

FCA's expectations of institutional governance

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Overview

- Role of the board and committees
- 'Culture'
- Directors' duties
- Enforcement

Role of the Board: FCA expectations

- FCA expects regulated entities to be operated and controlled by the board
- Therefore, boards must show decision making capabilities
 - high quality board documents and MI
 - allowing time for debate and challenge
 - demonstrating 'challenge'
 - must know what they 'sell'

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Common approach to 'board management'

- The Board:
 - Meets four times a year
 - Primarily discharges statutory duties
 - Also responsible for high-level strategy and oversight
 - 'Signs off' the Executive Committee's management of the firm
- The Executive Committee / Management Committee:
 - Meets monthly (or more)
 - 'Runs the business'
 - Responsible for key business and risk decisions (etc)
 - Would sign off 'emergency decisions'

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FCA's view of a board's role

- Board responsible for setting the strategy and holding management to account for implementation
- Directly involved with all key decisions
- Scheduled meetings with key business and control function personnel
- Show "challenge"
- Consequently needs to meet a lot more often (than the traditional view)
- Section 166 risk
- Role of NEDs

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FCA's view of a board's role/cont

- Can delegate responsibility to an ExCo but should be responsible for:
 - Setting the culture and tone from the top
 - New business (products, markets, material client changes)
 - Key financial matters
 - Risk related matters
 - Key regulatory obligations

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'Culture'

- FCA: the conduct regulator
- FCA thinks that 'culture can be regulated'
- FCA will therefore judge culture and integrity
- 'Good culture should be lead by senior management'
 - setting the right tone
 - integrity and ethical values of staff
 - management's operating style and philosophy
 - "culture is like DNA" [Clive Adamson 19.4.13]
- More – "follow the money" regulation
- How will FCA assess culture?
 - Do boards review high risk areas?
 - Can a board display discussions of conduct at board levels?

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RBS: FCA feedback

- FCA expects governance arrangements to provide checks and balances and to ensure effective oversight and challenge
- Boards should consider whether a CEO's (or other individual's) management style discouraged robust and effective challenge. The risks that can emerge when there is a dominant CEO can result in a lack of effective challenge by the Board and senior management to the CEO's proposal, resulting in risks being overlooked and strategic mistakes being made
- Boards must consider the extent to which management and control infrastructure are keeping pace with the growth of the business

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Pottage: Introduction

- CEO at UBS at a time of some turmoil
- FCA's accused Pottage of a failure to discharge managerial responsibilities
- Tribunal disagreed

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The Tribunal's views on the responsibilities of a CEO

- CEO is not required to design risk controls
- CEO is permitted to delegate, and can rely on the views of experts e.g. risk, compliance
- CEO is not required to ensure risks are managed, but to take reasonable steps
- CEO's actions must fall within a range of reasonable responses – there is no single right way
- CEO can chair Committees whose composition overlaps – this may enable issues to be dealt with more efficiently

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Pottage is specifically given credit for -

- Ordering a review of risk management – and allowed almost a year to come to this view
- Having Risk and Management Committee minutes that show his active involvement
- Producing decent pre-meeting materials and seeking verbal updates from key persons, even outside formal meetings
- Investigating every specific control failure, and remedying it or having a plan to do so
- Taking steps to support and strengthen Compliance
- FCA's hurdle in the future:
 - *"An Approved Person will only be in breach of a Statement of Principle where he is personally culpable, and not simply because a regulatory failure has occurred in an area of business for which he was responsible".*

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Directors' duties (Companies Act 2006)

- Duty to promote the success of the company (*section 172*)
- Duty to exercise reasonable care, skill and diligence (*section 174*)
 - objective test: *"the care, skill and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill and experience that may **reasonably be expected** of a person carrying out the functions carried out by the director in relation to the company; and*
 - subjective test: *the general knowledge, skill and experience that the director **has**."*
- Duty to avoid conflicts of interest (*section 175*)
- Duty to declare an interest in proposed transaction or arrangement with the company (*section 177*)

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Non – executive directors (“NEDs”)

- A NED is a director but without any specific executive function
- Expectation (FSA now FCA) that even wholly-owned insurer subsidiaries need NEDs
- Corporate Governance Code (statement of ‘best practice’):
 - NEDs should constructively challenge and debate
 - NEDs should be independent in character and judgement
- ABI proposals (for listed companies) – “Improving Corporate Governance and Shareholder Engagement”

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Approved persons regime

- In order to be a senior manager of an insurer, an individual must be a FCA “approved person”
- Statements of Principle
 - An approved person must act with integrity in carrying out his accountable functions (Principle 1)
 - An approved person must act with due skill, care and diligence in carrying out his accountable functions (Principle 2)
- Must report to the authorised firm and to the FCA any matter that may impact on their on-going fitness and propriety
- Non-compliance may result in the FCA taking enforcement action against the approved person (fine / revoking approval etc.)

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FCA's view of with-profits committees ("WPC")

- FSA CP11/15 – "Protecting with-profits policyholders"
 - WPCs should be fully independent or have an independent majority
 - £500m+ WP fund should have a WPC
 - Responsibility of the board to identify suitable personnel
- PS12/4 established COBS 20.5 – "With profits governance"

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COBS 20.5 requirements

- WPC or "advisory arrangement" (depending on size of fund)
- Any person appointed to the WPC must have appropriate skills, knowledge and experience
- Terms of reference to address the conflicting rights and interests of with-profits policyholders and other policyholders / stakeholders / shareholders
- Consider:
 - Any "significant changes to the risk or investment profile"
 - Operating costs
- WPC may obtain external professional advice
- Dialogue with board
- WPC can notify FCA if board fails to follow WPC's advice

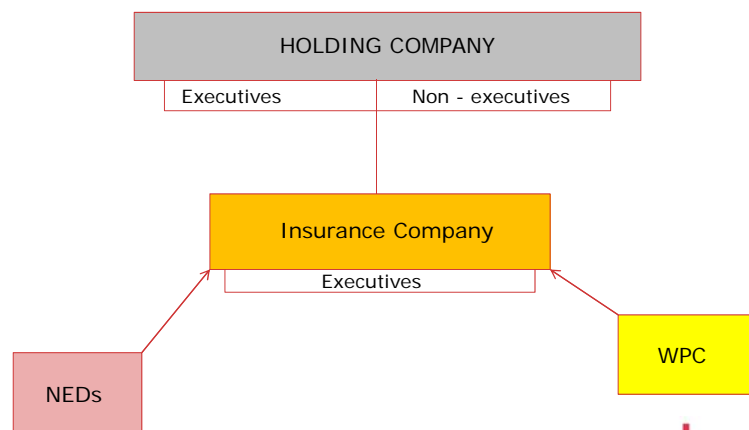
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COBS 20.2 – “Treating with-profits policyholders fairly”

- COBS 20.2.1A - Prohibition against WP funds giving “unfair” benefits to shareholders or others
- COBS 20.2.39 – Material transactions affecting WP fund must not adversely affect WP policyholders
- PS12/4 - *“In our view the with-profits committee’s role (and that of the independent person) is to provide focused advice and challenge to management on the running of the with-profits fund, including the conflicts of interest arising, with specific reference to with-profits policyholders.”*

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Overview



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FSA Enforcement Case Study: Sun Life Assurance (2010)

- Sun Life Assurance Company of Canada fined £600,000 for its failings in the governance of its with-profits business
- Related to two significant transactions (Put / Spread Collars) for WP fund (114,000 policies and £1.2 billion in assets)
 - Executed without formal approval of board (but most directors were aware)
 - Inadequate review from the WPC (no meeting held)
- FSA did not question the merits of the transactions

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FSA Enforcement Case Study 2: Angela Burns (2012)

- NED of MGM and Teachers Provident
- Also chair of the investment committees
- Proposed a certain investment manager to manage the relevant funds (for MGM and Teachers) while actively soliciting a paid role with that manager
- Did not disclose potential conflict to MGM or Teachers
- FSA accepted the NED helped get a better deal from the investment manager
- FSA findings:
 - Breached principle of integrity (including fiduciary duties as a NED)
 - Breached relevant companies legislation, articles of association and corporate conflicts policies
- Financial penalty of £154,800

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