

Significant influence functions

Conolly Tunnard explains the implications of the recent changes to the controlled function regime and their impact on firms and what they must do now.

The FSA has been consulting on changes to the controlled function regime. In January its Consultation Paper CP10/3 was published, and now Policy Statement PS10/15 Effective Corporate Governance has been produced which gives the FSA's final views.

The Policy Statement confirms the main thrust of CP10/3, which was to give a greater degree of granularity to the controlled function regime. The drive behind the changes was to give greater definition to particular roles within the controlled function regime.

The Governance functions

The FSA over recent years has become very interested in the issue of the Governance of firms. It is of the view that a failure of Governance was one of the reasons for the banking crisis, in that the senior management of banks did not recognise the risks that were being run and failed to mitigate those risks. The changes in the table below referring to the Governance functions can be seen as part of the initiative to put this right.

The CF00 has been created for situations where the senior management and directors of overseas companies have significant influence over the activities of a regulated subsidiary in the UK because they can

directly influence decisions made by the UK firm. There are complexities as to who might have to be a CF00, and the FSA recommends firms that might be in this position should discuss the issue with their supervisor.

The other change within the Governance function is to add a number of subsidiary functions to the CF2 function, thus giving the NED Governance function greater granularity. The idea is that firms will have to focus more on recruiting candidates who have the necessary skills and talents to fulfil the new roles CF2a to CF2e. The FSA has identified that it is desirable for candidates for the new NED roles to have the particular skills necessary to meet the requirements of their posts. It is certain that applicants for CF2a to CF2e will be more closely

Table 1: Explanation and impact of changes

Significant influence function (SIF)	Current function	New / changed / unchanged	Proposed new function
Governing functions	CF1 (Director) CF2 (NED)	New Changed Changed	CF00 (Parent Entity SIF) Decreased scope Decreased scope CF2a (Chairman) CF2b (Senior Independent Director) CF2c (Chair of Risk Committee) CF2d (Chair of Audit Committee) CF2e (Chair of Remuneration Committee)
	CF3 (Chief Executive) CF4 (Partner) CF5 (Director of Unincorporated Association) CF6 (Small Friendly Society)	Unchanged Unchanged Unchanged Unchanged	
Required functions	CF8 (Apportionment and Oversight) CF10(Compliance Oversight) CF11(Money Laundering Reporting) CF12 (Actuarial) CF12A (WP Actuary) CF12B (Lloyd's Actuary)	Unchanged	
Systems and Controls functions	CF28 (Systems and Controls)	New Changed	CF13 (Finance function) CF14 (Risk function) CF15 (Internal Audit function) Deleted
Significant Management function	CF29 (Significant Management)	Changed	Increased scope

examined by the FSA, in order that it can be satisfied that they have the necessary competencies and experience to carry out these new controlled functions. The FSA clearly expects the people fulfilling the new NED roles to have expertise in the relevant area, and be able to lead any challenge to the executive on that topic. The FSA is clearly looking to NEDs to be more challenging of the executive in future. Defining these new controlled functions may well give rise in a number of firms to changes in recruitment practices for NEDS. Some firms may well find difficulties in recruiting people of the right background experience. The costs of recruiting such people may also rise.

It is expected that in many cases new NEDs will continue to have the existing CF2 function. Whilst it is not prohibited for an executive to be the Chairperson of the Risk/Audit /Remuneration Committee where it is appropriate to the circumstances of the firm, the FSA would regard the circumstances as exceptional and normally expect these posts to be held by a NED with the appropriate experience and background.

The responsibilities and liabilities of NEDS as set out in the rule book have changed. SYSC 2 and 4 are to be deleted from the Handbook, and thus any protection that these sections offered to NEDs will be no longer available. It is clear by this action that the FSA expects NEDs to challenge the decisions of the executive and to have the desire and ability to do so.

The required functions

These functions CF8 to CF12B have not altered and remain the same.



Systems and controlled functions

This is the existing CF28 function, and under the new regime it will alter. CF28 will disappear and CF13 (Finance function), CF14 (Risk function) and CF15 (Internal Audit function) will be created.

The intention is again to give greater granularity to the System and Controls function and enable the FSA to focus on three new areas which it feels are of vital importance. In a similar way to the new NED roles the FSA will be able to focus more closely on whether the new postholders have the necessary attributes to do the job required of them.

The FSA has made the comment that it would expect any current holders of a CF28 position to transfer across to a CF13-15 role. The FSA also does not ban more than one person holding any of these roles if it is warranted. For instance, there might be a separate CF14 for market risk and operational risk in a larger organisation. Smaller firms should note that there is not a requirement to have a CF13-15 if the size and scale of the firm do not warrant it.

Firms should note that the FSA has given guidance on whether the CF13-15 roles can be outsourced. The position is that the controlled function holder, if required, can only be allocated to a person employed

Table 2: Timetable for applications for new controlled functions

New controlled functions	Required action by firms where the individual currently performing the role is already approved to perform a relevant controlled function for the firm	Required action by firms where the individual currently performing the role is already approved to perform a relevant controlled function for the UK parent firm	Required action by firms where the individual currently performing the role is not an approved person	Required action by firms where the individual currently holds a governing function but now requires separate approval for a systems and control function
CF00	Must notify the FSA on specified form between 1 May 2011 and 31 July 2011.	Must notify the FSA on specified form between 1 May 2011 and 31 July 2011.	Must apply for approval between 1 May 2011 and 31 October 2011, though the transitional period will extend beyond 31 October if necessary for all applications submitted before 31 July 2011.	N/A
CF2a-e	As above	As above	As above	N/A
CF13-15	As above	N/A	N/A	Firms must notify the FSA on the specified form between 1 May 2011 and 30 April 2012 (or by 31 July 2011 for firms already subject to the remuneration code).

by the firm. The work may be outsourced but, in line with normal FSA practice, the responsibility cannot.

There are special rules that are going to be introduced around the CF15 Internal Audit function. An amendment to SUP 10 will make clear that a CF15 may not be responsible for any other governing function. However, the FSA realises that in small firms this change may not be practical, and so the new SUP guidance will apply only to those firms that have an impact score of low to medium or higher.

The timetable

The FSA has set out a timetable for the applications to be made for the new controlled functions as shown in Table 2

above. Most of these have to be made within periods beginning in the second quarter of 2011. Firms therefore will need to address this issue soon to work out which of the new functions they need to apply for.

What firms must do now

Firms clearly need to review the structure of their controlled functions. In particular, they will need to look at the registration of the existing NEDs, and it is certain that NEDs who act as Chairmen of Audit and Risk Committees will need to be registered under the relevant new category.

Firms that have existing CF28s will have to consider how these transfer across into the new CF13-15 functions.

How can OAC help?

OAC can advise on the issues concerning this FSA initiative and would be happy to help firms seeking guidance on how they should meet the challenges posed by this modification to the controlled function regime.

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