s158(5)).

Rules, guidance and practice subject to competition scrutiny (ss 159-164).

FSA says that its guidance

- will not bind the court;
- may be of persuasive effect for the court in deciding, for instance, whether it is just and equitable for a contract to be enforced (under s28(3), 30(4));

but that if a person acts in accordance with it, FSA will treat that person as complying with the aspects of the requirement to which the guidance relates. (AUTH 7.1.3 in CP 104).

### 8.4.1 FSA's Approach To Giving Guidance/Waivers To Firms - Policy Statements September 1999 & January 2002

FSA recognises that open and responsive communication is the key to effective regulation. FSA therefore aims to be helpful and forthcoming "while furnishing firms with the means to stand on their own feet" (PS 9/99 para 2).

#### General Guidance (Policy Statement January 2002)

- 'General guidance' means written guidance given to persons generally or to all or a class of regulated persons. It may or may not be intended to have continuing effect. It will usually be given in the Handbook (as a "G" item) or in a Guidance Note if it is urgent or temporary. Material which FSA publishes in another way, such as on its website, in a newsletter, or written to a trade association, may not be relied upon as Guidance unless it expressly states so (PS1/02 para 3).

- FSA will not operate with unwritten rules; “rules of thumb” about the interpretation of general requirements will go into handbooks (PS 9/99 para 6).
- Because the demand for guidance can outstrip resources to provide it, (PS 9/99 para 7) FSA will favour working with trade associations and consumer organisations in providing it (PS 9/99 para 8).
- FSA will only give general guidance through a trade body if urgent (PS 1/02 paras 3.14, 14).
- If a firm acts in accordance with general guidance in circumstances which it contemplates, FSA will view it as complying with the underlying rule (PS para 9). This is confirmed in the Annex to FSA’s Readers Guide – see 8.5.2.

#### **Individual Guidance (Policy Statement September 1999; SUP 9)**

- FSA wishes to preserve open lines of communication and will aim to respond quickly, responsively and without charge to reasonable requests from people who have tried to analyse the issue themselves (PS 9/99 para 17) with higher priority given to enquiries about innovative practices and products (PS 9/99 para 18).
- Depending upon the formality of the firm’s query and FSA’s guidance, the lapse of time from the giving of the guidance, whether circumstances have altered and the interests of relevant third parties, FSA will not take regulatory action against a firm for behaving in accordance with current written individual guidance in circumstances contemplated by that guidance (PS 9/99 para 20).
- FSA may give individual guidance to a firm through its trade association when the association is asking on its behalf (PS 1/02 paras 3.13, 3.14).
- FSA will generally not publish individual guidance (PS 9/99 para 22).

**FSA’s procedure for individual guidance:** A person may at any time seek individual guidance from FSA (SUP para 9.2) and FSA may give guidance to a firm on its own initiative (SUP para 9.3). FSA will treat a person who properly relies on current written individual guidance as acting compliantly (SUP para 9.4).

## **8.5 Key statements on policy and implementation**

### **8.5.1 FSA Principles For Business (High Level Standards - February 2001)**

The eleven principles are contained in the PRIN Sourcebook, and are as follows:

1. **Integrity :** A firm must conduct its business with integrity.
2. **Skill, care and diligence:** A firm must conduct its business with due skill, care and diligence.
3. **Management and control:** A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
4. **Financial prudence:** A firm must maintain adequate financial resources.
5. **Market conduct:** A firm must observe proper standards of market conduct.
6. **Customers’ interests:** A firm must pay due regard to the interests of its customers and treat them fairly.
7. **Communications with clients:** A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.
8. **Conflicts of interest:** A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.

9. **Customers: relationships of trust:** A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.
10. **Clients' assets:** A firm must arrange adequate protection for clients' assets when it is responsible for them.
11. **Relations with regulators:** A firm must deal with its regulators in an open and cooperative way, and must disclose to FSA appropriately anything relating to the firm of which the FSA would reasonably expect prompt notice.

### **Purpose of Principles**

The Principles are a general statement of the fundamental obligations of authorised firms under the regulatory system. They are considered to achieve (Response to CP13 - October 1999):

- Coverage, so regulatory system never silent in a rapidly changing environment.
- Consistency, providing assurance how FSA will view fresh issues.
- Continuity in that they incorporate the FSAct Principles.
- And cohesion because Handbooks based upon them.

The Principles are available for FSA's powers of:

- investigation;
- intervention;
- discipline;

but breach does not give rise to a right to bring an action under s150 FSM Act.

FSA considers Principles appropriate for discipline because otherwise the regulatory system may lag behind regulatory developments. Introduction to Principles states that fault is needed for breach (PRIN para 1.1.7). FSA will discipline (ENF para 12.7) where Principle breached without rule breach, or cumulative effect of rule breaches indicates breach of Principle.

### **Application to firms**

The Principles apply to all firms (PRIN para 3.1) except:

- Incoming EEA/Treaty firms: where they apply only to host state regulatory issues (Guidance in SYSC App 1).
- Incoming BCD credit institution without top-up permission: only Principle 4 applies, and then only to branch liquidity.
- UCITS firm: only Principles 1, 2, 3, 7 and 9 apply, and then only to financial promotion.

### **Application to business**

The Principles apply to the following activities (PRIN para 3.2):

- Regulated activities.
- Dealing in investments as principal.
- Ancillary activities. These are activities carried on in connection with, or held out as being for the purposes of, a regulated activity, in relation to designated investment business (ie the regulated activities other than deposit taking, effecting/carrying out contracts of insurance, Lloyd's business and funeral plan contracts).
- Approval of unauthorised persons' financial promotions.

### **Particular points on application of Principles**

- The Principles apply to deposit taking/general insurance/long term pure protection contracts only in the prudential field.

- Principles 3, 4 and 11 take into account group activities and non regulated activities.
- Principles 1, 2, 3, 4, 5 and 11 apply to worldwide activities, but the other Principles only to activities carried on in the UK, (PRIN para 3.3). Principles 1, 2 and 3 are relevant worldwide from a prudential stand point only and Principle 5 is only relevant to a worldwide activity that might negatively impact the UK financial system.
- In considering action under the Principles for non-UK activities, FSA will take local standards into account.
- Principles 6 to 10 distinguish between customers and clients. A “customer” is a private or intermediate customer; a “client” is wider and, subject to a detailed definition, includes market counterparties. Principle 7 only requires that a communication of information to a market counterparty is not misleading.
- In Principle 11, “regulators” includes both FSA and other UK/overseas regulators with recognised jurisdiction over regulated activities.
- Limited application EEA/Treaty firms passporting in.

## 8.5.2 General Provisions (CP71 and Policy Statement April 2001)



These rules apply to the entire FSA Handbook.




Key points are as follows (quoting the draft GEN rule in each case):

- 2.2.17 There are limited disapplication rules in the case of emergency.
- 2.2.18 Provisions must be interpreted in the light of their purpose.
- 2.2.19 “In writing” means in legible form and capable of being reproduced on paper.
- 2.2.20 Every general rule made under section 138 FSM Act applies to a firm’s regulated activities, but only to its unregulated activities where expressly stated.

Annexes include a Reader’s Guide to the Sourcebooks. This explains:

- The structure of the sourcebooks and manuals.
- The status of the different provisions:

Letter	Symbol	Description	Effect
<b>C</b>		<b>Behaviour not amounting to market abuse</b> C is for “conclusive”. It is used for paragraphs made under section 119(2)(b) of the FSM Act which are conclusive in describing behaviour that does not amount to market abuse.	Binding upon those persons to whom the Code of Market Abuse (MA) is applicable.
<b>D</b>		<b>Directions and requirements</b> e.g. directions under section 51(3) of the FSM Act about the form and content of applications for Part IV permission.	Binding upon the persons or categories of person to whom they are addressed.

<b>E</b>		<b>Evidential provisions</b>	An evidential rule is not binding in its own right, but always relates to another binding rule. Depending on the wording of the provision, it may “tend to establish compliance with and/or contravention of” another rule to which it relates.
		<b>Code of practice for approved persons</b>	The Code may be relied on so far as it “tends to establish compliance” with the Statements of principle for approved persons (APER).
		<b>Certain paragraphs in the Code of market conduct</b> These specify: <ul style="list-style-type: none"> <li>descriptions of behaviour that amount to market abuse (the opposite of <b>C</b> above); and</li> <li>factors to be taken into account in determining whether or not behaviour amounts to market abuse.</li> </ul>	Indicative only, relevant to those persons to whom the Code of Market Abuse (MA) applies.
<b>G</b>		<b>Guidance</b> Guidance can relate to: <ul style="list-style-type: none"> <li>the FSM Act</li> <li>the Handbook</li> <li>other matters</li> </ul> The purpose of Guidance may be to: <ul style="list-style-type: none"> <li>explain other provisions</li> <li>indicate possible means of compliance</li> <li>recommend a course of action</li> <li>address other matters</li> </ul>	Guidance is not binding, nor does it have evidential effect. It need not be followed in order to achieve compliance, and failure to follow it will not lead to enforcement or any presumption that a breach of the rule has occurred.  However, if a firm follows guidance, FSA will proceed on the basis that the firm has complied with the related rule.  Guidance does not affect rights conferred on third parties e.g. the firm’s clients.  Guidance does not bind the Courts.
		<b>Arrangements for complaints against FSA</b> These arrangements are made by FSA under paragraph 7 of Schedule 1 to the FSM Act.	These are procedural arrangements applicable to any person who seeks to complain against action taken by FSA.
<b>P</b>		<b>Statements of principle for approved persons</b>	Binding upon approved persons.

<b>R</b>	<b>R</b>	<p><b>General rules</b> made under FSA's rulemaking powers in the FSM Act.</p> <p>Rules include the FSA Principles for businesses, not to be confused with <b>P</b> above.</p>	The legal effect of a rule varies, depending on the power used and the language used. Most of the rules in the Handbook create binding obligations on firms - contravention may lead to enforcement action or an action for damages.
----------	----------	--	--

Provisions marked "**E**" and "**G**" are therefore not mandatory. However, current experience is that a firm's failure to follow guidance under the FSAct 1986 can be used by FSA as evidence of non-compliance with a rule or a Principle.

Every sourcebook or manual will, on final publication, contain schedules as follows:

Schedule 1 - Relevant record keeping requirements

Schedule 2 - Relevant notification requirements.

Schedule 3 - Any fees or other required payments.

Schedule 4 - FSA's statutory powers for making the sourcebook or manual.

Schedule 5 - Availability of rights of action for damages against a firm for breach of rules in the sourcebook or manual.

Schedule 6 - List of any rules that FSA can waive.

Plus a Schedule of transitional provisions.

### 8.5.3 Prudential Standards - FSA's Approach (CP31 - November 1999) and Response (May 2000)

FSA's approach to prudential standards is as follows:

- From N2, the Prudential handbook will reproduce the requirements of existing regulators, updated to reflect the new legislation so that firms will require little systems development before N2. However, banks and building societies will notice greater alteration because current prudential arrangements require codification. Also, there will be new material for Lloyd's, Lloyd's firms, professional firms and mortgage firms.
- During 2002 FSA will develop a new prudential sourcebook with a set of integrated prudential requirements based on different types of risk, such as credit risk and operational risk, rather than sector-specific risk.

Fulfilment of prudential standards will be relevant:

- on authorisation;
- during supervision;

and breach may lead to enforcement action.

Resources required will depend upon:

- A minimum absolute amount.
- The sum of a set of risk-based capital requirements similar to those for current FSA firms comprising:
  - expenditure based requirement,
  - position risk,
  - credit risk,
  - operational risk,

together with margin of solvency for insurers.

**(a) Interim Prudential Sourcebook for Investment Firms (CP54 - June 2000; Policy Statement March 2001)**

This applies to firms other than banks, building societies, Lloyd's firms, insurers and friendly societies and will apply pending issue of a single Prudential Sourcebook.

It details requirements - which largely reproduce current SRO and other rules - in relation to:

- Financial resources.
- Ad hoc notification.
- PI cover.

For:

- Professional firms (IPRU 2).
- Securities and futures firms (i.e. ex-SFA) (IPRU 3 - non ISD and IPRU 10 - ISD).
- Lloyd's firms: members' advisers (IPRU 4).
- Investment management firms (ie ex-IMRO) (IPRU 5).
- Service companies (IPRU 6).
- Personal investment firms (ie ex-PIA) (IPRU 13).

**(b) Interim Prudential Sourcebook for Insurers (CP41 January 2000; CP84 March 2001; Policy Statement June 2001)**

FSA states that its prudential rules for insurers are to be seen in the context of its Principles for Business, especially Principles 3 (organisation) and 4 (financial resources).

The business of an insurer is restricted to insurance business (1.3), so reproducing the former section 16 ICA restriction.

Areas addressed are:

- Margin of solvency (2).
- Assets and liabilities for long-term business (3).
- Admissibility and valuation of assets (4).
- Determination of liabilities (5).
- General insurers' resources (6).
- Currency matching and location of assets (7).
- Non-UK insurers (8).
- Statements, accounts and returns (9).
- Supervision of insurance groups (5).

Transitional provisions are in 12.

FSA Guidance Notes, DD and DAA Letters appear in volume 3.

**(c) Interim Prudential Sourcebook for Banks (CP51, 52 June 2000; Policy Statement June 2001)**

This covers the following areas:

- Adequacy of capital.
- Adequate liquidity.
- Adequate records, systems and controls.

- Fitness and properness of controllers.
- Miscellaneous topics. This includes a section on outsourcing, which is discussed at section 8.5.11 of this Guide.

**(d) The Draft Integrated Prudential Sourcebook (CP97 – June 2001)**

The Integrated Prudential Sourcebook was intended to take effect in January 2004 (but see (e) below) and to replace the Interim Prudential Sourcebooks (discussed at (a), (b) and (c) above).

The Integrated Prudential Sourcebook focuses on the requirements that firms maintain:

- adequate financial resources, which is addressed in a series of rules; and
- adequate systems and controls. FSA considers that this aspect is properly addressed by the SYSC rules, and therefore mainly provides guidance on this topic.

FSA emphasises that these rules and guidance are largely based on EC directives and international standards, and that it does not have a general policy to set standards above those requirements.

The rules and guidance are drafted by reference to risks, rather than industry sectors as at present. FSA's individual minimum capital resources requirements are contained in SUP, together with an explanation of how FSA will monitor compliance with these requirements.

Key changes from the current Prudential requirements can be briefly summarised as follows. For all firms, a new requirement that they take a view of the overall level of financial resources required to enable them to meet liabilities. In addition:

For deposit takers:

- a close alignment of the detailed capital resources requirements to the minimum standards of EC directives, particularly for credit risk and concentration risk;
- a new approach to 'material holdings' (holdings of capital instruments issued by other financial institutions).

For insurers:

- an increased emphasis on the identification and management of risks relative to the adequacy of technical provisions and the solvency margin;
- extensive new guidance on systems and controls;
- simpler asset valuation rules;
- increased base capital resources requirements;
- clearer requirements on managing with profits business, including codifying existing practice on attribution of 'estates';
- new requirements on the outsourcing of key functions.

For investment firms:

- a new framework that:
- applies broadly harmonised risk-based capital resources requirements only to those firms which hold client money or safeguard and administer clients' investments and/or trade as principal;
- introduces a simple framework for other firms: a capital resources requirement that is the higher of a low minimum amount and a percentage of annual income; a proposal that a wider range of firms have Professional Indemnity Insurance than at present (all those whose permission includes investment advice to private customers);
- a new capital resources requirement to replace the expenditure-based requirement (other than for most ISD firms).



Firms are divided into five Prudential categories, and the chart at the beginning of CP97A indicates how the rules will apply to them. The categories are as follows:

1. Deposit takers. } whose defining characteristic is they have a  
}
2. Insurance companies } direct creditor relationship with customers.
3. Firms which deal as principal, and whose customers are therefore exposed to loss.
4. Firms which hold client assets, and whose customers are therefore exposed to loss.
5. Other firms, such as advisers and arrangers, who will mainly not be subject to EU directives.

Appendix 5 of CP97 contains a “conversion chart” mapping current Prudential categories into the proposed ones.

Firms that will be exempt from the new Prudential requirements include EEA firms, OPS firms, UCITS qualifiers, and ICVCs.

The principal requirements of the Integrated Prudential Sourcebook are as follows:

**Capital:** firms must calculate capital adequacy in accordance with FSA’s requirements, and have adequate capital resources to meet those requirements, which are as follows:-

Firm type	Capital resources requirement
PRU category 1	The higher of:  (i) the base capital requirement (which varies according to whether the firm is a bank or building society); and  (ii) the sum of the market and credit risk requirements.
PRU category 2	The higher of:  (i) the base capital requirement (which varies according to type of insurance firm); and  (ii) the insurance minimum solvency requirement.
PRU category 3	The higher of:  (i) the base requirement (which varies according to whether the firm is an ISD firm or not); and  (ii) the sum of the credit and market risk and other risks requirements (the expenditure-based requirement for ISD firms – PRU category 3A – and the income-based requirement for non-ISD firms, PRU category 3B).

PRU category 4	<p>The higher of:</p> <p>(i) the base capital requirement (which varies according to whether the firm is an ISD firm or not); and</p> <p>(ii) either:</p> <ul style="list-style-type: none"> <li>for PRU category 4A and 4B firms, the sum of the credit risk and market risk requirements and other risks requirement (the expenditure-based requirement for ISD firms – PRU category 4A – and the income-based requirement for non-ISD firms PRU category 4B) or</li> <li>for PRU category 4C firms, the higher of the sum of the credit risk and market risk requirements and the expenditure-based requirement.</li> </ul>
PRU category 5	<p>The higher of:</p> <p>(i) the base capital requirement (which varies according to whether the firm is an ISD firm or not); and</p> <p>(ii) the income-based requirement.</p>

The base capital requirement is the minimum amount of capital resources, as defined, which a firm must hold at all times. This will be in all cases the minimum EC requirement for firms subject to Directives, which ranges from €50,000 up to €730,000 for investment firms, from €1 million to €3 million for insurance firms and €5 million for banks. For investment firms not subject to EC Directives, there will be a base requirement of £10,000.

**Credit risk:** how to calculate capital requirements for credit risk.

**Market risk:** how to calculate capital requirements for market risk.

**Operational risk:** largely guidance on systems and controls, including on outsourcing (see separate note at 8.5.11) and a requirement for certain firms to have PI cover.

**Insurance risk:** this is relevant for firms which transact insurance business as principal.

**Group risk:** guidance on systems and controls and additional rules on capital requirements.

#### (e) **Timetable for Implementation of IPRU (CP115 – November 2001)**

The draft timetable which FSA published in CP97 envisaged implementation of the Integrated Prudential Sourcebook in January 2004. However, this will most likely be postponed because of delays in the timetable for the new Basle Accord and related EU legislation on banking supervision, ISD firms and so on.

CP115 discusses the implementation of some parts of IPRU in 2004, including:

- Systems and controls (CP97-2.34)

- Insurance Firms
- Non-ISD category 5 firms, mainly advisory firms not holding client money/assets
- Miscellaneous (chapter 5)
- Market Risk (chapter 8)
- Operation Risk (chapter 9)

but postponing the following:

- Capital (chapter 6)
- Credit Risk (chapter 7)
- Group Risk (chapter 11)
- Liquidity Risk

until EU discussions are progressed.

#### 8.5.4 CP43 - Customer Classification

This has now been subsumed into the Conduct of Business Sourcebook, discussed at 8.5.6, 7.

Customers are divided into 3 categories:

- Private.
- Intermediate.
- Market counterparty.
- A **private customer** is the category for retail investors and, by default, for any customer who is not an intermediate customer.
  - key consequences of private customer status:
    - most Conduct of Business rules are applicable,
    - s150 FSM Act applies,
    - eligible complainant to Ombudsman scheme (see section 14 of this Guide),
    - may “opt up” to intermediate status,
  - converting a private customer to intermediate status if sufficiently expert:
    - show sufficient expertise and understanding (may be in relation to a specific category of investment),
    - give warning, time to consider; get consent,
    - review annually,
    - keep record.

- An **intermediate customer**
  - can be an “opted up” private customer,
  - substantial corporates, etc.
  - intermediate customer may opt up to market counterparty status if satisfies asset thresholds. But may not opt up a private customer.
- **Market counterparty** category includes:
  - UK authorised firms,
  - overseas firms,
  - consequence: few Conduct of Business rules apply; instead governed by Interprofessional Conduct - see 8.5.5.
- Position of **underlying customers**:
  - firm is your customer even if you know it is acting as agent for others,
  - market counterparty may “opt down” to intermediate customer to protect its underlying customers.

### 8.5.5 Rules On Interprofessional Conduct (“IPC”) (CP47 May 2000; CP83 February 2001 & MAR 3)

The IPC sets out the requirements that will apply, largely in place of the Conduct of Business Sourcebook, for firms that:

- deal\* with or for market counterparty (“MC”);
- arrange\* with or for market counterparty;
- advise with or for market counterparty;

in an inter-professional investment (regulated investments other than packaged and other retail products). It does not apply to approving a financial promotion, certain CIS activities, corporate finance business or custody (MAR 3.1).

\*Even if MC is acting as agent for a person who is not an MC.

Main consequences:

- COB disappplied, but not:
  - financial promotion,
  - chinese walls,
  - client classification,
  - PA dealing,
  - client assets.
- Principles disappplied, but not the following, which are particularly relevant in relation to:
  - Principle 1 – integrity, and the need to control inducements;
  - Principle 2 - act skilfully;
  - Principle 5 – market conduct: need to clarify capacity and firmness of quotation, and to disclose any conflict
  - Principle 7 - communications must not be misleading.

- FSA's guidance on the application of these Principles is set out at MAR 3.4. FSA will take relevant codes into account (MAR 3.8).
  - An IPC firm may not enter into an off-exchange transaction other than at prevailing market price unless satisfied that the counterparty is not entering into it for an improper purpose (MAR 3.5);
  - IPC firms are advised to tape conversations (MAR 3.6);
  - if a name – passing broker compensates a market counterparty for a difference, it must be settled in money (MAR 3.7).

## 8.5.6 Conduct Of Business Sourcebook - Policy Statement February 2001

### Introduction

FSA's approach to this Sourcebook is to replace and integrate the existing standards, seeking to harmonise where appropriate. FSA has, however, reviewed these rules from first principle in order to ensure that they will fulfil what is expected of FSA under the new regime (CP45).

The format of the rules replicates existing SRO conduct of business rules in so far as they are structured along functional rather than business lines.

FSA's Policy Statement of February 2001 indicates that FSA will keep these rules under review. Areas at which it will be looking include (COB paras 3.8-3.21):

- polarisation;
- customer disclosure;
- best execution in light of alternative markets. FSA commenced a consultation exercise in April 2001 by issuing a discussion paper concentrating on the role of best execution in light of technical advances and multiple execution venues;
- projections for retail financial products;
- regulatory disclosures;
- client assets;
- inducements;
- execution only stockbroking;
- round-the-clock trading;

together with products such as long term care and funeral plans.

FSA has published transitional provisions - see 8.5.7.

At present any "private person" (as defined) can bring an action for breach of statutory duty under section 150 FSM Act for breach of any conduct of business rule. The Treasury is currently considering whether a non-private person should be able to do so.

The purpose of the following summary is to set out the principal conduct of business rules to enable a reader to identify which rules may require detailed study. It is by no means comprehensive and necessarily omits much detail, including important exceptions and qualifications.

It is not practicable to highlight how the COB Sourcebook differs from those of the preceding SROs because this would involve a detailed comparison between a number of significantly different regimes. However, the following are the key areas to which firms should be alert:

- Application (COB para 1.2.1).
- Territorial scope (COB para 1.4).
- Internet/email (COB paras 1.8.2 and 3.14).

- Financial promotion (COB para 3).
- Customer classification (COB para 4).
- Charges to private customers (COB para 5.6).
- Custody (COB para 9.1).
- Client money (COB para 9.3).

**(a) Application of the Conduct of Business Sourcebook**

**Applies to all firms subject to exceptions (COB para 1.2.1)**

- Applies to regulated activities unless the rule provides for narrower or wider application, and only to unregulated activities as stated (COB para 1.3.1).
- Applies to regulated activities falling within “designated investment business” so excluding activities outside the RAO but includes dealing as principal (RAO para 13).
- Limited application to deposits, pure protection contracts, general insurance contracts and Lloyd’s activities.
- “Customer” includes private and intermediate customer, but not market counterparty. Only rules relating to Chinese walls, client classification, PA dealing, approving a financial promotion, inducements and customer assets apply to Inter Professional Business (COB paras 1.3.3 and 4).

**Territorial scope of the rules (COB para 1.4)**

- Activity from firm’s UK establishment: all rules apply.
- Firm’s other activities with or for UK client: all rules apply, subject to limited exception for overseas business.
- Firm carries on business from passported branch in another EEA state: limited application.
- In other circumstances: limited application.

**Application to particular business:**

OPS firms, stock lending, corporate finance, oil market and energy market (COB paras 1.5-1.6)

A firm is responsible for its AR's compliance (COB para 1.7)

**Operators of collective investment schemes (COB para 10)**

- Application of conduct of business rules (COB para 10.2).
- Modification of allocation rule (COB para 10.3).
- Modification of suitability rule for unregulated CIS (COB para 10.4).
- Modification of best execution rule for unregulated CIS (COB para 10.5).
- Scheme documents for unregulated CIS with particular provision for private customers (COB para 10.6).
- Periodical statements on valuation and composition of unregulated CIS (COB para 10.7).

**Trustee and depository activities (COB para 11)**

- Application of conduct of business rules including:
  - the firm appointing a permitted third party (COB para 11.6),
  - the firm must obtain and consider proper advice before exercising powers of investment (COB para 11.8).

### Lloyd's (COB para 12)

Application of conduct of business rules to the following activities:

- Advising on syndicate membership.
- Managing the underwriting capacity of a Lloyd's syndicate.
- Designated investment business in relation to members' assets held by Lloyd's.
- Financial promotions relating to Lloyd's.

#### Guidance on:

- Electronic communication with customers (COB para 1.8.2).
- Internet financial promotions (COB para 3.14)
- Programme trading (COB para 7.14).

### (b) Rules applicable to all firms carrying on designated investment business

- **Communications** of information to customers should be clear, fair and not misleading (COB para 2.1.3).
- A firm should not give or accept an **inducement**, or direct any business, if this would be likely to conflict with its or the recipient's duty to its customers (COB para 2.2.3). There are detailed rules in relation to:
  - provision of benefits to an independent intermediary in association with the sale of a **packaged product** (COB para 2.2.5),
  - benefits permitted under, and disclosure of, **soft commission agreements** (COB para 2.2.8-20).
- A firm may rely on **information provided by a third party** in stated circumstances (COB para 2.3.3).
- A firm may rely on **Chinese wall** arrangements in stated circumstances (COB para 2.4.4).
- A firm may not in a communication seek to **exclude or restrict any duty or liability** it owes to a customer under the regulatory system (COB para 2.5.3).

### (c) Rules on Financial Promotion

These rules generally apply to firms which communicate or approve a financial promotion, but not in relation to deposit taking, general insurance or pure protection contracts.

- **Exempt promotions** (to which the rules do not apply) include:
  - promotions made to market counterparties/intermediate customers,
  - promotions excluded under the Financial Promotions Order,
  - certain overseas promotions,
  - certain one-off (ie bespoke) financial promotions,
  - image financial promotions,
  - personal quotation,
  - Takeover promotion (COB para 3.2.5).
- The rules apply principally to financial promotions **directed at persons in the UK** (COB para 3.3.1), but note exceptions at COB para 3.3.3.
- A firm must confirm compliance before communicating or approving a non-RTFP (COB para 3.6.1). It must keep a record (COB para 3.7).
- A firm communicating a non-RTFP approved by another must observe COB para 3.6.5.

- A financial promotion should be **clear, fair and not misleading**. Detailed rules and guidance is provided on the contents of financial promotions (COB para 3.8). Rules for RTFPs are at COB para 3.8.22.
- Rules for **direct offer financial promotions** (such as an off the page advertisement or a fulfilment pack) for private customers (COB para 3.9):
  - prohibit the issue of such promotions for **broker funds, unregulated collective investment schemes, derivatives and warrants** unless the advertiser has previously determined that the investment is suitable for the customer,
  - lay down requirements for the **contents of permitted promotions**.
- An **unsolicited real time financial promotion** may only be communicated to a private customer in stated circumstances (COB para 3.10). They are:
  - The recipient has an established relationship with the firm which envisages unsolicited RTCs; or
  - The promotion relates to a generally marketable packaged product (not involving a higher volatility fund); or
  - The promotion relates to readily realisable securities (not warrants) or generally marketable non-g geared packaged products.
- There are **restrictions** on:
  - the promotion of **unregulated collective investment schemes** (COB para 3.11),
  - approving financial promotions for **overseas or unauthorised** persons (COB para 3.12),
  - approving financial promotions for **overseas life offices** (COB para 3.13).
- Guidance on **internet financial promotion** is provided at COB paragraph 3.14.

**(d) Accepting customers**

- See CP43 at 8.5.4 for **customer** classification.
- Before conducting investment business, a firm should **establish whether a customer** is a private or intermediate customer or a market counterparty (COB para 4.1.4).
- A firm may:
  - subject to exceptions, treat an **agent**, rather than his principal, as its client (COB para 4.1.5);
  - subject to exceptions, treat another firm or overseas financial services institution as a **market counterparty** (COB para 4.1.7);
  - subject to exceptions, treat an **expert private customer** as an intermediate customer in accordance with a stated procedure (COB para 4.1.9);
  - treat a **large intermediate customer** as a market counterparty in accordance with a stated procedure (COB para 4.1.12).
- A firm must generally provide customers with its **terms of business** (COB para 4.2.5) and enter into a **customer agreement** with specified contents with a private customer for specified business (COB para 4.2.7) subject to exclusions set out in the table at COB paragraph 4.2.9.



(e) **Advising and selling**

- A firm which advises private customers on a packaged product must observe **polarisation**; in other words, it must act as or on behalf of a product provider selling only that product provider's range or as an independent financial adviser which can sell the products of the full range of providers (COB para 5.1, which contains detailed rules). Recent changes introduced by FSA allow a tied firm to offer the stakeholder pension products of other firms and to distribute their direct offer financial promotions.
- Before making a personal recommendation of an investment to a **private customer**, or acting as his investment manager, a firm must:
  - "**know your customer**"; in other words, find out sufficient personal and financial information about the customer relevant to the service. Guidance is provided on the type of information which may be required (COB para 5.2.5),
  - ensure that a personal buy/sell recommendation or discretionary transaction is **suitable** (COB para 5.3.5). This duty extends to managing OPS/SHP assets. Guidance is provided on different classes of investment,
  - take reasonable steps to ensure that the private customer **understands the risks** involved. This duty is also relevant to arranging a deal in a warrant or derivative, engaging in stock lending and certain other activities (COB para 5.4.3).
  - records must be kept showing compliance with each of these rules.
- A "**suitability letter**" with prescribed contents is required for certain life policy and stakeholder pension transactions (COB para 5.3.14), and rules and guidance are provided in relation to particular retail products (COB para 5.3.29).
- A firm must give **adequate information** about itself to its private customers (COB para 5.5). This includes regulatory 'footers' on cards and letters – COB para 5.5.5.
- A firm's **charges** to its private customers must not be excessive, taking into account charges in the market, any trust placed in the firm and the disclosure of those charges (COB para 5.6). Those charges must also be disclosed to a private customer (COB para 5.7) and there are detailed rules relating to disclosure of remuneration and commission for packaged products (COB para 5.7.5).

(f) **Product disclosure**

- A firm which sells, personally recommends or arranges the sale of a **packaged product** to a private customer, trustees of an OPS or the trustee or manager of a stakeholder pension (and certain other transactions) must:
  - provide a **key features document** with prescribed contents (COB para 6.1.4, 6.1.5, 6.2, 6.4 and 6.5),
  - provide specified post-sale information for **life products** (COB para 6.3 and 6.5).
- Detailed rules on the contents of **projections** for life policies, schemes and stakeholder pensions are contained at COB paragraph 6.6.
- **Cancellation and withdrawal rights** for stakeholder pensions, cash ISAs, insurance products and funds are contained at COB paragraph 6.7.
- Certain information should be provided for **pure protection** and **general insurance** contracts (COB para 6.8).
- A life office which issues **with-profits policies** must publish a with profits guide (COB para 6.9).

**(g) Dealing**

- A firm with a **material interest or conflict** must ensure fair treatment for its customer (COB para 7.1).
- A firm must not deal or arrange a deal or exercise discretion for, or advise a private customer to deal unless it is in the **customer's best interests** (COB para 7.2).
- A firm must not **deal ahead** of its own research or written recommendation (COB para 7.3).
- A firm must **execute** own and customer orders fairly and in due turn (COB para 7.4).
- Subject to stated exceptions, a firm which executes a customer order must provide **best execution** (COB para 7.5). Exceptions are:
  - life policies and an operator dealing in regulated CIS units,
  - an intermediate customer with whom the firm has a written agreement (but not OPS or certain trusts),
  - where the firm takes reasonable care to ensure that a third party will provide best execution.
- A firm must provide **timely execution** once it has decided to execute or arrange a customer order (COB para 7.6).
- **Aggregation** of own and customer (or customer and customer) orders must be in accordance with written consistent policy, and reasonably be believed to be advantageous to each customer concerned. Subsequent **allocation** must be timely (COB para 7.7.5) and fair, with customers generally taking priority over the firm's order (COB para 7.7.9).
- A firm must not **realise a private customer's assets** unless it is legally entitled to do so, and this power is stated in its terms of business or the customer is given due notice (COB para 7.8).
- A firm must not, subject to stated exceptions, **lend or give credit to a private customer** without first assessing the customer's financial standing and ensuring that the loan is suitable for them (COB para 7.9).
- A firm must obtain from a private customer **margin** payable for a contingent liability investment, and close out his position if a margin call is not met within 5 days (COB para 7.10).
- If selling a **non-exchange traded security** to a private customer as a market maker, a firm must give specified notice (COB para 7.11).
- A firm must maintain specified **customer order and execution records** (COB para 7.12).
- A firm must ensure that **personal account dealing** does not conflict with its regulatory duties (COB para 7.13).
- Guidance is provided on **programme trading** in COB paragraph 7.14.
- A firm must not enter into a **non-market price transaction** unless it has taken reasonable steps to ensure that it is not being entered into by the customer for an improper purpose (COB para 7.15).

**(h) Reporting to customers**

- A firm which executes a sale or purchase of a designated investment must promptly send **written confirmation** with prescribed contents to the customer or his agent (COB para 8.1). Exceptions include:
- A life policy, a personal pension contract.
- A regular payment purchase of units in a regulated CIS.

- Where the customer requests that it is not sent (COB para 8.1.6).
- A firm which is an investment manager or administrator, or operates a customer account containing uncovered open positions in a contingent liability investment, must generally provide a **periodical statement** to a customer with prescribed contents (COB para 8.2).

(i) **Client assets**

**Custody rules** (COB para 9.1)

**Application**

- Apply to firms which **safeguard and administer** investments (COB para 9.1.1) and their **nominee companies** (COB para 9.1.11). These are assets of clients (ie market counterparties as well as customers). The rules apply to both **custody assets** and **safe custody investments** (COB para 9.1.3).
- Do not apply to:
  - an **incoming EEA firm** for passported activities (COB para 9.1.6),
  - a firm which holds a designated investment for an **affiliated** company,
  - the operator of a **regulated CIS**,
  - a **personal investment firm** temporarily holding non-bearer investments (COB para 9.1.9),
  - a DVP transaction through a **commercial settlement system** where fulfilment is intended within one business day (COB para 9.1.13).
- The application of the custody rules to the following is set out at:
  - trustees and depositories (COB para 9.1.16),
  - arrangers (COB para 9.1.21),
  - depository receipt business (COB para 9.1.24).
- A safe custody investment must be **segregated** from own investments and title duly **recorded and registered** (COB paras 9.1.28, 9.1.30 and 9.1.35).
- A firm must hold **documents of title** safely or with a custodian (COB paras 9.1.40 and 9.1.42).
- A firm must undertake a pre-appointment **risk assessment** of a proposed custodian (COB para 9.1.43).
- Where a firm provides custody services, its **client agreement** must include prescribed terms (COB para 9.1.49).
- A firm must provide appropriate risk disclosure before holding or arranging for a customer's safe asset investment to be held **overseas** or **in its name** (COB paras 9.1.54 and 9.1.57).
- A firm must provide a **statement of client's custody assets** with prescribed contents at least annually (COB paras 9.1.59 and 9.1.64).
- Where a firm holds a client's safe custody investment with a **custodian**, it must agree appropriate written terms with that custodian (COB para 9.1.69).
- **Use of a safe custody investment** by a firm, for another client or for stock lending requires notification or consent (COB paras 9.1.72-9.1.74).
- A firm must at least every 25 business days **reconcile** its record of safe custody investments for which it is responsible but does not hold with the custodian's statements or those of the registrar of a dematerialised safe custody system. The period is extended to six months for unit trust, OEIC and mutual fund holdings in certain circumstances (COB paras 9.1.85 and 9.1.87).

- A firm must at least twice in each period of 12 months **reconcile** safe custody investments which it holds on behalf of clients against its records either by total count or other (eg rolling stock) methods (COB paras 9.1.89 and 9.1.93).
- Any **discrepancy** must be promptly corrected, and made good where the firm is responsible (COB para 9.1.94).
- Failure to observe these rules must be **promptly notified** to FSA (COB para 9.1.97).
- **Records** must be maintained (COB para 9.1.98).

### Client money (COB para 9.3)

- The client money rules **apply to a firm** which receives or holds money, from or on behalf of a client (meaning a customer or market counterparty), in connection with designated investment business (COB para 9.3.1), **but not to**:
  - the permitted activities of a life office or friendly society,
  - bullion,
  - an approved bank,
  - depositories subject to Chapter 11 (COB para 9.3.2),
  - an **incoming EEA firm's** passported activities (COB para 9.3.3),
  - money received from or held on behalf of a **market counterparty** or **intermediate customer** with a written agreement (COB para 9.3.9,11),
  - a DVP transaction through a **commercial settlement system** where fulfilment is intended within one day (COB para 9.3.15),
  - the DVP transaction for units in a **regulated CIS** intended for same/next day trading (COB para 9.3.16),
  - money held for **affiliates** (COB para 9.3.18),
  - money **properly due and payable** to the firm (COB para 9.3.19).
- The client money regime for trustees (not of a unit trust) is specified at COB paragraph 9.3.29. They must:
  - always hold client money **separately** (COB para 9.3.27),
  - hold it on a **statutory trust** (COB para 9.3.31).
- A firm must:
  - transfer client money to a market counterparty/intermediate customer as client money (COB para 9.3.13),
  - hold client money **separate** from its own money (COB para 9.3.37),
  - **only** hold client money in a client money account (COB para 9.3.39),
  - **pay client money received** into a client money account (COB para 9.3.42) within one business day (the "normal approach") or (with additional safeguards) may receive client money into its own account and perform the segregation calculation (COB para 9.3.101) on a daily basis (COB para 9.3.46) (the "alternative approach"). There is a time extension for ARs and field agents (COB para 9.3.49).
- A firm must within one business day **pay money due to a client** into a client bank account or to the client (COB para 9.3.58).
- A firm must pay a private client all **interest** earned on client money unless he is notified otherwise (COB para 9.3.60).
- Client money may only be held by a **third party** in limited circumstances (COB para 9.3.64).

- A firm must hold client money in a client money bank account at an **approved bank** (COB para 9.3.68) with the exception of a permitted third party (COB para 9.3.64) and certain overseas settlement/distribution transactions (COB para 9.3.74). A firm must:
  - be satisfied that the bank is **appropriate** (COB para 9.3.76),
  - disclose if it is a **group bank** (COB para 9.3.80),
  - provide **notice to the bank** on opening the account to acknowledge it is client money (COB para 9.3.82).
- Provide notice to the client before using an **overseas bank** (COB para 9.3.90).
- Provide notification and receive acknowledgement of trust in respect of certain **contingent liability transactions** before opening a client transaction account (COB para 9.3.86).
- Provide **notice** to a client before using an intermediate broker, settlement agent or OTC counterparty outside the UK (COB para 9.3.95).
- Promptly **notify** FSA if a third party holding client money fails (COB para 9.3.98).
- A firm which adopts the “**normal approach**” must each business day check whether the aggregate of its client money bank accounts at close of business on the previous day is at least equal to its client money requirement as at close of business on that day (COB para 9.3.100) and make good any shortfall.
- A firm which adopts the “**alternative approach**” must ensure that the aggregate of its client money bank accounts as at close of business on each day is at least equal to the client money requirement as at close of business on the previous day (COB para 9.3.101). No excess or shortfall is permitted.
- The **client money requirement** is calculated in accordance with COB paragraphs 9.3.105-9.3.120.
- A firm must **notify FSA** if it has failed to perform the prescribed daily calculation, or if it may not be able to make good any shortfall under the “normal approach” (COB paras 9.3.121-9.3.122).
- A firm must perform **client money reconciliations** at least every 25 business days and correct any discrepancies as soon as possible (COB paras 9.3.123-9.3.131).
- Money **ceases to be client money** (COB para 9.3.133) where paid to a client, to a third party on instructions of the client or to a firm when due to it.
- A firm may cease to treat **unclaimed client money** as client money once it has taken reasonable steps to trace the client (COB para 9.3.138).
- COB para 9.5 contains provisions relating to **client money distribution** on failure of the firm, its bank or any other relevant third party.

#### **Mandates**

- A firm which **holds a mandate** over a client’s assets or liabilities must maintain proper records and internal controls (COB para 9.2).

#### **Collateral**

- A firm which **receives assets** as collateral for a client’s obligations must maintain adequate records (COB para 9.4).

### **8.5.7 Conduct of Business Sourcebook: Transitional Arrangements - Policy Statement July 2001**

SRO Conduct of Business Rules will cease to have effect on N2 and the Conduct of Business Sourcebook (“COBS”) will be implemented in full on that date, subject to limited transitional

relief where COBS introduces significantly new or different requirements (PS 3.2). The purpose of this relief is to limit the volume of compliance work which needs to be undertaken by firms around N2.

In order to facilitate an orderly transition, FSA has used its rule making powers under section 156(2) FSM Act to make transitional rules to allow existing firms extra time to adjust to certain conduct of business rules. The extension periods are:

- until 30th June 2002 for ex-SRO firms (but indefinitely for TSP rules - see below); and
- until 30th November 2002 for firms formerly regulated by Recognised Professional Bodies such as the Law Society and Institute of Chartered Accountants. They are given more time because the change to FSM Act will be more significant for them and the new Designated Professional Bodies have not yet issued their rules.

The transitional provisions extend beyond the draft rules set out in CP45, and FSA states that:

- Any further requests for waivers will fall to be considered under section 148 FSM Act.
- FSA expects to see full compliance with all other COBS from N2 (PS 3.4, 3.5, 3.34, 3.35).

### **The transitional arrangements for ex-SRO firms**

COBS rules subject to transitional relief are set out in full in Table TR2, and the following is a brief summary of the main provisions of the three types of transitional arrangement.

FSA emphasises that in each case a firm must be satisfied that:

- it has complied with the corresponding rule of its previous regulator or applicable Statutory Instrument (the "former rule"); and
- the former rule is substantially similar in purpose and effect to the COB in question.
- FSA suggests that a firm may wish to use FSA's table of derivations set out at Table TR2 in the Policy Statement. This list is not, as drafted, fully accurate and it does not correspond to the COB Transitional Provisions in Table TR1.

### **Extra time provisions ("ETP")**

These will allow firms extra time to make system and procedural changes. A firm will not contravene specified COBS provided it complies with the former rule in each of the following areas.

- ETP1 is a general provision, and FSA indicates in Table TR2 a number of areas where it can apply, including:
- **Soft commission** (COB 2.2).
- **Financial promotions:** confirmation of compliance (COB 3.6), records (COB 3.7), contents (COB 3.8), direct offer financial promotions (COB 3.9).
- **Terms of business** (COB 4.2).
- **Know your customer** (COB 5.2).
- **Suitability** (COB 5.3).
- **Risk warnings** (COB 5.4).
- **Disclosure of charges** (COB 5.7).
- **Cancellation** (COB 6.7).
- **Confirmations** (COB 8.1).
- **Periodical statements** (COB 8.2).
- Parts of **client assets** and **client money** (COB 9.1, 9.3).
- ETP2: Non real-time **financial promotions**.

- ETP3: Expert private **customer classification**.
- ETP5: Client assets in relation to use of **approved banks and custodians**.
- ETP6: **Client money**.
- ETP8: Provision of **information** about a firm (but not its ARs).

#### Technical timing provisions (“TTP”)

An obligation which requires periodic fulfilment, such as to send statements to customers, will be deemed to have been fulfilled in relation to the period when N2 falls by the performance of that obligation in accordance with the former rule. This is a “one off” relief with future performance needing to comply with COBS. FSA has identified three areas which will benefit from TTPs, which are as follows:

- Disclosure of **soft commission** (TTP1).
- Use of **with profits guides** (TTP2).
- **Periodic statements** (TTP3).

#### Timeless (saving) provisions (“TSP”)

Firms which comply with the rules of their previous regulator will be grandfathered indefinitely in relation to designated COBS for so long as their work remains valid. These are as follows:

- **Client classification** in accordance with Table TR3. This enables a firm to transfer existing clients across to the new system of classification without formal reclassification. Annex E to the Policy Statement provides a “conversion table” between SRO and COB client classification terms.
- Confirmation of compliance of **investment advertisements** (TSP1).
- Use of pre-N2 **terms of business and client agreements** with existing clients (TSP2). FSA says that these may continue in use unless the basis of business has changed beyond the scope of the customer agreement. It is also necessary to notify private clients of their rights under the Ombudsman and Compensation Schemes. See also PS 3.23, 3.24.
- A record of **private customers’ circumstances** may be relied upon for the purposes of know your customer and suitability provided they are still relevant (TSP3).
- A firm may use a pre-N2 **suitability letter and risk warnings** for transactions executed or arranged before 30th June 2002 (TSP4).
- The operator of an **unregulated UCIS** may use scheme documents provided to a participant before 30th June 2002 (TSP5).
- A firm may rely on **notices to/consents from clients** under investment agreements concluded before 30th June 2002 (TSP6). Table TR2 lists the specific rules.
- Pre-N2 **cancellation rules** will apply to investment agreements entered into before 30th June 2002 (TSP7).

### 8.5.8 Money Laundering (CP46 - April 2000; Policy Statement January 2001)

Fighting financial crime is one of FSA’s four statutory objectives, and FSA attaches particular importance to combating money laundering.

FSA’s key means of discharging this objective is to impose money laundering rules upon firms, and there can be little doubt that FSA will exercise greater vigilance over money laundering than the predecessor SROs.

#### Background

Until recently, work against money laundering has been primarily focused on combating the handling of the proceeds of drug trafficking and terrorism, although the ambit of money

laundering, both under the Criminal Justice Act and the draft Second European Directive on Money Laundering, extends to proceeds of all serious criminal activities in any part of the world, including:

- Corruption.
- Theft.
- Fraud.
- Tax evasion.
- Forgery.
- Product piracy.
- Unauthorised investment business.

### **FSA's stance**

FSA's stance is to cooperate with the criminal authorities without duplicating their work, by concentrating on the systems and controls of authorised firms, which are:

- Care on customer take-on.
- Constant alertness to possible money laundering.
- Communicating suspicions of money laundering to the criminal authorities.
- Ensuring senior management oversight and control over activities which could be used for money laundering.
- Maintaining employees' informed participation.
- Proper maintenance of records.

### **FSA's rules in context**

The purpose of FSA's rules on money laundering is to require firms to exercise additional vigilance against the risk of being used for the purpose of handling the proceeds of criminal activity. They do not:

- alter the definition of what constitutes money laundering; or
- change the criminal offences relating to money laundering.

Nor do they set out detailed identification procedures, which are contained in the Joint Money Laundering Steering Group Guidance Notes.

### **FSA's rules**

Key rules set out in FSA's Policy Statement of January 2001, which are intended to apply to activities carried out from a firm's UK establishment, are as follows:

- A firm must appoint a Money Laundering Reporting Officer with appropriate seniority and resources (ML para 2 and 7).
- A firm must identify its customer on take-on, subject only to limited exclusions and a measure of relaxation for financially excluded customers (ML para 3). These records must be maintained as they will form an important source of information about the firm's customers, and also its own compliance activities (ML para 7.3). CP46 contained detailed guidance as to the nature of acceptable evidence of client identity, and while it has been deleted from the Policy Statement, it is suggested that it nonetheless remains a useful indicator of prevailing regulatory standards. Further guidance is contained in the Joint Money Laundering Steering Group's Guidance Notes.
- A firm must provide its Money Laundering Reporting Officer with information about customers' financial circumstances and transactions to facilitate him reporting money laundering to the authorities (ML 4.2). FSA's original proposal, set out in CP46, was



for firms to make effective use of this information so that staff could review a customer's profile and financial records in order to judge whether a transaction was suspicious. This proposal has, however, been withdrawn in light of concerns over burdensomeness, confidentiality and non compatibility with Chinese walls. Nonetheless, where a firm does feel able to make this information available to transaction-handling staff, it would assist them to enable the firm to fulfil one of FSA's key requirements, which is to maintain constant vigilance to post take-on money laundering.

- Suspicions of money laundering must be promptly reported to the Money Laundering Reporting Officer and then, after appropriate review, to NCIS (ML para 4).
- A firm should take into account any public notification made by FSA that a particular jurisdiction has defective safeguards against money laundering (ML para 5).
- A firm should provide awareness training for staff (ML para 6).

### **Conclusion**

FSA attaches great importance to countering money laundering in order to fight serious crime effectively, to defend the financial services sector from reputational and other risk, and to protect consumers. Indeed, one of the Threshold Conditions which FSA will consider in assessing the suitability of an applicant for authorisation will be whether it has appropriate money laundering systems and training in place.

Firms should be alert to the requirements to maintain demonstrable vigilance in this area.

## **8.5.9 Training & Competence - Policy Statement 60 (PS60 - December 2000)**

FSA's Training and Competence Sourcebook provides as follows:

- A firm must ensure that all its employees are and remain competent for their work and its business and that they are appropriately supervised (TC para 1.2).
- FSA's formal training and competence requirements apply to staff who deal, manage or advise and a wide range of supervisory staff, including:
  - supervisors of administrative functions (TC para 2.1),
  - supervisors of life office administration,
  - supervisors of staff taking private customers through stakeholder pension ("SHP") decision trees and of SHP administration.

To the staff of an incoming EEA/Treaty firm they only apply in limited circumstances (TC para 2.1.1 (1)).

- Imposes obligations in relation to recruitment and training of staff involved with private customer business (TC para 2.2, 2.3).
- Relevant employees may not work unless competent or supervised. Employees dealing with private customers, even under supervision, must have passed an examination (TC 2.4).
- Defines competence in terms of job-specific assessment plus holding appropriate qualification (TC para 2.4.5 and 2.5).
- Requires firms to ensure that employees remain competent (TC 60 para 2.6) and to monitor their activities (TC para 2.7).

## **8.5.10 Draft Mortgage Sourcebook - CP98 (June 2001)**

This Sourcebook applies generally to Mortgage Lenders or Mortgage Administrators when they enter into or administer a Regulated Mortgage Contract (RMC). An RMC is, in summary, lending secured by a first charge such as for house purchase, lending for debt consolidation and

secured banking products. A Mortgage Administrator is a person who does either or both of notifying a borrower of changes in interest rates, payments due or other matters which a mortgage contract requires to be notified; and collecting or recovering payments due. This goes further than just having a right to enforce an RMC. New RMCs entered into after N3 (31st August 2002) will be subject to the Mortgage Sourcebook rather than the Consumer Credit Act. The Mortgage Sourcebook was planned to come into force on 31st August 2002, with chapters 6 and 12 being delayed for a further 6 months. However, FSA will reconsult on rules and timetable in light of the Government's announcement on 12 December 2001 that FSA would additionally regulate mortgage advice.

The Mortgage Sourcebook will also (if they are not already covered) apply to firms which communicate or approve financial promotions relating to Qualifying Credit (which is credit provided by a Mortgage Lender or Mortgage Administrator secured on land, and associated unsecured lending (1.1.1(2), 1.4.1)).

### **Mortgages becoming or ceasing to be RMCs**

Where a contract becomes an RMC after inception, FSA considers that the Mortgage Lender will probably not have entered into an RMC, but the Mortgage Administrator will probably then be carrying on a regulated activity. If a mortgage ceases to be an RMC, the provisions of the Mortgage Sourcebook will cease to apply (1.2.1).

### **Unauthorised persons**

An unauthorised person may only administer an RMC for one month (Article 62 RAO). FSA's policy on taking proceedings for infringement of this provision is contained at paragraph 1.2.3. An authorised firm may outsource mortgage administration to an unauthorised person under article 63 RAO, but FSA will hold the authorised firm responsible (1.2.4). Provisions relating to a Mortgage Administrator appointed by an authorised person are contained at chapter 15. Capital requirements are contained at chapter 14.

### **COB Standards**

Communications must be **clear, fair and not misleading** (2.1).

A Mortgage Lender should **avoid inducements or referrals** to a mortgage intermediary if this might give rise to conflict with its duty to customers (2.2).

A Mortgage Lender or Mortgage Administrator may not seek to **exclude liability** under the FSM Act (2.4).

Communications may be made by electronic media (2.5).

### **Financial promotion**

A financial promotion relating to Qualifying Credit is subject to a regime almost identical to financial promotion at COB3.

- Exceptions from financial promotion regulation (3.2.4).
- Form and content of non-real time Qualifying Credit promotions (3.6).
- Unsolicited real time Qualifying Credit promotions are prohibited other than to certain existing customers (3.7.3).
- Form and content of real time Qualifying Credit promotions (3.8).
- Contents of direct offer qualifying credit promotions (3.9).
- APR calculation and references - chapter 8.

### **Responsible lending**

A mortgage lender must be able to **demonstrate that affordability** was taken into account before it entered into an RMC or further advance (9).

### **Charges**

Any **early repayment charge** under an RMC must be able to be explained as a cash value and be a reasonable pre-estimate of relevant costs (10.3).

Any **arrears charge** must be a reasonable pre-estimate of relevant costs (10.4).

No charge may be **exorbitant** (10.5).

### Disclosure

When a mortgage lender makes a recommendation to a customer, provides customer-specific information or the means for a customer to make an application, then **certain disclosures should be made**. The obligation is expressed in this way in order to apply to intermediaries, who are not regulated under FSM Act.

- An **illustration** should be clear, fair and not misleading (4.3), and issued after appropriate information has been obtained (4.4.5). An illustration should be provided at stated times (4.4.1) and with specified contents (4.5). There are separate requirements for illustrations for bridging loans, secured overdrafts and secured credit cards (4.6).
- The **offer document** for an RMC must contain prescribed contents (5.4).
- An RMC other than a bridging loan, secured overdraft or secured credit card must **provide information before the first payment** is made about the number of matters, including:
  - Amount of payment.
  - Method of payment.
  - Details of any insurance.
  - Details of the mortgage contract.
  - What to do in the event of arrears (5.6).
- A Mortgage Administrator (or the Mortgage Lender making a second advance or amending an RMC) must provide **annual statements** with prescribed contents (6.4) and **reasonable advance notice** of changes to interest and terms (6.5) and **appropriate information** in other stated circumstances (6.6, 6.7).
- There are particular provisions for **lifetime mortgages** (7).

### Cooling off

A cooling off period of 7 calendar days applies to an RMC other than with an existing Mortgage Lender, or a bridging loan or a loan on land. The cooling off period will therefore apply to an RMC which involves a re-mortgage with a new lender, or a loan secured on a house (11).

### Arrears

Mortgage Lenders and Mortgage Administrators should have a policy (12.3)

- To **reach agreement** with the customer in arrears as an alternative to taking possession.
- To liaise with a **Citizen's Advice Bureau** or equivalent if the customer requests.
- To take a reasonable approach to **time required for repayment**.
- Only to **repossess** when all other reasonable attempts to resolve the position have failed.

Specified **information** should be provided to a customer in arrears (12.4, 12.5). A Mortgage Administrator must endeavour to **market a repossessed property** as soon as possible and to obtain the best price (12.6).

### Key alterations

The key alterations for Mortgage Lenders and Mortgage Administrators now that RMCs are regulated by the FSA are likely to be as follows:

- **Complaints handling:** a person who suffers loss because of a rule breach may bring a claim under section 150 FSM Act, and may also complain to the Ombudsman. This

will require affected firms to establish a complaints handling system to FSA's standards.

- **FSA monitoring and discipline:** FSA will monitor firms' observance of these rules, and can take disciplinary action for breach against firms and individually approved senior managers.
- **Records and compliance:** FSA will require firms to keep detailed records of their observance of these rules, and to establish a compliance system to ensure observance.
- Firms will be subject to **other provisions contained in FSA's Handbook**, including the Principles, the requirement to be fit and proper, money laundering, authorisation and senior management responsibility.

## 8.5.11 FSA's Requirements on Outsourcing

### Introduction

Although there have for some time been detailed rules and requirements for banks and building societies which outsource various activities, and IMRO firms were subject to guidance on the delegation of functions (see IMRO Reporter 16), it is clear that FSA has a general expectation that all firms which outsource certain functions should ensure that such arrangements are set up in a controlled manner so that they are not exposed to undue operational risk.

### Post N2 regime

Post N2, firms which outsource certain functions will be required to comply with a more concrete set of rules and guidance. In addition to Principle 3 (Management and Control) and the requirements of SYSC, when the Integrated Prudential Sourcebook comes into effect, scheduled for January 2004 but now possibly delayed, this will contain a specific chapter dealing with this area.

These draft requirements are of current significance because they reflect what is understood to be FSA's policy on outsourcing, and address areas of concern which have been apparent in recent - and continuing - enforcement cases involving outsourcing. It is suggested that these draft requirements do no more than set out in detail obligations that already arise under PRIN and SYSC.

### What is outsourcing?

Outsourcing commonly involves an authorised firm contracting with the third party (who may or may not be FSA authorised, and may be based in the UK or overseas) for it (the 'supplier') to provide certain functions for the authorised firm (the 'outsourcer'). FSA's requirements apply with equal force to inter-group outsourcing, although with rather less formality. The outsourcing may be of administrative functions such as:

- accounting
- systems
- "back office" administration of retail or wholesale investments
- clearing
- pricing

but may be for the provision of assistance with sales and marketing, or at management level.

### Problems with outsourcing

The experience of regulators over the past few years is that outsourcing is vulnerable to risk of non-compliance because of failures of control. It may, for example, not be:

- properly documented
- properly defined
- properly monitored

- competently performed

and management controls may be improperly relinquished to the supplier. There may also be an inadequate information flow from the supplier to the outsourcer.

### **FSA's policy**

FSA's policy is based on Principle 3 – the requirement for a firm to be organised; the Threshold Condition of suitability, which requires a firm to conduct its affairs soundly and prudently; and the SYSC rules, which require that a firm's management runs the business with appropriate systems and controls in place.

FSA's policy focuses on material outsourcing contracts entered into by significant business units. The test is, would weakness or failure in the outsourced activity cast serious doubt on continuing compliance with FSA's Principles for Business or Threshold Conditions? FSA considers that outsourcing regulated activities will be a material outsourcing, but not custody or appointment of ARs. However, it would be prudent for firms to observe the following requirements in relation to any outsourcing.

### **FSA's requirements**

FSA's requirements seek to address these issues as follows:

- FSA should be notified of any intended material outsourcing, changes to such arrangements, and material problems if they occur. This reflects FSA's requirements in SUP 15.3.8.
- A firm must be satisfied that, if it outsources a function (or significantly amends an existing outsourcing), it will remain able to comply with FSA's Principles for Business, Threshold Conditions and SYSC requirements. It must have regard to the interests of its customers. The firm should document its reasons.
- A member of the firm's senior management, who should be an approved person, should be responsible for any material outsourcing. That person should also be responsible for ensuring that adequate systems and controls are in place in order to monitor and control risks arising from the outsourcing. Firms should also be aware that suppliers' employees may be subject to individual approval under the APER rules.
- a firm should verify that a supplier is competent, financially sound and with appropriate expertise, and can devote sufficient adequate resources to the proposed outsourcing on an on-going basis. A firm should also monitor the supplier's performance.

### **Need for a written agreement**

FSA considers that a firm should have a written agreement with its supplier addressing the following points:

- clear reporting line
- requirement to provide information about developments
- protecting customer confidentiality
- restricting sub-contracting
- observation of FSA's rules
- requirement to inform of developments which may impact the supplier's obligations
- setting out data protection obligations
- giving right to terminate on supplier's change of control or insolvency
- including service level agreements with specified targets, including appropriate reports, reviews and remedies
- granting rights of access to FSA and the firm's internal and external auditors
- orderly termination and handover of records.

**Additional requirements**

Firms should additionally:

- maintain a contingency plan for where the supplier fails or the contract terminates
- carefully review each outsourced function and determine how it will remain able to comply with FSA's requirements under the proposed outsourcing
- note that there are particular requirements for the outsourcing of internal audit
- check both legal and regulatory enforceability if the supplier is overseas.

**8.5.12 Service Company Regime (Policy Statement October 2001)**

A service company provides trade support services to market professionals, generally software and communication links to facilitate electronic trading, order routing and post-trade processing.

The Service Company regime is available to such firms whose permission is restricted to making arrangements.

## 9. Information gathering - Part XI sections 165-177, Section 413

### **Summary:**

This section sets out FSA's powers to obtain information and to conduct an investigation. This section summarises:

- Duty of authorised persons to provide information to FSA (9.1)
- Appointment of investigators (9.2)
- Offences (9.3)
- Relevant parts of FSA's Enforcement Manual (9.4.1)
  - FSA's policy for using information gathering powers
- Relevant parts of FSA's Supervision Manual (9.4.2)
  - FSA's approach to supervision
  - Lead supervision
  - Co-operation with FSA
  - Requirement to appoint actuary
  - Reports by skilled persons
  - Notifications to FSA
  - Reporting to FSA
  - Transaction reporting

### 9.1 Providing information to FSA

FSA may require an authorised person to provide information/documents (s165(1)):

- But only if reasonably required for FSA's functions (s165(4)) or at request of overseas regulator (s169).
- FSA may require same from connected persons and scheme/RIE/RCH (s165(7)); connected persons = group members, controllers, officers or employees (s165(11)).

FSA may require authorised person/group member to provide expert's report on section 165 matter (ie reasonably required for FSA's functions) (s166):

- FSA to approve expert (s166(4)).
- Staff and contractors must co-operate with expert (s166(5)).

### 9.2 Investigations

FSA/HMT may appoint investigators into business/ownership (s167) of:

- Current or former authorised person or AR (s167(1)).
- Including group members (s167(2)).
- Including unregulated business (s167(5)).

FSA/HMT may also investigate any person in stated circumstances (s168) including in relation to:

- Insider dealing.
- MA.
- Breach of general prohibition.

- Rule breach.
- Financial promotion.
- Money laundering. See **Regulations relating to Money Laundering** at 10.5.5.
- Not fit and proper.
- Approved individuals.

Investigation may be at request of overseas regulator (s169(1)-(2)).

Revenue may give information to FSA/HMT (s350).

Investigator must (s170):

- Give written notice to person under investigation (s170(2) and (4)),
- Unless designated circumstances or frustration likely (s170(3)),
- Act as directed by FSA/HMT (s170(7)-(8)),

Investigator under section 167 can require (s171):

- Person under investigation or connected person (s171(4));
- To answer questions/provide information (s171(1))/provide documents (s171(2)) so long as they are relevant (s171(3));
- Plus (in case of s168 investigation) require anyone to answer/provide information if necessary in stated cases (s172);
- Plus (in case of s168 investigation) to provide documents and give all assistance in stated cases (s173).

Statement to investigator admissible in proceedings (s174(1)), but not criminal/MA proceedings (s174 (2)) subject to exceptions (eg perjury) (s174(3)).

FSA/investigator can require a third party to produce document (s175(1)) and can also:

- Take copies and require explanation of document (s175(2)).
- Require disclosure of whereabouts of document (s175(3)).
- Require lawyer to give client name and address (s175(4)).
- Obtain entry under warrant in stated cases (s176).

This is subject to some protection for bankers (s175(5)).

No person can be compelled to produce a “protected item”. These are communications between a professional legal adviser and his client made for giving legal advice or in contemplation of legal proceedings (s413).

For disclosure of information under sections 165-167, see 9.4.3.

## 9.3 Offences

It is an offence to:

- Fail without reasonable excuse to comply with Part XI requirement (s177(1)).
- Falsify/conceal/destroy documents (s177(3)).
- Provide false or misleading information (s177(4)).



## 9.4 Key statements on policy and implementation

### 9.4.1 Enforcement Manual

FSA's policy for use of its information gathering powers is set out as follows (ENF section 2.5):

- FSA's general policy is at ENF 2.11.
- Section 165 - requiring information and documents - a broad power, which FSA will use for routine supervision.
- Section 166 - reports by skilled persons - FSA will use for routine supervision, and also where concerns arise.
- Sections 167 and 168 - appointment of investigators FSA - will use for investigations where serious concerns require a thorough investigation, although FSA may not always use statutory powers, such as to require a compulsory interview (ENF section 2.14).
- Section 168 - investigations into market misconduct - FSA will use where circumstances suggest specific contraventions or offences (ENF section 2.6).]
- FSA will usually issue a preliminary findings letter to a firm once an investigation is complete (ENF 2.5.12).
- Section 169 - FSA will use when assisting overseas investigators (ENF section 2.8).
- Section 170 - conduct of investigations - circumstances when FSA will give notification to persons under investigation are described at ENF section 2.12. FSA will not normally give publicity to an investigation, but there are exceptions (ENF section 2.13).
- Section 176 - entry of premises under warrant - FSA's policy for obtaining search warrant is set out at ENF section 2.15.
- Investigation into unauthorised business (ENF section 2.7). FSA's primary aim will be to protect the interests of consumers, and may not always need to carry out a formal investigation. (See also CP25 at 2.5.2.)
- Guidelines on investigating cases of concern to FSA and other agencies are contained in ENF 2 Annex 1G.

### 9.4.2 Supervision Manual

The contents of the Supervision Manual are discussed as follows:

Section of Manual	Section in this Guide
FSA's approach	9.4.2
FSA's information gathering	9.4.2
Auditors	9.4.2
Actuaries	9.4.2
Skilled persons	9.4.2
Vary/cancel Part IV permission	5.4
Individual requirements	5.4
Waiver of rules	8.2, 8.4.1
Individual guidance	8.4.1
Approved persons	6.2, 6.7.2

Controllers and close links	7.8.2
ARs	4.6.2
UK firms passporting out	4.6.5
EEA firms varying passporting rights	4.6.6
Notifications to FSA	9.4.2
Reporting requirements	9.4.2
Transaction reporting	9.4.2
Business transfers	15.6.3

The Supervision Manual has been designed with two objectives:

- To reflect in FSA's own requirements and procedures the relevant provisions of the FSM Act.
- To avoid major change to the approach of the pre-N2 regulatory bodies (CP64 para 3.8).

There are transitional rules including in relation to:

- Notifications.
- Record keeping.
- Auditors (SUP 3) and actuaries (SUP 4).
- Individual guidance (SUP 9.4).

### **FSA's approach to supervision (SUP 1 & CP30)**

FSA views the core elements of its supervisory regime (CP30 para 11.1) as follows:

- Receipt and analysis of information about a firm, its controllers, its financial standing, the people it deals with, and the investments and sectors in which it operates.
- Analysis of risk presented in light of that information: risk of breaches of rules, or Principles, possible customer detriment and risk to FSA's objectives.
- Gathering further information at firm-focused level, by inspection visits and by other means.
- Analysis of this information and consideration of further action if necessary.

FSA's approach to supervision is as follows:

- FSA adopts a risk-based approach to supervision based on the extent to which a firm poses a risk to meeting FSA's regulatory objectives, taking into account both the probability of such occurrence and the impact if it does occur. FSA's methodology for impact and probability assessment is described at SUP paragraph 1.3. What FSA describes as high impact firms (ie higher probability of posing risk plus potentially serious impact) are likely to experience a continuous relationship with FSA, whereas low impact firms will receive fewer visits and less contact.
- Management is responsible for ensuring that a firm acts in accordance with regulatory requirements (SUP 1.1.4). If a firm or individual falls short of regulatory requirements, FSA expects senior management to remedy the matter and to deal fairly with any affected customers. FSA repeats this at ENF 3.5.3.

### **Lead supervision (SUP 1.5 and Lead Supervision: FSA's New Approach - June 1999)**

The purpose of lead supervision arrangements is to ensure that, where a group includes a number of different FSA-regulated financial services businesses information about the individual firms is shared within FSA, and a co-ordinated approach taken to their regulation.

Businesses falling within such groups are likely to be subject to lead supervision, depending on their "predominant business" as follows:

- Banks: by Complex Groups/Banks and Building Societies Division.
- Investment business: by Complex Groups/Investment Business Division.
- Insurance: by IFSD.

The lead supervisor will be responsible for:

- Overall assessment of the group's systems, controls and resources.
- Agreeing a co-ordinated supervision programme.
- Co-ordinating a supervisory relationship with the group.

### **Co-operation with FSA and information gathering (SUP 2)**

FSA expects firms to provide information voluntarily and sets out what a firm should do; FSA itself expects to give reasonable notice of such requests. A firm must grant FSA access to its premises, and take reasonable steps to ensure that its material suppliers to whom it has outsourced functions are open and cooperate with FSA (SUP paras 2.2-2.3). FSA may mystery shop a retail firm (SUP para 2.4).

### **Auditor (SUP 3)**

The requirements for a firm to appoint an auditor are contained in SUP Chapter 3. A firm must cooperate with its auditor (SUP para 3.6) and the auditor with FSA (SUP para 3.8). He must provide an annual report to FSA on the audited firm (other than banks/insurers) with prescribed contents (SUP para 3.9,10).

### **Actuary (SUP 4)**

Long term insurers and friendly societies must appoint an actuary (SUP para 4) who must perform prescribed duties.

### **Skilled persons (SUP 5)**

When a firm appoints a skilled person (accountant, actuary, lawyer etc) under s166, the firm must enter into a prescribed form of appointment (SUP para 5.5). In CP91 - Reports by Skilled Persons (May 2001) - FSA amended Chapter 5 of the Supervision Manual, and explained its policy in greater detail.

- FSA will expect to meet the great majority of information needs from firms themselves, and will use its own staff to analyse and assess it. It may, however, need to use its statutory powers in defined circumstances (CP91 paras 3.26 and 3.28).
- FSA may make use of a skilled person for specific purposes, after consideration of the alternatives, and where it considers that this will "add value" (CP91 paras 3.7 and 3.29)
- FSA may nominate a person who has the requisite skills, resources, knowledge and detachment (CP91 para 3.31).

The amended Chapter 5 SUP provides:

- SUP paragraph 5.3 - FSA's policy.
- SUP paragraph 5.4.5 - FSA will normally seek to agree the appointment of a skilled person with the firm itself.
- SUP paragraph 5.5.1 - The firm must cooperate with a skilled person.

- Annex 1G provides guidance on the circumstances when FSA may appoint a skilled person.

### **Notifications to FSA (SUP 15)**

Firms are required to notify prescribed information to FSA including:

- Matters having serious regulatory impact (SUP para 15.3).
- Under Principle 11. SUP paragraph 15.3.7 gives examples of some applicable circumstances including:
  - new business developments,
  - significant systems failure/weaknesses in internal controls,
  - proposed action materially impacting capital adequacy or solvency.
- Significant rule breach (significant in terms of loss, frequency, implications and delay in identification or rectification).
- Offences, breaches of FSM Act, institution of proceedings.
- Fraud, irregularities and insolvency.
- Details regarding overseas firms' notifiable persons (SUP para 15.4).
- Core information requirements (SUP para 15.5).

A firm must take steps to ensure that all information it provides to FSA is accurate, fair and complete and immediately notify FSA where it believes it may have supplied inaccurate, false or misleading information (SUP para 15.6).

Form and method of notification is stated at SUP paragraph 15.7.

### **Provisions of reports to FSA (SUP 16)**

Firms must provide FSA with prescribed reports in a complete and timely fashion to FSA's specified address (SUP para 16.3). These reports include (in summary):

- an annual report about the identity of the firm's controllers (SUP para 16.4);
- an annual report identifying any persons with which the firm has close links (SUP para 16.5);

together with detailed requirements for compliance reports from:

- Banks (SUP para 16.6.4);
- Trustees of authorised unit trust schemes, ICVC depositories and OPS firms (SUP para 16.6.6);
- Firms' financial reports (SUP para 16.7);
- Insurers' annual persistency reports (SUP para 16.8).

### **Transaction reporting (SUP 17)**

Firms which effect (in summary) on-exchange securities transactions must report them to FSA unless:

- They are effected on a designated exchange; or
- Another firm makes appropriate notification.

## **9.4.3 Disclosure of Information by Prescribed Persons Regulations (2001 No. 1857)**

Came into force 18th June 2001.

Schedule Person = performs function under:

- Section 165 (6) verification/authentication of document
- Section 166 Report
- Section 167, 168, 169, 262, 284 investigation.

Scheme Person = manager or operator of ICS or FOS/ombudsman

Schedule Person and Scheme Person:

- may disclose information for discharge of function
- may disclose information to FSA for discharge of public function (which for Schedule Person must be in good faith and reasonably believed to be for stated purpose).

Applies to information received in connection with function under FSM Act:

- relevant information received by Schedule Persons
- the opinions of Scheme and Schedule Persons for both kinds of information
- does not apply to confidential information within Section 348 (2)
- but relevant to Section 353 (3) because disclosure in accordance with Order is not breach of duty.

## 9.5 Transitional provisions

See paragraphs 9 and 10 at section D at the start of this Guide.

## 10. Enforcement

Part XIV sections 205-211; Part XXVI sections 387-396;  
Part IX sections 132-137; Part XXV sections 380 & 382  
Part XXIII sections 347-354; Part XXVII sections 397-403

### Summary:

This section describes in turn:

- FSA's power to take discipline (10.1)
- Procedures relating to giving notices (10.2)
- Injunctions and restitution orders (10.3)
- Compensation Scheme (10.4)
- Miscellaneous Offences
  - making a misleading statement (10.5.1)
  - misleading FSA (10.5.2)
  - Procedural matters (10.5.3)
  - FSA's policy for criminal matters (10.5.4)

- Money laundering (10.5.5)
- Financial Services & Market Tribunal

- Constitution & Procedure (10.6.1)
- Tribunal rules (10.6.2)
- Legal assistance (10.6.3)
- Legal assistance (costs) (10.6.4)

- Protection of confidential information (10.7)
- FSA's Policy & Practice

- Enforcement Manual (10.8.1)
- Decision Making Manual (10.8.2)

- Mediation Scheme (10.8.3)

### 10.1 FSA'S power to take discipline

If FSA considers that an authorised person has contravened a requirement of FSMA

➔ Public censure (s205).

➔ Penalty (s206) (but FSA may not also end authorisation).

FSA may also discipline an approved person – see section 6.7.7

Proposal to take discipline ➔ warning notice ("WN") (s207).

Decision to take discipline ➔ decision notice ("DN") (s208). Authorised person may then refer matter to Tribunal.

FSA must have scheme for applying penalties for benefit of authorised persons, and must consult on this. Penalties may not be determined by FSA's costs. (Sch 1 para 16). FSA's scheme is contained in CP79 and summarised at 1.6.2.

FSA must publish policy on penalties (s210) after consultation (s211).

## 10.2 Procedures relating to giving notices

### **Warning notice ("WN") (s387)**

Must:

- State FSA's proposed action with reasons.
- Draw attention to any right of access to FSA material (s387(1)).
- Give reasonable period (at least 28 days) to make representations to FSA (s387(2)).

FSA must decide within reasonable period (after person's representations) whether to give Decision Notice (s387(4)).

### **Decision notice ("DN") (s388)**

Must:

- State FSA's action with reasons.
- Draw attention to any right of access to FSA material.
- State if person has right to refer to Tribunal (s388(1)).

Action must be under same Part of FSM Act as any preceding WN (s388(2)).

Before taking action, FSA may with person's consent give different DN (s388(3)-(4)).

FSA must give **Notice of Discontinuance** ("NoD") if decides not to take WN/DN action (s389).

FSA must give **Final Notice** ("FN") when it takes action in DN which has not been referred to Tribunal, or when FSA acts as the Tribunal/court directs, together with details of implementation (s390).

### **Supervisory notice ("SN")**

- Is given under prescribed sections (s395(13)) and is separate from disciplinary powers.
- When takes effect, FSA must publish appropriate information (s391(5)-(8)).
- FSA must publish procedures (s395) see 10.

FSA must give **Notice of Discontinuance** ("NoD") if decides not to take WN/DN action (s389).

FSA must give **Final Notice** ("FN") when it takes action in DN which has not been referred to Tribunal, or when FSA acts as the Tribunal/court directs, together with details of implementation (s390).

### **Access to material**

FSA must grant certain recipients of WN/DN (s392) access to material it relied upon plus other material considered/obtained by FSA which might undermine its decision (s394(1)-(6)).

But not:

- Material intercepted under warrant.
- Third party information used for comparative purposes only (s394(2)).
- Legally privileged material (s413) (although FSA must notify of existence (s394(4)).
- If use would be unfair/not in public interest (s394(3)) (though FSA must notify when this is the case (s394(5)).

### **Publicity**

No publication of WN/DN or (without consent) of NoD but FSA must publish appropriate details of FN/SN (s391).

Third party identified in certain (s392) WN/DN should normally be given copy and may refer to Tribunal (s393).

### **Procedures**

FSA must publish procedures for giving WN/DN/SN (s395). See 10.2

Failure to follow procedure will not invalidate the notice but the Tribunal may take such failure into account (s395(11)-(12)).

FSA must consult on procedure (s396).

### 10.3 Injunctions and restitution orders

FSA/HMT may obtain:

- Injunction against future/repeat contraventions of FSM Act, to remedy contravention or to freeze assets (including person knowingly concerned in contravention) (s380).
- Restitution order against a person who has contravened FSM Act/knowingly concerned in contravention. FSA then distributes profits/compensation for loss to affected persons (s382) where that person has made profits or others have suffered because of that person's activity.

Corresponding powers for MA in sections 381 and 383 - 386.

FSA's policy is at ENF 6.6 (injunctions) and ENF 9.6 (restitution).

### 10.4 Compensation scheme

Where widespread/regular failure to comply with rules and private persons may suffer compensatable loss, Treasury may authorise FSA to establish and operate scheme for:

- Investigating.
- Compensating investors (s404).

Order needs positive resolution SI (s429). It has been used for the pensions review – see section 1.6.5. This is quite separate from the FS Compensation Scheme discussed at section 13.

### 10.5 Miscellaneous offences

#### 10.5.1 Substantive Offences - Misleading Statement/Impression (s397)

Offence to:

- knowingly make materially misleading statement; or
- dishonestly conceal material facts; or
- recklessly make statement;
- connected with UK (s397(6));

if done with intent to induce another to deal etc (s397(1)-(2)).

Offence to act intentionally to create false or misleading impression as to market or value of investments to induce another to deal etc connected with UK (s397(3) and (7)).

The **Misleading Statements and Practices Order** (2001 No. 3645) specifies the following activities and investments for Section 397 (9)(a) and (10).

##### **Specified Activities**

- All controlled activities set out in Part 1 Schedule 1 Financial Promotions Order except paragraphs 9, 10 or (so far as relevant) paragraph 11;
- Providing or agreeing to provide funeral plan contracts (FPO 9) (from 1 January 2002);
- Providing or agreeing to provide qualifying credit (FPO 10) (from 1 September 2002);



- Sending dematerialised instructions (FPO 45), establishing a CIS (51), establishing a stakeholder pension (52), or managing a Lloyd's Syndicate (57).

#### **Specified Investments**

- All controlled investments as set out in Part II Schedule 1 Financial Promotion Order except paragraphs 25 and 26;
- Funeral plan contracts (25) (from 1 January 2002);
- Agreements for qualifying credit (26) (from 1 September 2002).

### **10.5.2 Substantive Offences - Misleading FSA**

Offence to give false or misleading information to FSA (s398).

### **10.5.3 Procedural Matters (ss 400 - 403)**

Officer/partner also guilty if company's/partnership's offence is committed with his consent or neglect (s400).

Proceedings may only be instituted by FSA (under HMT restrictions)/HMT/by or with consent of DPP (s401) .

FSA may also institute proceedings (under HMT restrictions) for ID/ML (s402). See 10.5.5.

Unincorporated association proceedings (see ss 400 and 403).

### **10.5.4 FSA's Policy for Criminal Matters**

- Policy for interviews under caution is set out at ENF section 2.14.4.
- Approach to prosecuting criminal offences is set out at ENF section 15.4. FSA may consider concurrent civil or regulatory action. FSA will observe the Code for Crown Prosecutors (ENF section 15.5).

### **10.5.5 Regulations relating to Money Laundering (2001 No. 1819)**

Money Laundering Regulations 1993 prescribed for Sections 168 (4) and (b) and 402 (1) (b) and therefore FSA may investigate possible offences against the Regulations and institute proceedings for those offences other than in Scotland.

## **10.6 Financial services and markets tribunal**

### **10.6.1 Constitution & Procedure**

- Lord Chancellor to make Tribunal rules (s132). Rules addressing procedural matters are contained in the **Financial Services & Markets Tribunal Rules 2001 No. 2476** - see 10.6.2.
- Tribunal constitution is contained in Schedule 13, which provides that the Tribunal:
  - may compel attendance (Sch 13 para 11),
  - decisions must give reasons (Sch 13 para 12),
  - may award costs against FSA if its decision was unreasonable (Sch 13 para 13).
- Person must generally refer matter to Tribunal within 28 days (eg of date of DN) (s133(1)):

- tribunal may consider any evidence (s133(3)),
- tribunal must remit matter to FSA with directions (s133(5)) (within limits (s133(6)-(7)),
- which directions FSA must follow (s133(10)),
- FSA must not act pending final outcome (s133(9)),
- appeal with permission to Court of Appeal (s137).
- Legal assistance may be available for individual who refers matter to Tribunal (Lord Chancellor to make rules) funded by authorised persons through FSA (ss 134-136).
- An authorised person or approved individual is entitled to refer a number of FSA's decisions to the Tribunal, of which the principal ones are as follows.
  - refusal to consent to passport out (Sch 3 para 19),
  - imposition of requirements on permission (s43),
  - cancellation of requirements on permission (s44),
  - prohibition order (ss 57-58),
  - withdrawal of approval (s63),
  - disciplinary action against approved persons (s67),
  - penalty for market abuse (ss 126-127),
  - change of control (ss 183 and 185-187),
  - refusal of application to vary requirement on authorisation (s200),
  - disciplinary action by issue of a decision notice (ss 207-208),
  - refusal to authorise unit trust scheme (s245),
  - revocation of authorisation of unit trust scheme (ss 254-256),
  - recognition of overseas schemes (ss 265 and 269),
  - recognition of other schemes (ss 271 and 280),
  - reapplying general prohibition to individual professional firms (s331),
  - disqualification of auditor or actuary (s345),
  - restitution for market abuse (ss 383-384).

## 10.6.2 Tribunal Rules

The **Financial Services and Markets Tribunal Rules (2001 No. 2476)**

provide as follows:

- an applicant must refer a matter to the Tribunal within 28 days of the date of FSA's notice (4), and may withdraw such reference (14).
- FSA must file a statement of its case in support of the action which is subject of the reference within a further 28 days, accompanied by the documents on which FSA relies, and further material which may undermine FSA's decision to take action (5), but subject to exceptions (8). FSA may accept the applicant's referral and not contest proceedings (14).
- the applicant must reply within 28 days (6) and FSA must within 14 days file any further material which may assist the applicant (7), again subject to exceptions (8)
- the Tribunal may give directions, and hold a pre-hearing review (9). Directions may be as to:
  - oral hearing,

- alteration of time limits,
- suspension of FSA notice which is the subject of the application,
- permit or require production of further information/documentation,
- require witness statements to be filed,
- provide for appointment of expert (10).
- Tribunal may summons witnesses (12) and require production of documents.
- Tribunal may determine reference without oral hearing if directions appointment, or parties agree, or unopposed hearing, and consider whether public pronouncement appropriate (16).
- hearing shall be in public and decisions publicly announced subject to limited exceptions (17, 20).
- subject to the discretion of the Tribunal, parties may be assisted or represented at the hearing (18).
- Tribunal determines its own procedure (19, 26 (3)), and has wide discretion to admit evidence.
- Tribunal may order costs but only against FSA for an unjustified prosecution, and not against the firm or individual being disciplined (21).
- Tribunal may set aside its own decision where new evidence becomes available or Tribunal staff made error no later than 14 days after decision (22).
- appeal lies with permission of Tribunal to Court of Appeal/Court of Session, or with their permission and they may remit matter for rehearing (23-25).

### 10.6.3 Legal Assistance before the Tribunal

The **Tribunal (Legal Assistance) 2001 No. 3632** Order governs the provision of legal assistance where an individual accused of market abuse refers the matter to the Tribunal.

- Procedure for application (4): The application should be accompanied with the reasons why it is in the interest of justice for legal assistance to be granted, together with details of financial resources (plus those of cohabitee, and those of employer or firm where they may be available to applicant) (11).
- Eligibility: The individual must require financial assistance, and it must be in interests of justice that it be granted, for which a detailed test is provided (8-10).
- Assessment of financial resources: this involves consideration of the applicant's (and any other contributor's) capital and income. An assisted person is, in principle, expected to contribute all of his disposable capital greater than £3,000, and 1/36<sup>th</sup> per month of his disposable income greater than £3,110 per annum (11-35). This is refundable in certain circumstances (36).
- The Tribunal will decide the level of legal representation for which the assisted individual will be entitled in accordance with the circumstances of the matter (37-40).
- Legal assistance may be withdrawn by the Tribunal (41,42).

## 10.6.4 Legal Assistance Costs

**The Tribunal (Legal Assistance Scheme – Costs) Order (2001 No. 3633)** addresses remuneration of lawyers representing an individual before the Tribunal on a charge of market abuse under the legal assistance scheme.

There are strict controls on the amount and timing of payments, which must be approved by the High Costs Office. Approval is required for certain disbursements, and interim payments, and the Costs Office can disallow both disbursements and time charges.

The maximum rate allowed for a solicitor providing legal assistance under this scheme is currently £55 per hour, although this can be increased in exceptional circumstances. Rates are also not significantly higher for either Solicitor Advocates/Junior Counsel or Queens Counsel (Schedules 1 and 2).

It is noteworthy that the Government has chosen to remunerate lawyers who provide legal assistance under this scheme at the lowest rates of publicly funded work - that of "legal advice and assistance". Even though this work is likely to be novel and complex, and any appeal lies directly to the Court of Appeal, the level of remuneration is lower than that paid for publicly funded work in a County or High Court.

## 10.7 Protection of confidential information ("CI") (s348)

### 10.7.1 Statutory Provisions

CI = information concerning business/other affairs of any person (s348(2)) received by FSA/investigator etc (s348(5)) in connection with functions of FSA etc and not made public other than in breach of this section. FSA may, however, publish summaries (s348(4)).

Neither FSA nor its recipient may disclose CI without subject's and source's consent (s348(1)) - offence (s352) (defences: ignorance/"Tesco") unless:

- For public function (s349(1)(a) and (5)).
- Under Treasury regulations (s349(1)(b)) - see 10.7.2 below.

Improper disclosure of information gained under competition provisions is also offence (s351 - see 10.8.5).

Inland Revenue may disclose information to FSA/HMT for s168 investigation (s350).

Treasury regulations may permit disclosure of non-CI (s353) – see 10.7.2

Persons may not be required to produce, disclose or permit inspection of certain professional legal adviser documents ("protected items") (s413).

The **Competition Information (Specification of Enactment etc) (2001 No. 1858)** specifies Gas and Electricity Markets Authority for Part I Schedule 19 FSM Act, and Competition Act 1998 and Utilities Act 2000 for Part II. Therefore disclosure of competition information to facilitate performance by GEMA is not improper disclosure under Section 351 (5) FSM Act. Similarly Competition Act and Utilities Act are "specified enactments" under that section and therefore information disclosed for civil proceedings under those enactments is not improperly disclosed.

### 10.7.2 Exceptions to s348 restriction

The **Disclosure of Confidential Information Regulations (2001 No. 2188)** came into effect from 18 June 2001. They have been amended by the **Disclosure of Confidential Information (Amendment) (2001 No. 3437)** and **(Amendment) (No. 2) Regulations (2001 No. 3624)**. They provide exceptions to restriction in Section 348 against disclosure of confidential information. Disclosures of confidential information are therefore permitted:

- by or to FSA, Secretary of State or Treasury in discharging public function (3);
- for purposes of criminal investigation or proceedings in any country (4);

- for certain civil proceedings in stated circumstances. The civil proceedings are:
  - civil proceedings under FSM Act, Banking Act, ICAct and certain other Acts
  - tribunal proceedings
  - civil proceedings to which FSA is party
  - director disqualification and certain insolvency proceedings (5)
- in pursuance of Community obligation (6);
- any restriction imposed when disclosure is made other than to FSA, Secretary of State, Treasury or Bank of England must be observed by that person (7);
- confidential information under Single Market/UCITs directives: FSA may disclose to persons detailed in Schedule for specified purposes (9) who may only on-disclose in stated circumstances (10);
- confidential information which is not Directive information or received by FSA when carrying out Part VI function may be disclosed
  - to person in Schedule for stated function, who may only on-disclose in limited circumstances
  - to a disciplinary proceedings authority (11-12), which may on-disclose in limited circumstances. Prescribed for Section 349(5)(d) in Schedule 3 of the SI are disciplinary proceedings in relation to
    - o professional duties of barristers, solicitors, auditors, accountants, valuers and actuaries
    - o employment matters before tribunals relating to Crown, FSA and certain other statutory employers
    - o transitional provisions apply to confidential information under ICAct, FSAct, Banking Act and SRO rules (13-16).

Confidentiality provisions relating to information provided to, or obtained by the Bank of England from overseas regulators and under companies legislation set out in the **Confidential Information (Bank of England) (Consequential Provisions) Order (2001 No. 3648)**.

## 10.8 Key statements on policy and implementation

These are contained in:

### 10.8.1 Enforcement Manual (June 2001)

The Enforcement Manual sets out how FSA **proposes to use** its enforcement powers, and contains its policies and procedures. The way in which FSA will reach a decision relating to discipline and other matters is contained in the Decision Making Manual (DEC), discussed at 10.8.2.

The contents of the Enforcement Manual are discussed as follows:

Section of Manual	Section in this Guide
2 – Information gathering	9.4.1, 12.10.4
3 - FSA's intervention of Part IV permission	5.6.3
4 – Intervention against incoming firm	4.5
5 – Cancellation of Part IV permission	5.4
6 – Injunctions	10.3
7 - Withdrawal of approval	6.3
8 - Prohibition of individuals	6.4
9 - Restitution and redress	10.3
10 - Insolvency proceedings	21.2.2
11 – Discipline	6.7.4, 10.8.2
12 – Discipline	6.7.4, 10.8.2
13 – Discipline	6.7.4, 10.8.2
14 - Sanctions for market abuse	11.3, 4
15 - Prosecution of criminal offences	10.5.4
16 - Collective investment schemes	12.10.3
17 - Disqualification of auditors and actuaries	20.2, 20.4
18 - Disapplication orders against members of professions	19.4

FSA sees effective and proportionate use of its disciplinary powers as playing an important role in its pursuit of regulatory objectives. Financial penalties and public statements demonstrate that regulatory standards are being upheld and helps fulfil FSA's four statutory objectives (ENF para section 11.2).

It may be appropriate to address breaches of rules or other requirements without disciplinary action but, where necessary, FSA will seek to exercise its enforcement powers **consistently and fairly**.

- FSA states (ENF section 11.1) that it has **other powers** to take protective or remedial action, including:
  - vary/cancel firm's permission
  - withdraw firm's authorisation
  - withdraw individual's approved status
  - prohibit individual from performing a specified activity.
- FSA may give a **private warning** rather than take disciplinary action in appropriate circumstances (ENF section 11.3).
- FSA's **criteria for deciding whether to take disciplinary action** are set out at ENF section 11.4. As under the FSAct 1986 they are:
  - nature and seriousness of breach,
  - conduct after the breach,
  - previous regulatory record,
  - any guidance given by FSA,

- action taken by FSA in previous similar cases,
- concurrent action by other regulators (see also ENF section 11.8).
- FSA can take disciplinary action for **breach of Principles** (ENF section 11.6).
- ENF section 11.7 explains the **standard of reasonable care**, relevant when a rule imposes this obligation.
- ENF section 11.9 is relevant to discipline for **money laundering**.
- In deciding whether to **publish a statement** of misconduct, FSA will consider the criteria at ENF section 12.3. They are similar to the criteria for deciding whether to **impose a fine** at ENF section 13.1, and are principally concerned with the seriousness of the offence. They are also similar to those used under the FSAct 1986. They are:

**Factors relevant for public censure rather than fine (12.3)**

- Did the firm/individual benefit from the breach?
- How serious was the breach?
- Has the firm/individual been open and cooperative with FSA?
- Has the firm/individual fully compensated investors?
- What is the firm's/individual's compliance record?
- How has FSA previously handled similar cases?
- What are the firm's/individual's financial resources?

**Factors relevant to level of fine (13.3)**

**In addition** to the factors set out above:

- How serious was the breach in relation to the relevant requirement?
- What was the duration and frequency of the breach?
- Did it reveal systemic weaknesses?
- How did it impact markets?
- Was there resulting loss or risk of loss?
- Was the breach deliberate or reckless?
- What remedial steps have been taken?
- Have other regulators taken action?

## 10.8.2 Decision Making Manual (DEC) – Final Text (Policy Statement May 2001)

This Manual principally provides guidance on FSA's decision making and other procedures for giving statutory notices. These are : **Warning Notices** when FSA proposes to take action (section 387), **Decision Notices**, which set out action FSA has decided to take (section 388), **Notices of Discontinuation**, where FSA has decided to halt action set out in a Warning or Decision Notice (section 399), **Final Notices**, which set out terms of FSA's action and date it takes effect (section 390) and **Supervisory Notices**, which detail action FSA has taken or proposes to take in relation to 7 defined circumstances - see Annex 3G (section 395). Annexes 1G and 3G list the circumstances when Warning, Decision and Supervisory Notices may be given, other than under Part VI.

Annexes to the Policy Statement contain **specimen Notices** and **procedural flow charts** as follows:

- Annex 2G: Issue of a Warning Notice and a Decision Notice in relation to an application
- Annex 3G: Issue of a Warning Notice and a Decision Notice in a non-application case

- Annex 4G: Issues of a Warning Notice and a Decision Notice in relation to change of control
- Annexes 5G & 6G: Draft Notices
- Annex 2G: Issue of a Supervisory notice
- Annex 3G: Specimen Supervision Notice

FSA will also make regulatory **decisions outside section 395** which do not require statutory notices. This will include decisions in relation to permissions, waivers, guidance, and day to day decisions. FSA's general policy is to be taken at an appropriate level of seniority (DEC 1.2.8 – 10).

### **Procedure for issue of a Statutory Notice**

FSA's procedure for issuing warning notices/decision notices is set out as follows, and tracks the provisions of the FSM Act:

- If FSA staff consider that action is appropriate, they will recommend to the relevant decision maker that a Warning Notice is given (DEC 2.2).
- The procedure for the issue of Decision Notices (DEC 2.3), Further Decision Notices (DEC 2.3.6), Notices of Discontinuation (DEC 2.3.8) and Final Notices (DEC 2.3.10) are also set out.
- Third party rights and access to FSA material are detailed at DEC 2.4. These track the FSM Act and do not confer further rights.
- FSA's guidance on the issue of Supervisory Notices (DEC 3.1) follow the text of the FSM Act.

### **A typical procedure involving issue of a Statutory Notice will therefore be**

- (i) FSA staff recommend action;
- (ii) FSA decision maker
  - RDC for certain action
  - FSA staff/committee for all other actions
 decides whether or not to take action;
- (iii) Warning or first Supervisory Notice issued;
- (iv) Recipient may make representations to FSA decision maker. Parties may also mediate - see 10.8.3 below.
- (v) FSA decision maker can:
  - proceed with Decision/second Supervisory Notice;
  - take no further action – issue Notice of Discontinuance;
- (vi) Recipient may accept FSA's determination and agree to fine. FSA cannot seek to recover its costs.
- (vii) Recipient may refer matter to Tribunal;
- (viii) If Tribunal upholds FSA's case, FSA will issue Final Notice. Tribunal cannot award costs against the recipient.



## Decision Making

- The Regulatory Decision Committee ("RDC") has responsibility for statutory notice decisions and associated decisions (such as granting further time for representations, or grant of access to material) in specified circumstances only (DEC 4.1.4, 5, 7). It also decides (other than when urgent) when to prosecute for a criminal offence, or to apply to a civil court (DEC 4.6).
- The RDC is an FSA Board Committee and accountable to it for its decisions. It has an employed chairman but is otherwise outside the FSA management structure (DEC 4.2). It will meet in private. Its constitution is set out at DEC 4.2.8.
- Statutory Notice Decisions which do not need to be taken by the RDC, and all other decisions, will be taken under FSA executive procedures (DEC 4.1.6, 8). This means that relatively junior staff may make them (DEC 4.3.4). The decision maker must be named on a statutory notice (DEC 4.3.13). Decisions can also be made by a senior staff committee (DEC 4.3.8).
- The need for a Statutory Notice issued under executive procedures to be issued by an FSA officer other than the evidence-gatherer (DEC 4.3.2, 4.3.17-19), and for the avoidance of conflicts internal to FSA (DEC 4.3.16), are addressed.
- Representations can be made in response to a Warning Notice/first Supervisory Notice (DEC 4.4.1). Representations can be written or oral, and can be made by a legal representative (DEC 4.4.8). A request for extension of time for making representations can be made (DEC 4.4.4).
- The RDC has delegated certain statutory notice/associated decisions to its Chairman/FSA staff (DEC 4.5.1) including:
  - Financial penalties for late submission of reports
  - Revocation of recognition of schemes
  - Urgent Supervisory Notices
  - Imposing requirements by consentand in these circumstances RDC procedure is modified accordingly
- A firm's right to refer matters to the Tribunal (generally upon receipt of a Decision or Second Supervisory Notice) is summarised at DEC 5.1.
- FSA is required to publish Final Notices and Supervisory Notices when they take effect (5.2)
- The service of notices by FSA is addressed at 5.3.

### 10.8.3 Mediation Scheme for FSA Disciplinary Actions

This Scheme is contained in DEC Appendix 1. A person subject to enforcement action **may discuss the matter** with FSA before or after issue of the Warning Notice (1.1).

**Written terms of settlement** will be considered by the RDC which, after requesting further information if needed, may accept or reject them. If the RDC accepts the terms of settlement, it will issue a Decision Notice or a Notice of Discontinuance. If the RDC reject the terms of settlement, it may invite further discussions, or otherwise give a Decision Notice (1.2.1-4).

Alternatively, if settlement is not reached, the person may **submit to mediation** (1.2.5) before a neutral independent mediator (1.5) who facilitates discussions (1.3.1). This is a one year pilot, and its operation will be reviewed after this period (1.12).

**Mediation is available** (but not obligatory) at a time between the issue of a Warning Notice and a Final Notice in disciplinary and market abuse cases which do not involve allegations of criminal offences, issues of not being fit and proper because of dishonesty and lack of integrity, or FSA's own initiative variation of permission (1.4). **Mediation is commenced** by FSA offering

the facility (1.6.1) and the parties jointly agreeing to use their best endeavours to advance mediation. FSA will agree fees with the mediator who will invoice both parties in advance (1.7.11). Either party may withdraw from or terminate mediation at any time (1.9.3).

The mediation provider will appoint a mediator (1.7.2) and set a date and timetable (1.7.3). The RDC may grant a **maximum 28 day extension** for a mediation (1.6). It is envisaged that mediations will generally not last longer than one full day. The mediation agreement will provide that it is confidential, subject to stated exceptions, and the parties **must have authority** to agree a proposed settlement, save that the RDC must approve any settlement on behalf of FSA (1.7.7,8; ENF 6.6.9G). A representative of the RDC will normally be available by telephone during the course of the mediation (1.7.9).

FSA will normally be **represented** by the enforcement staff who decided to take the disciplinary action (1.7.9). If the RDC declines to accept the outcome of the mediation, it may consent to continuing mediation. A firm's advisers may attend the mediation (1.11).

The **result of the mediation** will normally be:

- A proposal for settlement agreed between the parties. This will be laid before the RDC which can either issue a decision notice or a final notice (1.10.4). Strangely, this does not envisage issue of a Notice of Discontinuance.
- No agreed proposal, in which case the RDC will proceed to issue a Decision Notice.

## 10.9 Transitional provisions

See paragraph 10 at Section D at the start of this Guide.

## 11. Market Abuse - Part VIII sections 118 - 131

### Summary:

Market abuse ("MA") is a new civil offence for which FSA can take what is, in effect, disciplinary action. It is constituted by three elements. FSA has published a Code of Market Conduct (MAR). This section discusses:

- The three elements of market abuse (11.1)
- Safe harbours (11.2)
- Penalties (11.3)
- Further enforcement powers (11.4)
- FSA's criteria for taking action (11.5.1)
- Code of Market Conduct (11.5.2)

### 11.1 The three elements of Market Abuse

#### 11.1.1 First element

**Behaviour** (action or inaction) (s118)

- By authorised/unauthorised person.
- Includes dealing - arranging - managing - advising - making statements (MAR 1.3).
- Alone/jointly/in concert.
- In UK/in relation to investments traded on UK market or accessible electronically in UK (s118(5)) (specified in Treasury Order (s118(3))). The **FSM Act 2000 (Prescribed Markets and Qualifying Investments) Order 2001 (SI 2001 No. 996)** and **Amendment Order (2001/ 3681)** prescribed:
  - all markets established under the rules of a UK Recognised Investment Exchange (under s290(1)(a)). These are:
    - Jiway
    - London Stock Exchange
    - Virt – x
    - COREDEAL
    - IPE
    - LIFFE
    - LME
    - OFEX
    - OM London Exchange
- all investments specified under the **FSM Act 2000 (Carrying on Regulated Activities by way of Business) Order 2001**; see 2.2.3.

### 11.1.2 Second Element

In relation to **qualifying investments** (specified in Treasury Order (s118(3)). See MAR 1.11). This is wide and includes:

- The qualifying investments themselves.
- Investments which are the subject of the qualifying investments (ie the shares underlying a derivative).
- Investments which, while not qualifying investments themselves, invest in or include qualifying investments.
- Anything whose price or value is expressed by reference to a qualifying investment (s118(6)).

### 11.1.3 Third Element

**Which is: (a) + (d) or (b) + (d) or (c) + (d) (s118)**

- (a) Behaviour based on information not generally available (cannot obtain by market users' research or analysis (s118(7))), but regular user would regard as relevant when dealing (s118(2)(a)).
- (b) Behaviour likely to give regular user false or misleading impression of supply/demand/price/value of those investments (s118(2)(b)).
- (c) Behaviour regular user would regard as likely to distort the market in those investments (s118(2)(c)).
- (d) Which regular user would regard as failure to observe a reasonable standard of market behaviour (s118(1)(c)).

The regular user is a reasonable person who regularly deals on that market in those investments (s118(10)).

## 11.2 Safe harbours

Conformity to an express rule is not MA (s118 (8)). FSA has made price stabilising rules at MAR 2.

FSA must issue Code to give guidance on MA (s119) (see para 11.5.2 below):

- May cross refer to City Code (s120); see MAR 1.7.4
- Must follow consultation (s121).
- Code may be relied upon (s122). In other words, a person who observes the terms of the Code will not be liable to proceedings for MA.

## 11.3 Penalties

FSA may impose penalty/statement on person for (s123):

- engaging in MA (s123(1)(a));
- requiring/encouraging (by action/refraining) another to engage in behaviour which, if done by him, would be MA (s123(1)(b)) (See MAR 1.8);

unless FSA is satisfied that:

- he had reasonable grounds to believe behaviour is not MA (s123(1)(a)-(b)); or
- "Tesco" - defence applies (s123(2)).

FSA must follow WN/DN procedure (ss 126-127).

Imposition of penalty for MA does not impact the subject transaction (s131).

FSA must publish statement of policy on MA penalties (s124) (see para 11.7.1 below):

- Including guidance on section 123(1)(a)-(b).
- After consultation (s125).

Treasury may issue guidance on conduct which is both MA and insider dealing (s130).

## **11.4 Further enforcement powers**

FSA may:

- Seek injunction against occurrence/continuance of MA (s381(1)).
- Seek order for remedial action (s381(2)).
- Seek injunction restraining disposal of assets (s381(4)).
- Seek restitution order (s383).
- Itself require restitution (s384) against authorised person, in which case WN/DN procedure will apply (ss 385-386).
- When seeking sections 381 or 383 order, request court to impose MA penalty (s129).

## **11.5 Key statements on policy and implementation**

### **11.5.1 FSA's Criteria for Taking Action**

FSA may commence criminal prosecution rather than proceed for MA in serious cases; factors which FSA may take into account are set out at ENF section 15.7.

Factors relevant to FSA's decision whether to take action for MA are set out at ENF section 14.4 and are:

- The nature and seriousness of the behaviour.
- The conduct of the person after the behaviour.
- The degree of sophistication of the users of that market.
- Action taken by other regulatory authorities.
- FSA's action in previous similar cases.
- The impact that a penalty may have on financial markets or the interests of consumers.
- The likelihood of recurrence of the behaviour.
- The person's disciplinary record and compliance history.

Factors for determining whether to impose a financial penalty are at ENF section 14.5 and reflect section 123(2).

Factors relevant to:

- Whether to make a public statement rather than impose a financial penalty are at ENF section 14.6.
- Level of financial penalty are at ENF section 14.7.

## 11.5.2 Code of Market Conduct (MAR)

**CP59 (July 2000)** summarises FSA's stance and contains the draft **Code of Conduct**; the final version of the Code was made in July 2001.

- The UK's position as a leading global financial centre stems from open markets and good reputation. MA will undermine market confidence - users must not be unreasonably disadvantaged by MA (CP59 para 1.1).
- Code creates benchmark, rooted in market standards through consultation and "regular user" test (CP59 para 2.11). Regular user will only tolerate acceptable, not accepted, behaviour (CP59 para 6.6) and will take compliance into account (CP59 paras 6.7, 6.10, 6.15 and MAR 1.2).
- Normal market practices will generally not amount to MA provided behaviour meets standards reasonably expected by the regular user (CP59 paras 6.9, 6.13 and 6.16). A mistake is unlikely to fall below these standards provided reasonable care is taken to prevent and detect its occurrence (MAR 1.2.6).
- Focus is on effects, not intention (CP59 para 6.14, MAR 1.2.5).

The Code of Conduct provides as follows. A person who observes the Code will not be proceeded against for MA.

### (a) **Misuse of information (MAR 1.4)**

There are three elements to this, which are as follows:

#### (i) **You have information which is not generally available (MAR 1.4.5)**

Information *is* generally available if:

- You obtain it by research and analysis (therefore front running is not MA (CP59 para 6.38)).
- You obtain it from public records.
- You obtain it by observation.
- You obtain it through accepted market channels.

#### (ii) **A regular user must consider the information relevant (MAR 1.4.9)**

- The more specific/precise/material/current/reliable/novel the information is, then the more likely it is to be considered relevant by a regular user.
- Examples would include information about a company's business, the production of a commodity or a government statistic.

#### (iii) **The information is of a kind which a regular user must expect to be disclosed on the market (MAR 1.4.12)**

Examples of this would be:

- Information which is usually announced on that market.
- Information which is disclosed in accordance with legal or regulatory obligations, such as a company's trade reporting obligations, or a major new development.

Although there is no expectation that all information is known equally and simultaneously across a market (CP59 para 6.24).

#### (iv) **You then make use of this information (MAR 1.4.4)**

For example:

- You deal in the investment or product on the basis of this information.
- You require or encourage another person to do so.

(v) **Safe harbours (MAR 1.4.19)**

You will not be committing MA, even though elements (i) to (iv) are present, in any of the following circumstances:

- (a) You are required to deal, either by law or by pre-existing contractual obligation.
- (b) You have decided to deal before you became aware of the information.
- (c) You were not influenced by the information.
- (d) You were not aware of the information because of an established and effective Chinese wall within your organisation (MAR 1.5.27)
- (e) You deal based on information as to your or anyone else's dealing intention.
- (f) You facilitate a take-over bid.
- (g) You enter into an underwriting agreement.

**(b) False or misleading impression (MAR para 1.5)**

Your behaviour must be likely to give a regular user a false or misleading impression that the volume/price/value of an investment had been determined by normal forces of supply and demand when this is not, in fact, the case. There must be real likelihood that your behaviour will have this effect. Factors to be taken into account are set out at MAR 1.5.5. Safe harbours are listed at MAR 1.5.23 and 1.7.4 (takeovers).

There are four ways in which a false or misleading impression may be given, which are as follows:

(i) **You make an artificial transaction (MAR 1.5.8)**

An artificial transaction is one of which the principal effect is artificially to inflate/depress the apparent supply, demand, price or value of an investment so as to give a false or misleading impression to a regular user.

The Code gives factors at MAR 1.5.11. Examples of artificial transactions can include wash trades, fictitious trades, back to back trades. See MAR 1.5.14.

The transaction will not, however, be artificial if the real - ie predominant and substantive - motivation is a legitimate commercial rationale see MAR 1.5.24. Examples could be:

- An arbitrage trade.
- Position taking.
- A tax driven transaction.
- Hedging.
- A portfolio cross trade.
- Market making.

(ii) **You intentionally disseminate information which you know or ought to know is false or misleading (MAR 1.5.15)**

An example would be deliberately circulating a market rumour.

A relevant factor is whether you have an interest in the investment.

There are safe harbours at MAR 1.5.25, 27.

- (iii) **You carelessly disseminate information through an official channel likely to give a regular user a false or misleading impression (MAR 1.5.18)**

There is no need for intention, and examples could include:

- Issuing a press release in the wrong name.
- Putting a decimal point in the wrong place.
- There are safe harbours at MAR 1.5.25, 27.

- (iv) **Conduct of which the principal effect is likely to create a false or misleading impression to a regular user (MAR 1.5.21)**

There must be a real likelihood that it will have this effect (CP59 para 6.58).

This test will not be met if the principal rationale of the transaction is legitimate.

**(c) Distortion (MAR 1.6)**

**Engaging in a course of conduct which a regular user would regard as distorting the market**

A regular user must regard the behaviour as distorting. There must be a real likelihood that the behaviour will have this result (MAR 1.6.4). MAR 1.6.4,6 give examples of conduct FSA considers is not distortion.

Examples of distortion include:

- Price positioning: you have a contract and take a position with a view to increase or depress prices artificially (MAR 1.6.8).
- An abusive squeeze with the intention of distorting settlement prices in your favour (MAR 1.6.13).

### 11.5.3 Price Stabilising Rules (MAR 2)

Compliance with these rules is not market abuse pursuant to s118 (8) FSM Act. They apply to an offer for cash of securities traded on specified exchanges (MAR 2.1) and set out permitted stabilising conduct (MAR 2.2, 2.4) subject to fulfilling stated requirements (MAR 2.3 – 2.7).



## 12. Collective Investment Schemes - Part XVII sections 235 - 284

### Summary:

A Collective Investment Scheme ("CIS") is a fund with two principal characteristics – pooling of investors' contributions and management by a third party. This section covers:

- Relevant definitions (12.1)
  - CIS Order, which exempts specified arrangements from the definition of CIS (12.1)
- Restrictions on promoting a CIS (12.2)
  - exemptions from this restriction (12.2.1)
- Obtaining authorisation for a unit trust scheme (12.3)
- Obtaining authorisation for an OEIC (12.4)
- Obtaining recognition for non-UK CISs (12.5-8)
- Powers to investigate a CIS (12.9)
- FSA's rules
  - CIS Sourcebook (12.10.1)
  - Relevant parts of COB Sourcebook (12.10.2)
  - FSA's policy on enforcement in relation to CISs (12.10.3)

### 12.1 Definitions

**CIS** (s235) - unchanged from s75 FSAct. HMT order may exempt (s235(5)) - see 12.1

**OEIC** (s236) means CIS which satisfies (HMT may amend definition (s235(5)):

- Property condition: belongs to/managed by company with risk spreading objective (s236(2)).
- Investment condition: realisability and valuation (s236(3)).

FSA provides guidance on the meaning of these conditions in AUTH App 2.

**UTS** (s237).

**Authorised UTS** = under s243.

**Authorised OEIC** = under s262.

**Recognised scheme** = under s264 (EEA), s270 (designated), s272 (individually recognised).

#### 12.1.1 Collective Investment Scheme Order (2001 No. 1062)

This Order details 21 arrangements which are not collective investment schemes. They correspond to existing exclusions save where indicated. Articles 9, 18 and 21 have been amended by the **Miscellaneous Provisions Order (2001 No. 3650)** Article 2.

- individual investment management agreements (1).
- Enterprise Initiative Schemes (2).
- deposit based schemes (3).
- not operated by way of business (4).
- debt issues (5).
- common accounts (6).
- leasehold trust funds (7).

- employee share schemes (8).
- schemes entered into for commercial purposes (9).
- group schemes (10).
- franchise arrangements (11).
- trading schemes (12). This is a new exclusion.
- timeshare schemes (13). This is a new exclusion, but previously considered to fall within equivalent of (14).
- schemes relating to the use or enjoyment of property (14). This has been narrowed to exclude currency and specified investments.
- schemes relating to certificates representing securities (15).
- clearing services (16).
- contracts of insurance (17).
- FPCs (18), whether or not regulated. This is a new exclusion.
- individual pension accounts (19). This is a new exclusion.
- occupational and personal pension schemes (20). The exclusion of personal pension schemes is new.
- bodies corporate, but not limited liability partnerships (21).

## 12.2 Restrictions on promotion (s238)

Authorised persons may not communicate inducement/invitation to participate in CIS (s238(1)) except:

- Authorised UTS, Authorised OEIC, Recognised scheme (s238(4)).
- Under FSA Rules for promotion other than to general public (s238(5) - see 12.2.1 below).
- Under HMT order (s238(6) - see 12.2.1 below).
- Under HMT regulations for single property schemes (s239).

If communication originates outside UK, (s238(1)) applies only if capable of having effect in UK(s238(3)).

Authorised person may not approve under section 21 if prohibited under section 238 (s240).

Authorised person liable for BSD (s150) for contravention of sections 238 or 240 (s241).

### 12.2.1 HMT Exemption Order ("HMTEO"): FSM Act 2000 (Promotion Of Collective Investment Schemes) (Exemptions) Order 2001/1060

Scheme promotion restriction under section 238(1) does not apply as follows. Note: definitions are substantially the same as in Financial Promotions Order (see 3.5).

#### Overseas business

- A communication (but not an unsolicited RTC) made (from inside or outside the UK) to a **person outside the UK** (HMTEO para 8).
- A communication (but not an unsolicited RTC) directed (from inside or outside the UK) only **at persons outside the UK**. This is subject to qualifications (HMTEO para 8).
- An unsolicited RTC falling within either of the preceding two categories only if made from a place outside the UK and relating to an **overseas scheme** (HMTEO para 8).

- A solicited RTC made from outside the UK and relating to an **overseas scheme** (HMTEO para 9).
- A non-RTC or unsolicited RTC made from outside the UK by an authorised person to a **previously overseas customer** about an overseas scheme (HMTEO para 10).

#### Other exemptions

##### Media related

- Communications to persons who **place advertisements** (HMTEO para 17).
- Communications to persons who **disseminate information** (HMTEO para 20).
- Communications back to **advertisers** (HMTEO para 28).

##### To particular persons

- Communications to **investment professionals** (ie authorised and exempt persons, dealers and public authorities) (HMTEO para 14).
- Non-RTC/solicited RTC to **existing participants** in an unregulated scheme (HMTEO para 18).
- Communications within corporate **groups** (HMTEO para 19).
- Non-RTC/solicited RTC to certified **high net worth** individuals (HMTEO para 21).
- Communications to **substantial bodies corporate**, etc (HMTEO para 22).
- Communications to certified **sophisticated investors** (HMTEO para 23).
- Non-RTC/solicited RTC to **associations** of those falling within (HMTEO paras 21-23).
- Communications between settlors, trustees and beneficiaries on **trust** business (HMTEO paras 25-26).
- Where the communicator reasonably believes the recipient **understands the relevant risks** and would expect to be contacted in relation to the scheme (HMTEO para 28A added by 2001/2633).

##### Particular situations

- Authorised person's **follow up** non-RTC/solicited RTC to first communication exempt from scheme promotion restriction (HMTEO para 11).
- RTC made to **introduce** recipient to authorised or exempt person in relation to units in an unregulated scheme (HMTEO para 12).
- **Generic** promotions (HMTEO para 13).
- **One-off** non-RTCs and solicited RTCs (HMTEO para 15).
- Communications required or authorised by **other enactments** (HMTEO para 16).
- Communications relating to **Ombudsman** remedies (HMTEO para 27).

## 12.3 Authorised unit trust schemes

Manager and trustee apply to FSA as specified (s242).

Authorisation order (within 6 months - s244) if FSA satisfied with (among other things):

- Manager and trustee are EEA incorporated and have UK place of business.
- Both authorised and with permissions.
- Scheme complies with Rules (s243).

Proposal to refuse → WN/DN procedure (s245).

FSA will issue certificate for passporting out on request (s246).

FSA may make:

- trust scheme rules which are binding on manager, trustee and participants (s247);
- scheme particulars rules (s248);

which it may modify or waive on request as under s148 (s250).

FSA approval required to change manager or trustee or alter scheme. WN/DN procedure applies to refusal (ss 251(4) and 252).

FSA may revoke authorisation:

- Section 243 no longer satisfied/contravention/dormant/desirable (s254).
- Follow WN/DN procedure for revocation order (s255).

Manager or trustee may request revocation; refusal → WN/DN procedure (s256).

FSA may intervene (grounds as for revocation) and require cessation of issue/redemption or winding up (s257) and may apply to court to replace manager or trustee or to wind up (s258). FSA may revoke direction (s261).

Procedure: FSA proceeds by supervisory notice (ss 259 and 261).

Manager/trustee may seek revocation/variation (s257 (6)) which, if refused → WN/DN procedure (s260).

## 12.4 Authorised OEICS

HMT may make regulations for Authorised OEICS (s262), which require positive resolution SI (s429(2)).

## 12.5 Recognised overseas schemes

CIS constituted in another EEA state (contract/trust/OEIC (s264(5))) is a recognised scheme (s264) if:

- Gives prescribed information to FSA 2 months before commencing marketing (s264(1)) (see 12.5.1)
- Plus home certificate, UK place for service and prescribed information (s264(3)).

But not if FSA objects within 2 months about method of marketing (s264(2) and (4)) and if FSA not withdraw objection after representations → DN (s265).

Only financial promotion and UK facilities (s283) rules apply to operator, trustee or depository of Recognised Scheme (s266).

FSA may suspend promotion for breach of financial promotion rules (s267); procedure: FSA proceeds by SN procedure (s268); if operator seeks variation or revocation and refused → WN/DN procedure (s269).

### 12.5.1 Collective Investment Schemes Constituted in Other EEA States (2001 No.2383)

This Order sets out the requirements which a CIS must satisfy if it is to be recognised under Section 264. It must be a UCIT subject to that Directive. The Order also sets out the documents which must accompany a section 264(1) notice.

## 12.6 Schemes from designated territories

CIS which is not recognised EEA scheme is a recognised scheme (s270(1)) if:

- Managed and authorised in territory designated by HMT (equivalent investor protection plus regulatory cooperation (s270(2)) as reported on by FSA (s270(5)).
- Scheme is of class in HMT order.
- Written notice given to FSA which gives UK place of service plus prescribed information (s270(6)).
- FSA approves/no WN within 2 months (s270(1)).

FSA refusal: WN/DN procedure (s271).

## 12.7 Individually recognised schemes

FSA may declare other non-UK CISs recognised (s272(1)) if fulfil stated criteria in sections 272 (2)-(15) and 273).

Apply as FSA directs with UK place of service (s274).

FSA must determine within 6 months (s275); refusal → WN/DN procedure (s276).

FSA must approve certain alterations (s277).

## 12.8 Designated territory and individually recognised schemes

FSA may make rules for:

- Scheme particulars (s278).
- Operators to maintain UK facilities (s283(1)).
- Provision of information (s283(2)).

If contravention/non-compliance/desirable, FSA may:

- Revoke recognition (s279) by WN/DN procedure (s280)
- Temporarily withdraw recognition (s281) by SN procedure in s282.

## 12.9 Investigations

FSA/Sec of S may appoint investigator into:

- authorised UTS;
- recognised Scheme;
- any other CIS (but not an OEIC);

who may also investigate connected persons (s284).

## 12.10 Key statements on policy and implementation

### 12.10.1 Collective Investment Scheme Sourcebook - CP62 August 2000 And CP85 - Policy Statement February 2001

This Sourcebook applies principally to:

- Managers and trustees of Authorised UTs.
- ICVCs (UK authorised OEICs) and their directors and depositories.

It makes few substantive changes to current regulations, but:

- Seeks to align the current Regulated Scheme and OEIC Regulations.
- Consolidates these two sets of regulations and effects some rationalisation.

FSA has indicated that there is likely to be a one year transitional period after N2 while firms may continue to rely on the existing regulations.

Like the current Regulations the Sourcebook addresses a wide range of topics, including:

- Constitution.
- Investment and borrowing powers.
- Single and dual pricing and dealing.
- Valuation.
- Charges.
- Income.

### 12.10.2 FSA's Conduct of Business Rules

Rule 3.11.2 permits a firm to communicate an invitation or inducement to participate in an unregulated CIS in stated circumstances:

- Current or recent participants in a UCIS.
- A previously obtained customer for whom the CIS is suitable.
- An exempt person.
- An intermediate customer.

Plus, in specified circumstances, a CIS for charities, employees and Lloyd's.

### 12.10.3 Enforcement

FSA's policy on:

- Section 284 investigations - see ENF section 2.9.
- Section 254 (revocation), section 257 (intervention) and section 258 (court application) - see ENF section 16.2.10.
- Section 267 (suspension of promotion of recognised scheme) - see ENF section 16.4.3.
- Section 279 (revocation) and section 281 (suspension of recognition) - see ENF section 16.4.7.

A table of FSA's powers and procedures is set out at ENF 16 Annex 1G

### 12.11 Transitional provisions

The "grandfathering" of collective investment schemes at N2 is discussed at paragraph 4.5 of Section C at the start of this Guide. For pre-N2 authorisation of OEICs, see paragraph 10.

## 13. Financial Services Compensation Scheme - Part XV sections 212 - 224

### Summary:

FSA must establish a compensation scheme to compensate certain investors when authorised persons are in default.

This section summarises:

- FSA's duty to establish compensation scheme (13.1)
- Financial Services Compensation Scheme Rules (13.2.1)
- FSCS Finding Rules (13.2.2)
- Transitional Provisions (13.2.5)

### 13.1 Main provisions

FSA must establish scheme for compensation where authorised persons/ARs (but not necessarily EEA firms (s213(10) - see 13.2.4) are or are likely to be unable to satisfy claims (s213(1)).

Scheme rules are prescribed by sections 214-217.

Scheme manager:

- Is independent of FSA (s212(5)).
- Must publish annual report (s218).
- Has right to necessary information and documents from firm/AR against whom claim made (or its insolvency practitioner) (ss 219, 220 and 224).
- And staff have statutory immunity bar bad faith/breach of HRA (s222) and are not Crown servants (s212 (6)-(7)).

FSA also has the power, on Treasury authorisation, to establish an ad-hoc compensation scheme – see 10.4.

### 13.2 Key statements on policy and implementation

#### 13.2.1 Financial Services Compensation Scheme Rules (Policy Statement September 2001)

The key policy changes on compensation from pre-N2 are (CP58 para 1.7):

Protected claim	Pre-N2 limits	FSCS limits (COMP 10.2)
Deposits	£18,000 (90% of £20,000)	£31,700 (100% of first £2,000 and 90% of next £33,000)
Investments	£48,000 (100% of £30,000 and 90% of next £20,000)	£48,000 (100% of £30,000 and 90% of next £20,000)
Long-term insurance	at least 90% of value attributed to policy, including future benefits declared before date of default	at least 90% of remaining value attributed to policy, including future benefits declared before date of default
General Insurance	Compulsory: 100% of valid claim/unexpired premiums	Compulsory insurance: 100% of valid claim  Non compulsory insurance:

	Non compulsory: 90% of valid claim/unexpired premiums	100% of the first £2,000 of valid claim and 90% of remainder of claim
--	--	---

- **Application** – all firms, but not incoming EEA banking/investment firms covered by home state schemes, unless they choose to top-up under COMP 14 (COMP 1.4.1). See 13.2.4.
- The **duties** of FSCS are set out at COMP 2. It will **pay compensation** to an eligible claimant (see (i) below) or his representative (COMP 3.2.2) in stated circumstances (COMP 3.2). These are as set out at (i) – (viii) below.
- FSCS must **secure continuity of long term insurance cover** if reasonably practicable (COMP 3.3.1), and take appropriate measures to safeguard claimants in insolvent insurers (COMP 3.3.3).
- FSCS may **reject applications** for compensation, and **withdraw offers** of compensation (COMP 8). It must **pay a proper claim promptly**, but may **postpone payment** in stated circumstances (COMP 9). FSCS' duties of **payment** are at COMP 11 and method of **calculation** at COMP 12.

In order to receive compensation, an investor must be (COMP 1.3):

- (i) **An eligible complainant** who is any person outwith 14 classes. They are, in summary (COMP 4.2):
  - All private customers (other than companies or partnerships that are large companies or large partnerships) will be eligible claimants, whatever type of claim they have.
  - Intermediate customers will be eligible claimants where they claim compensation in respect of long term insurance contracts, or liabilities subject to compulsory insurance. In addition, certain types of market counterparty (such as small authorised persons) can claim compensation for deposits and in respect of general insurance contracts. And authorised persons who are sole traders or small businesses will be eligible claimants whatever type of claim they have, if the claim arises out of activity for which they do not have a permission from the FSA.
  - Customers with a connection to the defaulting firm (such as directors and managers of the firm, companies in the same group, and those whom The Scheme Manager judges responsible for the default) will not be eligible to claim compensation, whatever type of claim they have. The same applies to those whose claim arises from a transaction in connection with which they have been convicted of money laundering.
- (ii) **With a protected claim** (which means a civil liability), which is in summary (COMP 5.2)
  - A claim for a protected deposit (COMP 5.3).
  - A claim for a protected contract of insurance (COMP 5.4).
  - A claim relating to protected investment business (COMP 5.5).
- (iii) **Claiming against a relevant person**, who is in summary (COMP 6.2):
  - An authorised person (but not an EEA firm carrying on home state regulated activity from a branch in the UK under the provisions of the 2BCD or ISD).
  - A UK branch of an EEA firm carrying on home state regulated activity under the provisions of the 2BCD or ISD that is a participant firm.
  - An appointed representative of either of the above.



- (iv) **Who is in default** (COMP 6.3), which means:
- Unable to satisfy protected claims against him.
  - Likely to be unable to satisfy protected claims against him.
  - And, for protected investment business, the relevant person cannot be contacted.

Other key points are:

- (v) The claimant must assign his legal rights to FSCS if asked (COMP 7.2).
- (vi) The claim must be brought to FSCS within a set time, usually 6 years (COMP 8.2).
- (vii) The amount of compensation is set out at COMP 5.3 – 5.5 and 10.2.3, and will be calculated in accordance with COMP 12.2 – 12.4.
- (viii) Additional rules apply to an insolvent insurer (COMP 3, 10, 11 and 12).

### 13.2.2 Financial Services Compensation Scheme Funding Rules (Policy Statement September 2001)

COMP 13 contains FSA's funding rules, which are in summary:

- FSCS is funded by levies on firms for management expenses and compensation costs. FSA has consulted in CP 109 (September 2001) on levying management expenses from N2 to 31st March 2002.
- Firms allocated to contribution group of accepting deposits sub-scheme, or sub-groups within insurance business or investment business sub-schemes in accordance with their activities.
- Minimal cross-subsidisation between groups.
- Firms that do not do business with a customer who could be an eligible complainant will be exempted from the compensation levy, but not from contributing to the Scheme's management expenses (COMP 13.3.1).

### 13.2.3 Disclosure of Information

See 9.4.3.

### 13.2.4 Compensation Scheme: Electing Participants (2001 No. 1783)

This Order sets out circumstances when person who is authorised under incoming passport (under Schedule 3) may participate in Compensation Scheme:

- investment firms and credit institutions prescribed as ineligible to participate under Section 213 (10) - (2)
- may elect to participate under Section 214 (5): investment firm/credit institution which has established UK branch under passport and home state
- ICS offers less protection, or
- depositors' protection scheme is exceeded by the FSCS (3)
- investment fund/credit institution: Section 224 right of inspection does not apply (Section 224 (4)) - (4)

### 13.2.5 Transitional Provisions

The **FSM Act 2000 (Transitional Provisions, Repeals and Savings) (Financial Services Compensation Scheme) Order 2001/2967** provides for FSCS to take over responsibility for meeting claims for compensation relating to the eight predecessor schemes that occur before N2, including:

- Paying claims outstanding at N2.
- Claims made after N2 for pre-N2 business.
- Claims made after N2 for post-N2 business.

FSA has published CP108 (September 2001) on transitional rules to enable FSCS to pay claims in respect of pre-N2 activities, and certain other matters.

## 14. Ombudsman scheme - Part XVI sections 225-234

### **Summary:**

A scheme is established for the resolution of disputes principally for private customers.

This section summarises:

- Main provisions of the Scheme (14.1)
- Constitution of the Scheme (14.2)
- The Scheme's compulsory jurisdiction (14.3)
- The Scheme's voluntary jurisdiction (14.4)
- Complaints Sourcebook (14.5.1)
- Funding the Scheme (14.5.2)

### 14.1 Main provisions

Scheme established for resolution of disputes quickly and with minimum formality by an independent person (s225).

Ombudsman may require information from parties to a complaint (s231) and enforce as if contempt (s232).

FSA may make funding rules (s234).

### 14.2 Constitution (Sch 17)

- Panel of ombudsmen (Sch 17 para 4).
- Not Crown servants (Sch 17 para 6).
- Statutory immunity bar bad faith/breach of HRA (Sch 17 para 10).
- Proceedings privileged from defamation claims (Sch 17 para 11).
- Publish annual report (Sch 17 para 7).
- FSA must make Compulsory Jurisdiction rules (Sch 17 para 12).
- Scheme operator makes rules for procedure/rejection and must consult on them (Sch 17 para 14).
- Scheme operator makes rules for procedure for Voluntary Jurisdiction and must consult on them (Sch 17 paras 17-22).

### 14.3 Compulsory jurisdiction (s226)

depends on Rules:

- Requisite elements are:
  - eligible complainant (not necessarily individual) (s226(2)(a) and (7)),
  - authorised respondent (s226(2)(b)),
  - specified activity (within s22, whether/not regulated activity) (s226(4)).
- Complaint determined on what Ombudsman thinks fair and reasonable (s228(2)).
- Ombudsman must give reasons (s228(4)).
- Complainant only bound if accepts (s228(5)).

- May award fair compensation and/or order remedial steps (s229(2)):
  - money award subject to maximum (s229(6)),
  - remedial steps whether/not court could award (s229(2)(b)).
- Scheme operator may make costs rules but may only award costs against complainant in favour of scheme operator (s230).

## 14.4 Voluntary jurisdiction (s227)

depends on Rules:

- Firms are free to participate (s227(2)).
- Specified activities must fall within s22, whether or not regulated activities (s227(4)).
- Rules may allow pre-FSM Act complaints (s227(13)).

## 14.5 Key statements on policy and implementation

### 14.5.1 CP49 Complaints Handling Arrangements (May 2000); Complaints Sourcebook (September 2001)

The Complaints Sourcebook contains rules which will apply to all FSA authorised firms which conduct investment business with persons eligible to refer a complaint to the Financial Ombudsman Service ("FOS") (the "Compulsory Jurisdiction"), principally retail firms. The rules will also apply by contractual agreement to unauthorised firms which join the Voluntary Jurisdiction – see DISP 4.1, which varies the rules for VJ participants.

In summary, the Compulsory Jurisdiction will take in all regulated activities, plus mortgage lending, unsecured lending by authorised firms (such as overdrafts, loan accounts and card lending) and the provision of general insurance by a bank or building society.

Annex C to CP49 contains extracts from the Memorandum of Understanding between FSA and the FOS which provides, in particular, the provision of information by FOS to FSA.

The following text summarises the complaints handling rules, and has been amended to address transitional provisions - see CP99 June 2001.

#### **Eligible Complaints**

The complaint must be a relevant complaint, which includes:

- A relevant existing complaint – one referred to a former scheme and not rejected or determined; these complaints are subject to DISP as amended by Appendix 1;
- A relevant new complaint – a complaint referred to FOS after N2 which relates to certain pre-N2 acts or omissions.

#### **Firms' Complaint handling procedure**

- (a) Application: the rules apply (subject to exceptions) to every firm in respect of activities carried on from an establishment maintained by it or its appointed representative in the United Kingdom, or otherwise in the United Kingdom (DISP 1.1.1). This is subject to the exception of a firm which does not and is not likely to conduct business with eligible complainants, and who notifies FSA of this (DISP 1.1.7).
- (b) A firm must have (DISP 1.2.1) and publicise (DISP 1.2.9) appropriate internal written complaints handling procedure for handling expressions of dissatisfaction from an Eligible Complainant (see below) about its provision or non provision of a financial services activity. It must provide for (DISP 1.2.16, 17):
  - A competent and independent employee to investigate the complaint.

- That person to have (or have access to appropriate) authority to settle the complaint.
- An appropriate response and, when upheld, the offer of appropriate redress which must be provided fairly (DISP 1.2.17).
- A firm should train its staff in complaints handling and have controls in place to ensure that complaints are handled fairly, consistently and promptly. It should ensure that systemic problems are identified (DISP 1.2.21, 22).

Unless ineligible/settled next day (DISP 1.3), a complaint must be acknowledged within 5 days (DISP 1.4.1) with a final or holding response within four weeks (DISP 1.4.4). If a final response is not sent by 8 weeks, the firm must advise the complainant about the FOS (DISP 1.4.5). These two time limits are varied where a firm has an internal complaint appeals procedure (DISP 1.4.9). The final response must also mention the FOS (1.4.12).

A firm must keep records (DISP 1.5.1) and notify complaints to FSA twice per annum (DISP 1.5.4).

### **Ombudsman jurisdiction**

- Firms must cooperate with the FOS (DISP 1.6.1).
- Time limits (DISP 2.3): except for past business reviews (DISP 2.3.5), a complaint must be notified to the FOS within 6 months after the complainant has been advised by the firm in its final response of his right to refer the matter to the FOS; or within 6 years after the event or 3 years after the complainant knew or should have known that he had a cause for complaint. In exceptional circumstances the Ombudsman may consider complaints outside these limits.
- He must be an Eligible Complainant (DISP 2.4). An eligible complainant is:
  - a private investor or business/charity/trust with an annual turnover/income/net asset value of less than £1 million,
  - not an intermediate customer or Market Counterparty for the activity in question, nor a firm or Voluntary Jurisdiction participant in respect of business which is subject to FOS jurisdiction.

There are further detailed rules in respect of:

- the relationship required between the complainant and the firm in order to be an Eligible Complainant. (DISP 2.4.7-16)
- firms' activities falling within the Ombudsman jurisdiction (DISP 2.6)
- territorial scope (DISP 2.7).

### **FOS Complaint Handling Procedure**

- First, the Ombudsman must consider whether the complaint falls within his jurisdiction (DISP 3.2.1), and must give an affected complainant the opportunity to make representations before dismissing such a complaint (DISP 3.2.5)
- The Ombudsman can then dismiss the complaint without consideration of its merits in specified circumstances (DIS 3.2.8, 3.3).
- The Ombudsman must give a firm which has not issued a final response 8 weeks to consider a complaint (DISP 3.2.3).
- The Ombudsman may consider mediation (DISP 3.2.9).
- The Ombudsman may refer a complaint to be a more appropriate complaints scheme with the complainant's consent (DISP 3.4.1).
- The Ombudsman may investigate, giving the parties an opportunity to make representations (DISP 3.2.11). He will send a provisional assessment and, if this is not accepted, will formally determine the matter

- Prior to final determination the Ombudsman will invite further representations and will if necessary convene a hearing. He may admit or exclude evidence as he sees fit (DISP 3.5).
- The Ombudsman may fix and extend time limits for consideration stage (DISP 3.6). He must have regard to rights of privacy (DISP 3.10).
- The Ombudsman will determine the complaint by reference to what he considers fair and reasonable in all the circumstances, taking into account:
  - law,
  - regulations,
  - guidance,
  - codes,
  - good industry practice (DISP 3.8).
- The Ombudsman's determination binds the firm but not the complainant (DISP 3.8.3).
- The Ombudsman's maximum monetary award is £100,000 plus the complainant's costs (although it would be unusual to award costs) plus, when appropriate, an award for suffering, damage to reputation, distress or inconvenience (DISP 3.9).

### **Funding**

FOS will be funded by

- a general levy on firms (DISP 5.4)
- case fees (DISP 5.6)
- a supplemental levy towards establishment costs (DISP 5.7).

## **14.5.2 CP74 Funding The Financial Ombudsman Scheme (November 2000)**

The proposed basis for funding the Financial Ombudsman Services for 2002/03 onwards is set out in CP74 (November 2000):

- Funding arrangements will apply to FSA authorised firms (other than those certifying that they do not deal with FOS eligible customers) and to unauthorised firms which join voluntarily.
- FOS will be funded by a general levy to which all firms contribute, determined by reference to membership of 10 industry sectors and the firm's turnover plus a flat rate case fee for complaints made against individual firms.

For the first year of operation, case fees will be budgeted to contribute 50% of FOS's costs of operation. In future years, FOS will consider charging case fees which take into account how far the complaint progresses and the firm's industry sector.

## **14.6 Disclosure of information**

See 9.4.3.

## **14.7 Transitional provisions**

See paragraph 5 of Section D at the start of this Guide.

## 15. Banking and Insurance Transfers - Part VII sections 104 - 117

### Summary:

Banking and insurance transfers must now follow a standardised court procedure.

This section summarises:

- Need for approval of transfer schemes (15.1)
- Insurance business transfer schemes (15.2)
- Banking business transfer schemes (15.3)
- Procedure for transfer schemes (15.4)
- Relevant Sis (15.5)
- FSA's guidance on insurance transfers (15.6.3)

### 15.1 Need for approval

Insurance/banking business transfer scheme only effective with section 111 court order (s104).

### 15.2 Insurance business transfer scheme (s105)

This means:

- UK authorised person's business in member state to be transferred (whole or part) to a person in an EEA state (s105(2)(a)).
- EEA firm's UK branch reinsurance business to be transferred (whole or part) to a person in EEA state (s105(2)(b)).
- treaty firm's UK insurance business to be transferred (whole or part) to a person in EEA state (s105(2)(c)).
- and includes Lloyd's transfers – see 15.6.1.

But not:

- Friendly society transfer (Case 1).
- UK firm's EEA reinsurance transfer approved in EEA state (Case 2).
- UK firm's non-EEA (re)insurance transfer approved in non-EEA state (Case 3).
- Captive reinsurance transfer (Case 4).

### 15.3 Banking business transfer scheme (s106)

This means:

- UK authorised deposit taker transfers whole/part of this business (carried on anywhere); or
- non-UK authorised person who has permission to accept deposits transfers whole/part of this business to person who will carry it on in UK.

But not:

- Building society.
- Credit union.
- Companies Act 1989 compromise.

## 15.4 Procedure

Apply to court (s107), with Actuary's report for insurance transfers (s109).

Treasury may make regulations (ie as to notice) (s108) = see 15.6.1 below

FSA and persons adversely affected (including employees) may be heard (s110).

Court must be satisfied that (s111):

- Schedule 12 certificates obtained (which address solvency/financial resources/consent) from FSA/EEA regulators.
- Transferee duly authorised.
- Appropriate to sanction.

Court may make consequent orders dealing with (s112):

- Transfer, continuity of business and liabilities (s112(1)-(6)).
- For insurers, dealing with dissidents, dissolution and reduction of benefits (s112(8)) (also s113).

## 15.5 Miscellaneous

If EEA firm transfers rights and obligations under UK policies, then the transfer will be effective without UK consent if specified conditions are met (s116).

Treasury regulations may modify or amend Part VII (s117) and may extend it to Lloyd's underwriters (s323). – see 15.6.2 below.

## 15.6 Key statements on policy and implementation

### 15.6.1 Control of Business Transfers Regulations

The **FSM Act 2000 (Control of Business Transfers) (Requirements on Applicants) Regulations (2001/3625)** sets out the requirements to be observed on the transfer of an insurance or a banking business in terms of:

- Publishing notice of application.
- Publishing summary of scheme.

The **Control of Transfers of Business Done at Lloyd's Order (2001/3626)** applies sections 104 and 107-114 plus s108 regulations and Part 1 of Schedule 12 to transfers of present or former underwriting members' business so as to treat them as insurance transfers. This is subject to conditions.

### 15.6.2 Insurance Business & Friendly Society Transfers (CP110-September 2001)

This adds guidance on FSA's procedure, which is set out at SUP 18.

### 15.6.3 Guidance on insurance transfers – SUP 18

- Includes novations which amount to a transfer of business (18.1.5)
- When considering the transfer FSA will take into account the interests of remaining and transferring investors (18.2.2)
- Emphasises the importance of provision of information so a policyholder can decide if he may be adversely affected (18.2.3)



- The procedure is set out at 18.2.12, and FSA said that a proposed transfer should be discussed with it as soon as possible. Particular points are:
  - Use of independent expert (18.2.14)
  - FSA can consult with overseas regulators (18.2.23)
  - Form of Scheme Report (18.2.30)
  - Provision of statement to policyholders (18.2.41)
  - Giving notice of proposed scheme (18.2.44)
  - How FSA will access scheme (18.2.49)
  - Insurance business transfers outside United Kingdom (18.3)
  - Friendly Society transfers and amalgamations (18.4).

## 16. Recognised Investment Exchanges and Clearing Houses - Part XVIII sections 285-313

### Summary:

This section explains provision for the exemption and regulation of RIE and RCHs.

This section summarises:

- Main provisions (16.1)
- Recognition Requirements Regulations (16.2)
- FSA Sourcebook (16.3)

### 16.1 Main provisions

RIE exempt from general prohibition as investment exchange/in providing clearing services (s285(2)).

RCH exempt from general prohibition in providing clearing services (s285(3)).

HMT may make recognition and default regulations (s286) (see 16.2).

Application procedure (ss 287-289 and 292 (overseas)).

FSA may make recognition order (s290).

RIE/RCH statutory immunity bar bad faith/breach of HRA (s291).

FSA may make rules requiring RIE/RCH to provide specified information (ss 293 and 295 (overseas)) which FSA may modify or waive (s294).

FSA may give directions/revoke recognition for failure to comply (ss 296-297) after notice with reasons unless urgent (s298).

HMT may extend remit of Tribunal to RIE/RCH cases for MA (s300).

HMT may issue regulations extending Part VII Companies Act 1989 to prescribed contracts settled by a listed person (s301).

RIE/CH subject to competition scrutiny (ss 302-312).

### 16.2 Recognition requirements regulations

The **FSM Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001 (2001 No. 995)** contain the recognition requirements which an investment exchange or clearing house must fulfil in order to be recognised by FSA, including the following:

- Financial resources.
- Suitability.
- Systems and controls.
- Safeguards for investors.
- Rules.
- Discipline.
- Complaints.
- Default rules for market contracts.

### 16.3 Key statements on policy and implementation

### 16.3.1 Recognised Investment Exchange And Recognised Clearing House Sourcebook (CP39 - January 2000; Policy Statement April 2001)

The sourcebook contains Rules with the following provisions:

- Recognition requirements (CP39 para 2). These are requirements which an Investment Exchange or Clearing House must fulfil, and include:
  - facilities provided,
  - fitness and properness,
  - financial resources,
  - monitoring and enforcement.
- Rules for a United Kingdom RIE/RCH to make notifications to FSA (CP39 para 3).
- Supervision: how FSA will supervise a RIE/RCH and exercise its statutory powers (CP39 para 4).
- Guidance on a United Kingdom exchange or clearing house applying for recognition as an RIE/RCH (CP39 para 5).
- Provisions relating to an overseas investment exchange/clearing house (CP39 para 6):
  - applications,
  - recognition,
  - FSA supervision,
  - notification rules.

## 17. Official Listing - Part VI Sections 72-103

### Summary:

Part VI sets out the statutory basis for official listing of securities in the UK. Although it re-enacts Part IV FSAct 1986 it also contains new provisions. For the first time there are statutory duties on sponsors and penalties for breach of listing rules. This section summarises:

- The Competent Authority (17.1)
- Its general duty (17.2)
- Official List (17.3)
- Listing Particulars (17.4)
- Supplementary Listing Particulars (17.5)
- Registration of Listing Particulars (17.6)
- Publication of Prospectus (17.7)
- Compensation for false or misleading particulars (17.8)
- Breach of Listing Rules (17.9)
- Sponsors (17.10)

### 17.1 Competent authority

Part VI implements the requirements of EC directives which require each member state to nominate or create a competent authority to maintain an official list of securities, to regulate the admission of securities to the Official List and to monitor issuers' adherence to the listing rules thereafter.

The FSA (which is referred to as the UKLA in this capacity) is the competent authority for the purpose of the listing of securities (s72). Listing means inclusion in the Official List to be maintained by the UKLA. UKLA took over the role of competent authority from the London Stock Exchange under FSAct 1986 in May 2000. Certain provisions in Part VI are substantially the same as the provisions in FSAct 1986 which they replace. Others, in particular the sections on **sponsors** (ss 88-89) and **penalties for breach of listing rules** (ss 91-94) are entirely new and may be expected to result in a significant change in the approach of companies and their advisers to the listing rules and compliance with them.

### 17.2 General duty of competent authority

In making the listing rules and, in relation to Part VI, giving guidance and its general policy the UKLA must have regard to certain matters (s73). These include:

- The principle that a burden or restriction imposed on a person should be proportionate to the benefits expected to arise from that burden or restriction.
- Desirability of facilitating innovation in respect of listed securities.
- The international character of capital markets and desirability of maintaining the competitive position of the UK.
- Minimising adverse effects on competition of anything done as competent authority.
- Desirability of facilitating competition in relation to listed securities (s73).

### 17.3 Official list

- UKLA must maintain the Official List.
- UKLA may admit to the Official List such securities as it considers appropriate in accordance with Part VI.

Applications to the Official List may only be granted on an application to the UKLA made in accordance with the listing rules. The UKLA must notify the applicant of its decision within 6 months from the date of receipt of the application or from the date any information it requests is received by the UKLA (s75). In practice applications for listing are dealt with much more quickly than this.

### 17.4 Listing particulars

Listing rules may provide that securities (other than new securities) may not be admitted to the Official List unless listing particulars have been submitted to, and approved by, the UKLA and published (s79). In the case of new securities a prospectus is required. For the purposes of Part VI (and in the rest of this Guide) references to listing particulars are to be read as including a reference to a prospectus. New securities are securities which are offered to the public in the United Kingdom for the first time before admission to the Official List. In practice there are few differences in the requirements for listing particulars and a prospectus.

Listing rules set out in detail the information which must be contained in listing particulars. Listing particulars must include information specified in the listing rules and such other information as the UKLA may require. In addition there is a general duty of disclosure in listing particulars. This general duty (s80) (which was previously contained in the FSA 1986) is to disclose:

- All such information as investors and their professional advisers would reasonably require, and reasonably expect to find there, for the purposes of making an informed assessment of certain matters.
- Those matters are the assets and liabilities, financial position, profits and losses and prospects of the issuer of the securities and the rights attaching to those securities.
- However the information to be contained only applies to information within the knowledge of any person responsible for the listing particulars or which it would be reasonable for him to obtain by making enquiries.

In deciding what is reasonably required or reasonably expected to be found in listing particulars regard must be had (in particular) to:

- The nature of the securities and their issuer.
- The nature of the persons likely to consider acquiring them.
- The fact that certain matters may reasonably be expected to be within the knowledge of professional advisers of the kind which persons likely to acquire the securities may reasonably be expected to consult.
- Any information available to investors or their professional advisers as a result of requirements imposed on the issuer of securities by a recognised investment exchange by listing rules or by any other enactment.

### 17.5 Supplementary listing particulars

In two situations supplementary listing particulars must be prepared (s81). If after preparation of listing particulars and before the commencement of dealings in the securities concerned following their admission to the Official List:

- there is a significant change affecting any matter in them the inclusion of which was required by the general duty of disclosure, the listing rules or the UKLA; or

- a significant new matter arises, the inclusion of information in respect of which would have been required had it arisen when the listing particulars were prepared;

the supplementary listing particulars must give details of the change or new matter and be submitted to UKLA for its approval and publication.

## 17.6 Registration of listing particulars

On or before the date on which listing particulars are published as required by the listing rules a copy must be delivered for registration to the Registrar of Companies (s83).

## 17.7 Publication of prospectus

If listing rules require publication of a prospectus before the securities are admitted to the Official List it is unlawful to offer those securities to the public in the United Kingdom before the required prospectus is published (s85).

Schedule 11 determines the circumstances in which a person offers securities to the public in the United Kingdom. These rules are complex but broadly securities are offered to the public in the United Kingdom if:

- To the extent the offer is made in the UK, it is made to the public.
- It is not an exempt offer.
- An offer to members or debenture holders of a body corporate, to clients of the person making the offer or to persons "selected in any other manner" is to be regarded as made to the public.

"Exempt Offers" most commonly relied on to avoid publication of a prospectus are:

- Offers made to no more than fifty persons (Sch 11 para 4(d)).
- The securities are offered to a "restricted circle of persons whom the offeror reasonably believes to be sufficiently knowledgeable to understand the risks involved in accepting the offer". There is considerable uncertainty as to the precise meaning of who is "sufficiently knowledgeable to understand the risks" and so this exemption is not often relied on.
- The securities are offered in connection with a genuine invitation to enter into an underwriting agreement with respect to them (Sch 11 para 7). Prospective sub-underwriters or placers are commonly sent a final draft prospectus. Once the sub-underwriting or placing is complete the draft is finalised, formally approved by UKLA as a prospectus and filed at the Companies Registry.

## 17.8 Compensation for false or misleading particulars

Any person responsible for listing particulars is liable to pay compensation to any person who has acquired securities to which the particulars apply and suffered loss in respect of them as a result of any untrue or misleading statement in the particulars or the omission from the particulars of any matter required to be included in them.

If listing particulars are required to include information about the absence of a particular matter, the omission of that information is to be treated as a statement that there is no such matter.

## 17.9 Breach of the listing rules

Prior to FSM Act failure to comply with the listing rules was not, of itself, a breach of the law. The UKLA's sanctions under the listing rules were:

- Requiring the company to publish information.
- To censure privately or publicly, the company or any director concerned.
- Suspension or cancellation of listing.

Those sanctions remain in the listing rules but now UKLA may pursuant to the FSMA impose a penalty of such amount as it considers appropriate (s91).

If UKLA considers that any provision of the listing rules has been contravened:

- A penalty may be imposed on an issuer of listed securities or an applicant for listing.
- A penalty may also be imposed on a person who was a director of the issuer or applicant and knowingly concerned in the contravention.

There are procedures to be followed if UKLA proposes to impose a penalty or publish a statement censuring the company or director concerned (s92). These require:

- A warning notice about the proposal to impose a penalty.
- A decision notice.
- Notice that the person concerned may refer the matter to the Tribunal.

The UKLA is required to prepare and issue a statement of its policy with respect to the imposition of penalties and the amount of such penalties. The policy must take account of relevant factors such as the seriousness of the contravention, deliberate or reckless action. Such a statement has now been published.

## 17.10 Sponsors

For a number of years the listing rules (but not legislation) have contained provisions dealing with sponsors. Sponsors are normally corporate brokers or investment banks although they may also be other professional advisers. A sponsor is required to be approved by the UKLA and it undertakes to accept certain responsibilities to UKLA. There is a list of approved sponsors maintained by UKLA. FSMA contains a statutory basis for sponsors for the first time (s88). The Act specifies that listing rules may require a person (the issuer) to make arrangements with a sponsor for the performance by the sponsor of such services in relation to him as may be specified in the rules.

Listing rules may make provision for the competent authority, if it considers that a sponsor has contravened a requirement imposed on him by the rules, to publish a statement to that effect. Before doing so it must give the sponsor a warning notice setting out the terms of the proposed statement. If after considering any representation made in response to the warning notice the competent authority decides to make the proposed statement, it must give the sponsor a decision notice setting out the terms of the statement. Upon receipt of a decision notice the sponsor concerned may refer the matter to the Tribunal.

## 18. Lloyd's - Part XIX sections 314-324

### Summary:

Lloyd's is an authorised person for three specified activities, and FSA may further extend FSM Act to regulate Lloyd's underwriting.

This section summarises:

- FSA's duty (18.1)
- Lloyd's authorisation (18.2)
- Lloyd's underwriting (18.3)
- Other provisions (18.4)
- FSA's Lloyd's Sourcebook (18.5)

### 18.1 FSA's duty

FSA must keep itself informed about Lloyd's regulation and must keep under review the desirability of exercising these powers (s314).

### 18.2 Lloyd's authorisation (s315)

Lloyd's is authorised with permission (variable by FSA (s315(4))) to do the following:

- Arrange deals in insurance contracts written at Lloyd's ("basic market activity").
- Arrange deals in participation in Lloyd's syndicates ("secondary market activity").
- Activities connected with/for purposes of these activities.

### 18.3 Lloyd's underwriting

**"Core provision"** means FSM Act provisions (as modified - s317(3)) re individual approval, FSA rulemaking powers, information, control, discipline, compensation, ombudsman, auditors, insolvency, restitution and notices (s317).

FSA may (after consultation (s319)) extend FSM Act to Lloyd's underwriting (s316):

- FSA may direct that general prohibition or a core provision applies to (a) member(s) of Lloyd's re contracts of insurance written at Lloyd's (s316(1)). FSA may apply selectively (s316(6)-(7)).
- FSA must, in deciding, have regard to interests of policyholders, to any failure by Lloyd's to implement a Directive, and to the need to exercise effectively FSA's s315 functions (s315(4)).

FSA may (after consultation (s319)) direct Council or Lloyd's in relation to the exercise of their powers (s318).

### 18.4 Other provisions

Person ceasing to be underwriting member from 24th December 1996 may carry out previously underwritten contracts (s320) subject to such policyholder protection requirements as FSA may impose by SN procedure (ss 320-321) and rules (s322).

HMT may extend Part VII (Transfer Schemes) to Lloyd's underwriters.



## **18.5 Key statements on policy and implementation**

### **18.5.1 Lloyd's Sourcebook (CP 48 May 2000; Policy Statement March 2001)**

The rules, directions and guidance contained in the Sourcebook only apply to the Society of Lloyd's but have implications for underwriting agents and members' advisers, who will be FSA authorised and therefore subject to other parts of the FSA Handbook.

It provides:

- Guidance to the Society in performing its regulatory functions (LLD para 1).
- Directions to the Society in relation to the provision of specified information to FSA (LLD paras 2 and 15).
- The Society to maintain policy protection by a Central Compensation Fund (LLD para 3).
- Requirement to make byelaws governing the operation of the capacity transfer market (CP48 para 4).
- The requirement for policyholder complaints to be handled via the Financial Ombudsman Service (LLD para 6); to maintain complaints handling arrangements for members (LLD para 7) and compensation arrangements for individual members (LLD para 8).
- The obligation on the Society to maintain prudential standards (LLD paras 9, 12 - 14), to manage operational risk (LLD para 10) and to maintain solvency requirements with regard to individual members (LLD para 11).

### **18.5.2 Complaints (DISP)**

Lloyd's must maintain complaints handling procedures which comply with DISP 1 for policyholders' complaints against members (DISP 1.7).

## 19. Professions - Part XX sections 325-333

### Summary:

HMT can designate exempt professional bodies (such as lawyers and accountants), provided they fulfil stated criteria, so that the general prohibition does not apply. They will therefore not require authorisation from FSA.

This section summarises:

- FSA's duty (19.1)
- Procedure for designation (19.2)
- Disapplication of the general prohibition (19.3)
- FSA's power to reapply the general prohibition (19.4)
- FSA's power to make rules (19.5)
- FSA's Professional Firms' Sourcebook (19.7.2).

### 19.1 FSA duty

FSA must keep itself informed as to how designated professional bodies regulate their profession's exempt regulated activities and how members carry them on, and keep under review the desirability of exercising these powers (s325).

**"Members"** = persons who can practice a profession and who (whether or not members) are subject to a designated body's rules.

**"Exempt regulated activities"** = regulated activities which members of a profession may carry on without breaching the general prohibition.

### 19.2 Designation

HMT designates a body by order (s326(1)) (needs positive resolution SI procedure (s429(7)) which is then a designated professional body ("DPB") (s326(2)).

FSA may designate a body only if:

- it has exempt regulated activity rules (s326(4)); and
- it regulates a profession under a UK enactment; or
- membership is a statutory requirement; or
- it is recognised in UK under other enactment; or
- it is an EEA body corresponding to above (s326(5)).

Designated bodies must cooperate with FSA.

Bodies designated under the **FSM Act 2000 (Designated Professional Bodies) Order 2001/1226** are:

- The Law Societies of England and Wales, Scotland and Northern Ireland;
- The Institutions of Chartered Accountants in England & Wales, Scotland and Northern Ireland;
- The Association of Chartered Certified Accountants;
- The Institute of Actuaries.

### 19.3 Disapplication of general prohibition

The general prohibition does not apply to a person who is a member of a profession (or controlled or managed by such a person) ("P") who carries on a regulated activity (s327(1)-(2)) if:

- P accounts to client for any third party remuneration (s327(3)). FSA states (in CP69) that it will not accept general consent given in advance to the retention of commission.
- P's regulated activity is incidental to providing professional services (s327(4) and (8)) (in other words, DPB regulates and it is not a regulated activity).
- P does not carry on any other regulated activity (unless exempt) (s327(5) and (7)).
- P's activities are not prohibited in HMT order (s327(6)) (needs positive resolution SI procedure (s429(7))).

#### **The FSM Act 2000 (Professions) (Non Exempt Activities) Order 2001/1227**

Activities specified under s327(6) are as follows. They may therefore not be carried on by a person without FSA authorisation:

- Accepting deposits.
- Effecting and carrying out insurance contracts.
- Dealing as principal.
- Managing investments involving dealing unless delegated to or advised by an authorised/exempt person.
- Establishing etc a CIS.
- Establishing etc an SHP.
- Managing the underwriting capacity of a Lloyd's syndicate.
- Entering into funeral plan contracts.
- Entering into or administering regulated mortgage contracts, unless as trustee or personal representative, where the borrower is a beneficiary (**Miscellaneous Provisions Order** (2001 No.3650, Article 3)).
- Advising on membership of a Lloyd's syndicate.
- Advising to buy an investment under certain circumstances.
- Advising member of personal pension scheme to dispose of rights.

### 19.4 FSA powers to re-apply general prohibition

FSA may disapply section 327(1) generally (s327(7)) - ie so general prohibition applies - if desirable to protect clients (s328(1)-(6)), but only after consultation (s330).

FSA may disapply section 327(1) in relation to a particular member or firm if appears not fit and proper (s329(1)). FSA must follow WN/DN process (s331).

For FSA's policy see ENF section 18.

### 19.5 Rule making

FSA may make rules for exempt regulated activities to ensure that clients are aware that the firm is not authorised (s332(1)).

DPB must make rules for exempt regulated activities (s332(3)-(4)), which shall be approved by FSA (s332(5)).

## 19.6 Offence

Offence falsely to claim being exempted under section 327, subject to “Tesco” - defence (s333).

## 19.7 Key statements on policy and implementation

### 19.7.1 CP30 - Regulation Of Professional Firms - (October 1999)

This discusses the consequences of authorisation for a professional firm. It also sets out at Appendix B examples of investment business carried on by a professional firm which may require FSA authorisation. This has been superseded by the wording in the FSM Act, but nevertheless provides an indication of FSA’s general thinking.

### 19.7.2 Professional Firms Sourcebook (CP69 - October 2000; Policy Statement May 2001)

15,000 professional firms - solicitors, actuaries and accountants - are currently regulated under the FSAct 1986, 13,000 by recognised professional bodies.

An **exempt professional firm** is one which is not authorised by FSA but, instead, regulated by a DPB. The Professional Firms Sourcebook contains the following provisions relevant to such firms:

- An explanation of the applicable FSA regime (PROF 2.2).
- A summary of FSA’s relevant powers and duties (PROF 3.1).
- The requirement to make clear its unauthorised status (PROF 4.1).

Such a firm will additionally be subject to the DPB’s rules.

An **authorised professional firm** - one which is FSA authorised - which carries on a non-mainstream regulated activity is subject to a modified regime with many rules disapplied (PROF 5). These are activities which correspond to those specified in section 327(3)-(7) - see 1st, 2nd and 4th bullet points at 19.3 above.

## 20. Auditors and Actuaries - Part XXII sections 340 - 346

### **Summary:**

Authorised persons may be required to appoint an auditor or actuary, who is subject to specified duties.

This section summarises:

- Duty on authorised persons (20.1)
- Duties of auditors/actuaries (20.2)
- FSA's policy (20.4.1, 2)

### 20.1 Duty on authorised persons

Rules may require an authorised person (s340):

- To appoint auditor or actuary (s340(1) and (4)).
- To produce financial reports and have them reported on (s340(2)).

For rules, see SUP Chapters 3 and 4.

### 20.2 Auditor/Actuary duties and disclosure

Rules may impose other duties on authorised persons' auditors and actuaries (s340(3)).

Appointed auditor or actuary:

- Must observe, and be empowered under, such rules (s340(5)).
- Has right of access over/information from authorised person (s341).
- Does not contravene his duty because he gives FSA in good faith information acquired in that capacity/an opinion which he reasonably believes relevant to FSA function whether or not FSA has requested it (s342(1)-(4)).

Appointed auditor or actuary of authorised person who is also auditor/actuary of person with close links to it (parent/subsidiary s343(8)) does not contravene his duty because he gives FSA in good faith information acquired as other person's auditor/actuary which he reasonably believes is relevant to FSA function whether or not FSA has requested it (s343).

Treasury may make regulations requiring appointed auditor or actuary to communicate with FSA (ss 342(5)-(7) and 343(5)-(7)) - see 20.4.3.

Appointed auditor/actuary ceasing to hold office must promptly notify FSA (s344).

FSA may disqualify appointed auditor/actuary for non-compliance; WN/DN procedure applies (s345). For FSA's policy, see ENF section 17.4.

### 20.3 Offence

Offence for authorised person (and officer/controller/manager) knowingly or recklessly to give materially false or misleading information to appointed actuary or auditor (s346).

### 20.4 Key statements on policy and implementation

#### 20.4.1 Disqualification Policy

FSA's policy on disqualification of auditors and actuaries is set out at ENF section 17.4.

#### 20.4.2 Requirement to Appoint

Firms' obligation to appoint an auditor or an actuary are contained in SUP Chapters 3 and 4 - see 20.1 above.

#### 20.4.3 Communications by Auditors Regulations

The **FSM Act 2000 (Communications by Auditors) Regulations 2001 No. 2587** set out the circumstances where an auditor must make communication with FSA.

An auditor to whom Sections 342 or 343 apply must communicate to FSA information or opinion on matters in sub-sections (3)(a) in any of the following circumstances:

- he reasonably believes there is or has been, or may be or may have been, a contravention of certain requirements imposed under FSM Act which may be materially significant to FSA(2)(a);
- he reasonably believes the matter may be materially significant to FSA in determining fulfilment of threshold conditions (b);
- he reasonably believes the person concerned is not or may cease trading as a going concern (c);
- he cannot state that the annual accounts or other financial reports are true and fair or otherwise conform to applicable legislation (d), (e).

#### 20.4.4 Auditors disqualified under FSAct 1986 etc

An auditor disqualified under FSAct 1986 or the ICAAct will remain disqualified under FSM Act (Transitional Provisions Authorised Persons etc) Order 2001 No. 2636 article 78).

## 21. Insolvency - Part XXIV sections 355-379

<b>Summary:</b>
FSA has a right to initiate or participate in certain insolvency proceedings. This section covers:
<ul style="list-style-type: none"><li>• FSA's powers (21.1)</li><li>• FSA's policy (21.2.2)</li><li>• Material relevant to insurance (21.2.3)</li></ul>








### 21.1 FSA's powers

FSA:

- May participate in proceedings re authorised company's/insolvent partnership's voluntary arrangement (s356) or individual authorised person's IVA (s357).
- May petition for company's or insolvent partnership's administration order, where it is authorised/an AR/or is in breach of the general prohibition (s359) or may participate in its insolvency proceedings (s362).

An administrator/receiver/liquidator/insolvency practitioner must report contravention of the general prohibition to FSA (ss 361, 364, 370 and 373).

FSA:

- May participate in receivership proceedings of an authorised person/AR/person in breach of general prohibition (s363).
- May participate in authorised person's voluntary winding up (s365).

No voluntary winding up of long term insurer may take place without FSA's consent (s366). FSA must be served with winding up or provisional liquidation notice (s369).

FSA:

- May present winding up petition against an authorised person/AR/person in breach of general prohibition (s367), but for EEA/Treaty firms only if home regulator asks (s368).
- May participate in such winding up proceedings (s371).
- May present bankruptcy petition against individual authorised person/person in breach of general prohibition who is in default to counterparties/and may participate in such insolvency proceedings (ss 372 and 374).
- May seek order to avoid transaction at undervalue (s375).

Where long term insurer is being wound up, the liquidator must carry on its business with a view to transfer to another insurer (ss 376-379).

### 21.2 Key statements on policy and implementation

#### 21.2.1 Bankruptcy (FSM Act) Rules 2001 No. 3634

These modify the Insolvency Rules in respect of demands made by FSA under Section 372(4)(a).

### 21.2.2 Policy

FSA's policy in relation to insolvency proceedings is set out at ENF section 10 as follows:

- applications for insolvency orders under sections 359, 365 and 367 FSM Act (10.6)
- power to challenge voluntary arrangements under sections 356 and 357 FSM Act (10.7)
- power to apply for debt avoidance under section 375 FSM Act (10.9)
- rights on third party petitions and at creditors' meetings (sections 362, 371 and 374 FSM Act) (10.13).

### 21.2.3 Insurers

#### **Insolvency (Definition of "Insurer") (2001 No. 2634)**

In Part XXIV, other than Section 360, "insurer" means person carrying out RAO Article 10 (1) or (2) activity, who is not exempt from general prohibition for that activity; a friendly society; a person who affects or carries out contracts of insurance within paragraphs 14 to 18 RAO for banking business.

#### **Treatment of Assets of Insurers on Winding Up (2001 No. 2968)**

This provides that assets representing an insurer's long term business should only be available for meeting liabilities attributable to that business. Non-long term assets are only available in meeting corresponding liabilities, and separate creditors' meetings should be held for these two classes.

#### **Insurers (Winding Up) Rules 2001 No.3635**

These replace the Insurance Companies (Winding Up) Rules 1985.



## 22. Miscellaneous and supplemental Part XXI sections 334-339; Part XXVIII sections 404-416; Part XXIX sections 417-425; Part XXX sections 426-433

### Summary:

This section contains provisions relating to:

- Mutual societies (22.1)
- Implementation of EU and international decisions and obligations (22.2)
- Gibraltar/Channel Islands/Isle of Man (22.3)
- Miscellaneous matters (22.4)
- Commencement of FSMA (22.5)
- Interpretation of FSMA (22.6)
- Ministerial powers to supplement FSMA (22.7)
- Parliamentary control of SIs (22.8)
- Relevant SIs (22.9)

### 22.1 Mutual societies

Treasury order may provide for transfer of functions to FSA/Treasury from:

- Friendly Society Commission (s334).
- Registry of Friendly Societies (s335).
- Building Societies Commission (s336).

Treasury order may provide for transfer to FSA of:

- Industrial and Provident Society functions.
- Credit Union functions (s338).

The provisions are contained in the **FSM Act 2000 (Mutual Societies) Order 2001 No. 2617**.

### 22.2 Implementation of EU/International decisions/obligations

To implement an EU Council/Commission decision under a Passport Directive, Treasury may direct FSA to:

- Refuse/defer UK company's request for permission (ie authorisation under FSM Act).
- Object to person's acquisition of 50% stake in UK authorised person (ss 405-408).

Treasury may direct FSA etc to take or not to take action to comply with EU/international obligations (s410).

### 22.3 Gibraltar/Channel Islands/Isle of Man ("IOM")

Treasury order may allow Gibraltar firms EEA/Treaty rights (s409):

- And enable UK firms to passport into Gibraltar.
- And to recognise Gibraltar collective investment schemes.

Order in Council may extend FSM Act provisions to Channel Islands/IOM if already subject of other UK legislation (s430).

### **Gibraltar Order 2001 No. 3084**

- Banking and insurance firms authorised and with their head office in Gibraltar may exercise rights corresponding to (but narrower than) EU single market rights to establish a branch or provide services in the United Kingdom (2).
- Firms authorised in a non-UK EEA state which have "passported" into Gibraltar will qualify for authorisation under Schedule 3 FSM Act where they carry on UK activities corresponding to those covered by their Gibraltar "passport" (3).
- UK firms may "passport" into Gibraltar under Schedule 3 FSM Act (4).

## **22.4 Miscellaneous provisions**

These deal with:

- Tax treatment of levies and repayments (s411).
- Gaming contracts are enforceable in accordance with Treasury order (s412) - see 22.9.
- Treasury regulations may provide for service of notices under FSM Act (s414).
- High Court has jurisdiction in civil proceedings (s415).
- Enactments repealed (not FSAct) and bodies (not SROs) abolished (ss 416 and 432 and Schs 20-22).

The **Consequential Amendments & Repeals Order (2001 No. 3649)** came into force on 1<sup>st</sup> December 2001 and **repealed**

- Policyholders Protection Acts 1975 and 1997;
- Insurance Companies Act 1982;
- Financial Services Act 1986;
- Banking Act 1987;
- Insurance Companies (Reserves) Act 1995;

and **revoked**

- Banking Co-ordination Regulations 1982;
- Insurance Companies Regulations 1994;
- Investment Services Regulations 1995.

It also **amends** several hundred statutes and statutory instruments, including:

- Companies Act 1985 and 1989;
- Company Directors Disqualification Act 1986;
- Pension Schemes Act 1993;
- Consumer Credit Act 1994;
- Pensions Act 1995;
- Bank of England Act 1998.

## **22.5 Commencement (s431)**

The following sections came into force on passing of the FSM Act:

- Section 431 (ie this section).
- Sections 428, 430 and 433.
- Some Schedule 21 transitional provisions.

The remainder will come into force by commencement orders – see section D1 of this Guide.

## 22.6 Interpretation (ss 417 and 420-425)

The following sections contain particular definitions:

- Parent, subsidiary (s420).
- Group (s421).
- Controller, associate (s422).
- Manager (s423).
- Insurance, policy and applicable law (s424) - see 22.9
- EEA terms (s425).

Under section 11 Interpretation Act 1978, definitions in the FSM Act apply (in the absence of contrary indication) to SIs made under it.

## 22.7 Ministerial powers

These sections empower the Treasury Minister to amend the FSM Act by statutory instrument ("SI").

Minister has full powers to make (s426):

- Any incidental, consequential, transitional or supplemental provision.
- Which is necessary or expedient for purpose of the FSM Act, in consequence of the FSM Act or to give full effect to the FSM Act.
- Including early assumption of powers; or repealing any act.
- Including transitional provisions (s427) to:
  - continue (or not) authorisation/permission,
  - continue or modify legislative provisions,
  - continue liabilities,
  - continue disciplinary action and other proceedings,
  - which may modify, exclude or apply any legislation (including FSM Act).

Minister's power to make orders, and power to make regulations and Tribunal rules, are exercisable by SI (s428).

## 22.8 Control of SIs

The following SIs require positive resolution (in other words, vote on floor of House of Commons) (s429):

- HMT order for any of the following:
  - limiting FSA's power to make price stabilising rules (s144(4)),
  - amending control definitions (s192),
  - amending OEIC definitions (s236(5)),
  - for past business review scheme (s404),
  - defining "business" (s419),
  - transferring listing functions (Sch 8 para 1).
- OEIC regulations (s262).
- Certain financial promotion orders (s21).

- Certain exemption orders (s38).
- For designated professional bodies (s326-327).
- Commencement orders (s431).
- First RAO and subsequent extensions (s22).

## 22.9 Relevant SIs

### **Gaming Contracts (2002 No. 2510)**

Dealing as principal or agent, or agreeing to do so (ignoring any available exclusion), is not void or unenforceable because of law relating to gaming (Section 412(2)(b)), and securities and CBIs are specified for Section 412 (2) (c).

### **Law Applicable to Contracts of Insurance (2001 No. 2635) & Amendment Regulations (2001 No. 3542)**

This Instrument sets out the tests for applicable law:

- it does not apply to reinsurance contracts and has limited application to friendly societies (3);
- general insurance which covers risk in EEA states (4-7);
- contracts of long term insurance where the individual policyholder resides in an EEA state or (if not an individual) the establishment of the policyholder to which the contract relates is in an EEA state (8-10).

### **Consequential Amendments and Savings (Industrial Assurance) 2001 No. 3647**

Pursuant to the repeal of the Industrial Assurance Acts, this Order modifies the ongoing regime applicable to pre-N2 industrial assurance business in relation to collecting and record keeping requirements.

### **Dissolution of the Insurance Brokers Registration Council (Consequential Provisions) 2001 No. 1283**

This Order has been issued under Section 416 FSM Act.

### **Consequential Amendments (No. 2) 2001 No. 3801**

This Order makes consequential amendments to two Terrorism Orders.