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FCA's expectations of institutional governance

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Overview

- Role of the board and committees
- ‘Culture’
- Directors’ duties
- Enforcement

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Role of the Board: FCA expectations

- FCA expects regulated entities to be <u>operated</u> and <u>controlled</u> 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 led 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 evidence discussions of conduct at board level?

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RBS failure: FSA feedback

- Governance arrangements should provide checks and balances and ensure effective oversight and challenge
- Boards should consider whether a CEO's (or other individual's) management style discouraged effective challenge
- 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
- FSA 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 <u>are</u> 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 is 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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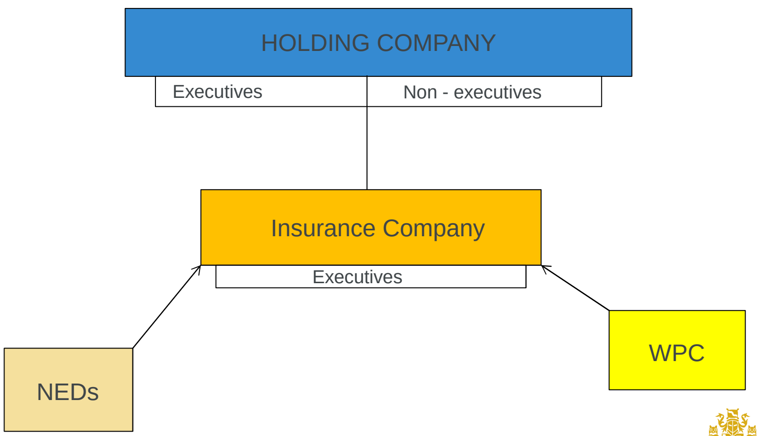
Overview



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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

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FSA Enforcement Case Study 2: Angela Burns (2012)/cont

- 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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Questions Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

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