

Chapter 3

Systems and controls

3.1 Systems and controls

- 3.1.1** **R** A *firm* must take reasonable care to establish and maintain such systems and controls as are appropriate to its business.
- 3.1.1A** **R** [deleted]
- 3.1.2** **G**
- (1) The nature and extent of the systems and controls which a *firm* will need to maintain under **SYSC 3.1.1 R** will depend upon a variety of factors including:
 - (a) the nature, scale and complexity of its business;
 - (b) the diversity of its operations, including geographical diversity;
 - (c) the volume and size of its transactions; and
 - (d) the degree of risk associated with each area of its operation.
 - (2) To enable it to comply with its obligation to maintain appropriate systems and controls, a *firm* should carry out a regular review of them.
 - (3) The areas typically covered by the systems and controls referred to in **SYSC 3.1.1 R** are those identified in **SYSC 3.2**. Detailed requirements regarding systems and controls relevant to particular business areas or particular types of *firm* are covered elsewhere in the *Handbook*.
- 3.1.2A** **G** *Firms* should also consider the additional *guidance* on risk-centric governance arrangements for effective risk management contained in **SYSC 21**.
- 3.1.3** **G** Where the *UK Corporate Governance Code* is relevant to a *firm*, the *appropriate regulator*, in considering whether the *firm's* obligations under **SYSC 3.1.1 R** have been met, will give it due credit for following corresponding provisions in the code and related guidance.
- 3.1.4** **G** A *firm* has specific responsibilities regarding its *appointed representatives* or, where applicable, its *tied agents* (see **SUP 12**).
- 3.1.5** **G** **SYSC 2.1.3 R (2)** prescribes how a *firm* must allocate the function of overseeing the establishment and maintenance of systems and controls described in **SYSC 3.1.1 R**.

Competent employees rule

- 3.1.6** **R** A *firm* must employ personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them.
- 3.1.7** **R** When complying with the *competent employees rules*, a *firm* must take into account the nature, scale and complexity of its business and the nature and range of financial services and activities undertaken in the course of that business.
- 3.1.7A** **G** ■ SYSC 28 contains *rules* and *guidance* relating to the minimum knowledge and competence requirements in relation to *insurance distribution activities* undertaken by a *firm*.
- 3.1.8** **G** The Training and Competence sourcebook (TC) contains additional *rules* and *guidance* relating to specified retail activities undertaken by a *firm*.
- 3.1.9** **G** *Firms* which are carrying on activities that are not subject to TC may nevertheless wish to take TC into account in complying with the competence requirements in SYSC.
- 3.1.10** **G** If a *firm* requires *employees* who are not subject to a qualification requirement in TC to pass a relevant examination from the list of appropriate qualifications maintained by the FCA, the *appropriate regulator* will take that into account when assessing whether the *firm* has ensured that the *employee* satisfies the knowledge component of the *competent employees rule*.

Insurance distribution activities

- 3.1.11** **R** A *firm* carrying on *insurance distribution activities* must approve, implement and regularly review its internal policies and procedures in respect of its obligations under ■ SYSC 28.
- [Note: first paragraph of article 10(8) of the IDD]
- 3.1.12** **G** ■ SYSC 2.1.6AR prescribes how a *firm* must allocate the function of ensuring the proper implementation of the policies and procedures approved in accordance with ■ SYSC 3.1.11R.



3.2 Areas covered by systems and controls

Introduction

3.2.1 G This section covers some of the main issues which a *firm* is expected to consider in establishing and maintaining the systems and controls appropriate to its business, as required by ■ SYSC 3.1.1 R.

Organisation

3.2.2 G A *firm's* reporting lines should be clear and appropriate having regard to the nature, scale and complexity of its business. These reporting lines, together with clear management responsibilities, should be communicated as appropriate within the *firm*.

- 3.2.3 G
- (1) A *firm's governing body* is likely to delegate many functions and tasks for the purpose of carrying out its business. When functions or tasks are delegated, either to *employees* or to *appointed representatives* or, where applicable, its *tied agents*, appropriate safeguards should be put in place.
 - (2) When there is delegation, a *firm* should assess whether the recipient is suitable to carry out the delegated function or task, taking into account the degree of responsibility involved.
 - (3) The extent and limits of any delegation should be made clear to those concerned.
 - (4) There should be arrangements to supervise delegation, and to monitor the discharge of delegates functions or tasks.
 - (5) If cause for concern arises through supervision and monitoring or otherwise, there should be appropriate follow-up action at an appropriate level of seniority within the *firm*.

- 3.2.4 G
- (1) The *guidance* relevant to delegation within the *firm* is also relevant to external delegation ('outsourcing'). A *firm* cannot contract out its regulatory obligations. So, for example, under *Principle 3* a *firm* should take reasonable care to supervise the discharge of outsourced functions by its contractor.
 - (2) A *firm* should take steps to obtain sufficient information from its contractor to enable it to assess the impact of outsourcing on its systems and controls.

3.2.5 **G** Where it is made possible and appropriate by the nature, scale and complexity of its business, a *firm* should segregate the duties of individuals and departments in such a way as to reduce opportunities for *financial crime* or contravention of requirements and standards under the *regulatory system*. For example, the duties of front-office and back-office staff should be segregated so as to prevent a single individual initiating, processing and controlling transactions.

3.2.5A **R** [deleted]

3.2.5B **G** [deleted]

Systems and controls in relation to compliance, financial crime and money laundering

3.2.6 **R** A *firm* must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the *regulatory system* and for countering the risk that the *firm* might be used to further *financial crime*.

3.2.6A **R** A *firm* must ensure that these systems and controls:

- (1) enable it to identify, assess, monitor and manage *money laundering* risk; and
- (2) are comprehensive and proportionate to the nature, scale and complexity of its activities.

3.2.6B **G** "*Money laundering risk*" is the risk that a *firm* may be used to further *money laundering*. Failure by a *firm* to manage this risk effectively will increase the risk to society of crime and terrorism.

3.2.6C **R** A *firm* must carry out regular assessments of the adequacy of these systems and controls to ensure that it continues to comply with ■ SYSC 3.2.6A R.

3.2.6D **G** A *firm* may also have separate obligations to comply with relevant legal requirements, including the Terrorism Act 2000, the Proceeds of Crime Act 2002 and the *Money Laundering Regulations*. ■ SYSC 3.2.6 R to ■ SYSC 3.2.6J G are not relevant for the purposes of regulation 76(6) or 86(2) of the *Money Laundering Regulations*, section 330(8) of the Proceeds of Crime Act 2002 or section 21A(6) of the Terrorism Act 2000.

3.2.6E **G** The FCA, when considering whether a breach of its *rules* on systems and controls against *money laundering* has occurred, will have regard to whether a *firm* has followed relevant provisions in the guidance for the UK financial sector issued by the Joint Money Laundering Steering Group.

3.2.6F **G** In identifying its *money laundering* risk and in establishing the nature of these systems and controls, a *firm* should consider a range of factors, including:

- (1) its customer, product and activity profiles;
- (2) its distribution channels;
- (3) the complexity and volume of its transactions;
- (4) its processes and systems; and
- (5) its operating environment.

3.2.6G **G** A *firm* should ensure that the systems and controls include:

- (1) appropriate training for its employees in relation to *money laundering*;
- (2) appropriate provision of information to its *governing body* and senior management, including a report at least annually by that *firm's money laundering reporting officer (MLRO)* on the operation and effectiveness of those systems and controls;
- (3) appropriate documentation of its risk management policies and risk profile in relation to *money laundering*, including documentation of its application of those policies (see ■ SYSC 3.2.20 R to ■ SYSC 3.2.22 G);
- (4) appropriate measures to ensure that *money laundering* risk is taken into account in its day-to-day operation, including in relation to:
 - (a) the development of new products;
 - (b) the taking-on of new customers; and
 - (c) changes in its business profile; and
- (5) appropriate measures to ensure that procedures for identification of new customers do not unreasonably deny access to its services to potential customers who cannot reasonably be expected to produce detailed evidence of identity.

3.2.6H **R** A *firm* must allocate to a *director* or *senior manager* (who may also be the *money laundering reporting officer*) overall responsibility within the *firm* for the establishment and maintenance of effective anti-*money laundering* systems and controls.

The money laundering reporting officer

3.2.6I **R** A *firm* must:

- (1) appoint an individual as *MLRO*, with responsibility for oversight of its compliance with the *FCA's rules* on systems and controls against *money laundering*; and

		(2) ensure that its <i>MLRO</i> has a level of authority and independence within the <i>firm</i> and access to resources and information sufficient to enable him to carry out that responsibility.
3.2.6J	G	The job of the <i>MLRO</i> within a <i>firm</i> is to act as the focal point for all activity within the <i>firm</i> relating to anti-money laundering. The <i>FCA</i> expects that a <i>firm's MLRO</i> will be based in the <i>United Kingdom</i> .
		Financial crime guidance
3.2.6K	G	The <i>FCA</i> provides <i>guidance</i> on steps that a <i>firm</i> can take to reduce the risk that it might be used to further <i>financial crime</i> in <i>FCG</i> (Financial Crime Guide: A firm's guide to countering financial crime risks) and <i>FCTR</i> (Financial Crime Thematic Reviews).
		The compliance function
3.2.7	G	<p>(1) Depending on the nature, scale and complexity of its business, it may be appropriate for a <i>firm</i> to have a separate compliance function. The organisation and responsibilities of a compliance function should be documented. A compliance function should be staffed by an appropriate number of competent staff who are sufficiently independent to perform their duties objectively. It should be adequately resourced and should have unrestricted access to the <i>firm's</i> relevant records as well as ultimate recourse to its <i>governing body</i>.</p> <p>(2) [deleted]</p> <p>(3) [deleted]</p>
3.2.8	R	<p>(1) A <i>firm</i> must allocate to a <i>director</i> or <i>senior manager</i> the function of:</p> <p>(a) having responsibility for oversight of the <i>firm's</i> compliance; and</p> <p>(b) reporting to the <i>governing body</i> in respect of that responsibility.</p> <p>(2) In (1) "compliance" means compliance with the <i>firm's</i> obligations under the <i>regulatory system</i> in relation to which the <i>FCA</i> has responsibility.</p>
3.2.9	G	■ SUP 10C.6.1R uses ■ SYSC 3.2.8R to describe the <i>controlled function</i> , known as the <i>compliance oversight function</i> , of acting in the capacity of a <i>director</i> or <i>senior manager</i> to whom this function is allocated.
		Conduct risk oversight (Lloyd's) function
3.2.9A	R	In relation to business done at Lloyd's, the <i>Society</i> must allocate to a <i>director</i> or <i>senior manager</i> the function of having responsibility for overseeing the conduct of business standards required of <i>managing agents</i> for which the <i>Society</i> has responsibility.

Risk assessment

3.2.10

G

- (1) Depending on the nature, scale and complexity of its business, it may be appropriate for a *firm* to have a separate risk assessment function responsible for assessing the risks that the *firm* faces and advising the *governing body* and *senior managers* on them.
- (2) The organisation and responsibilities of a risk assessment function should be documented. The function should be adequately resourced and staffed by an appropriate number of competent staff who are sufficiently independent to perform their duties objectively.
- (3) The term 'risk assessment function' refers to the generally understood concept of risk assessment within a *firm*, that is, the function of setting and controlling risk exposure. The risk assessment function is not an *FCA controlled function* itself, but *firms* it may fall under the *PRA chief risk officer controlled function*.
- (4) Paragraphs (1) and (3) do not apply to a *Solvency II firm* and (2) only applies as if the term 'risk assessment function' was replaced by 'risk management function'.
- (5) *Solvency II firms* are subject to requirements for an effective risk management system in PRA Rulebook: Solvency II firms: Conditions Governing Business 3.
- (6) Also, PRA Rulebook: Solvency II firms: Insurance Senior Management Functions makes the chief risk function a *PRA controlled function*. The chief risk function is the function of having responsibility for overall management of the risk management system, as specified in PRA Rulebook: Solvency II firms: Conditions Governing Business 3.
- (7) The *FCA* will take the requirements in (5) and (6) into account.

Management information

3.2.11

G

- (1) [deleted]
- (2) [deleted]

3.2.11A

G

- (1) A *firm's* arrangements should be such as to furnish its *governing body* with the information it needs to play its part in identifying, measuring, managing and controlling risks of regulatory concern. Three factors will be the relevance, reliability and timeliness of that information.
- (2) Risks of regulatory concern are those risks which relate to the fair treatment of the *firm's customers*, to the protection of *consumers*, to effective competition and to the integrity of the *UK financial system*. Risks which are relevant to the integrity of the *UK financial system* include risks which relate to its soundness, stability and resilience and to the use of the system in connection with *financial crime*.

3.2.11B

G

3.2.12 G It is the responsibility of the *firm* to decide what information is required, when, and for whom, so that it can organise and control its activities and can comply with its regulatory obligations. The detail and extent of information required will depend on the nature, scale and complexity of the business.

Employees and agents

3.2.13 G A *firm's* systems and controls should enable it to satisfy itself of the suitability of anyone who acts for it.

- 3.2.14 G
- (1) ■ SYSC 3.2.13 G includes assessing an individual's honesty, and competence. This assessment should normally be made at the point of recruitment. An individual's honesty need not normally be revisited unless something happens to make a fresh look appropriate.
 - (2) Any assessment of an individual's suitability should take into account the level of responsibility that the individual will assume within the *firm*. The nature of this assessment will generally differ depending upon whether it takes place at the start of the individual's recruitment, at the end of the probationary period (if there is one) or subsequently.
 - (3) [deleted]
 - (4) The requirements on *firms* with respect to *approved persons* are in Part V of the *Act* (Performance of regulated activities) and ■ SUP 10C and the Senior Insurance Management Functions parts of the *PRA Rulebook*

Audit committee

3.2.15 G Depending on the nature, scale and complexity of its business, it may be appropriate for a *firm* to form an audit committee. An audit committee could typically examine management's process for ensuring the appropriateness and effectiveness of systems and controls, examine the arrangements made by management to ensure compliance with requirements and standards under the *regulatory system*, oversee the functioning of the internal audit function (if applicable - see ■ SYSC 3.2.16 G) and provide an interface between management and the external auditors. It should have an appropriate number of *non-executive directors* and it should have formal terms of reference.

Internal audit

3.2.16 G

- (1) Depending on the nature, scale and complexity of its business, it may be appropriate for a *firm* to delegate much of the task of monitoring the appropriateness and effectiveness of its systems and controls to an internal audit function. An internal audit function should have clear responsibilities and reporting lines to an audit committee or appropriate *senior manager*, be adequately resourced and staffed by competent individuals, be independent of the day-to-day activities of the *firm* and have appropriate access to a *firm's* records.

- (2) The term 'internal audit function' refers to the generally understood concept of internal audit within a *firm*, that is, the function of assessing adherence to and the effectiveness of internal systems and controls, procedures and policies. The internal audit function is not an *FCA controlled function* itself, but for certain *firms* it may fall under the *PRA chief risk officer controlled function*.

(3) Paragraph (1) does not apply to *Solvency II firms*.

(4) *Solvency II firms* are subject to a requirement in PRA Rulebook: Solvency II firms: Conditions Governing Business, rule 5 to have an effective internal audit function.

(5) Also, the PRA Rulebook: Solvency II firms: Insurance Senior Management Functions makes the chief internal audit function a *PRA controlled function*. The chief internal audit function is the function of having responsibility for management of the internal audit function specified in PRA Rulebook: Solvency II firms: Conditions Governing Business, rule 5.

(6) The *FCA* will take the requirements in (4) and (5) into account.

Business strategy

- 3.2.17

G

A *firm* should plan its business appropriately so that it is able to identify, measure, manage and control risks of regulatory concern (see ■ SYSC 3.2.11 G (2)). In some *firms*, depending on the nature, scale and complexity of their business, it may be appropriate to have business plans or strategy plans documented and updated on a regular basis to take account of changes in the business environment.

Remuneration policies

- 3.2.18

G

It is possible that *firms'* remuneration policies will from time to time lead to tensions between the ability of the *firm* to meet the requirements and standards under the *regulatory system* and the personal advantage of those who act for it. Where tensions exist, these should be appropriately managed. See also *Solvency II Regulation* (Article 275) and *EIOPA Guidelines on system of governance* dated 28 January 2015 (EIOPA-BoS-14/253 EN) (Guidelines 9 and 10).

Business continuity

- 3.2.19

G

A *firm*, other than a *Solvency II firm*, should have in place appropriate arrangements, having regard to the nature, scale and complexity of its business, to ensure that it can continue to function and meet its regulatory obligations in the event of unforeseen interruption. These arrangements should be regularly updated and tested to ensure their effectiveness. *Solvency II firms* are subject to the business continuity requirements in PRA Rulebook: Solvency II firms: Conditions Governing Business, 2.6, and the *FCA* will take those requirements into account.

Records

- 3.2.20

R

(1) A *firm* must take reasonable care to make and retain adequate records of matters and dealings (including accounting records) which

- are the subject of requirements and standards under the *regulatory system*.
- (2) Subject to (3) and to any other record-keeping *rule* in the *Handbook*, the records required by (1) or by such other *rule* must be capable of being reproduced in the English language on paper.
- (3) If a *firm's* records relate to business carried on from an establishment in a country or territory outside the *United Kingdom*, an official language of that country or territory may be used instead of the English language as required by (2).

3.2.21 G A *firm* should have appropriate systems and controls in place to fulfil the *firm's* regulatory and statutory obligations with respect to adequacy, access, periods of retention and security of records. The general principle is that records should be retained for as long as is relevant for the purposes for which they are made.

3.2.21A G ■ SYSC 28 contains *rules* and *guidance* relating to knowledge and competence record keeping requirements in relation to *insurance distribution activities* undertaken by a *firm*.

3.2.22 G Detailed record-keeping requirements for different types of *firm* are to be found elsewhere in the *Handbook*. Schedule 1 to the *Handbook* is a consolidated schedule of these requirements.

Investment strategy and investment decision making

- 3.2.23 G
- (1) This *guidance* sets out the *FCA's* expectation on how a *firm* may take into account *ESG financial considerations* and *other financial considerations* and *non-financial matters* as part of its *investment strategy* and *investment decision making*, to demonstrate compliance with *Principles 2, 3, 6 or 8*.
 - (2) This *guidance* only applies where the *firm's investment strategy* or *investment decision* could have a material impact on a *policyholder's investment* returns and relates to a product where:
 - (a) the primary purpose is to provide an *investment return*; and
 - (b) any *investment risk* is borne by a *policyholder* who is a natural person or a *relevant policyholder*.
 - (3) As part of its *investment strategy* or *investment decision making*, a *firm* should take into account *ESG financial considerations* and *other financial considerations* over the period of time that the *firm* reasonably considers is needed to achieve the *investment objective* or *investment strategy*.
 - (4) References to *other financial considerations* in (3) may include (but are not limited to) interest rate, liquidity, concentration, exchange rate, political and counterparty risks.

		<p>(5) As part of its <i>investment</i> strategy or <i>investment</i> decision making in relation to a product, a <i>firm</i> may take into account <i>non-financial matters</i> if:</p> <p>(a) the <i>firm</i> has good reason to consider that affected <i>policyholders</i> or <i>relevant policyholders</i> would generally share the views on which the <i>non-financial matters</i> are based; and</p> <p>(b) taking those matters into account would not involve a risk of a significant financial detriment to any affected <i>investment</i>.</p> <p>(6) (5) does not apply to a <i>firm's investment</i> strategy or <i>investment</i> decision making in relation to a product (other than in relation to a <i>relevant scheme</i> or a <i>pathway investment</i>), that has been deliberately designed by the <i>firm</i> to take into account <i>non-financial matters</i>, and <i>policyholders</i> or <i>relevant policyholders</i> make an active decision to select that product.</p>
3.2.23	R	[deleted]
3.2.24	R	[deleted]
3.2.25	R	[deleted]
3.2.26	R	[deleted]
3.2.27	R	[deleted]
3.2.28	R	[deleted]
3.2.29	R	[deleted]
3.2.30	R	[deleted]
3.2.31	R	[deleted]
3.2.32	R	[deleted]
3.2.33	R	[deleted]
3.2.34	R	[deleted]
3.2.35	R	[deleted]
3.2.36	R	[deleted]



3.3 Additional requirements for insurance distribution

Application

3.3.1 R ■ SYSC 3.3 applies to an insurer in the course of it carrying on any insurance distribution activities.

Effect of provisions marked “EU”

3.3.2 G The IDD Regulation applies directly to an insurer when carrying on insurance distribution in relation to insurance-based investment products. Some of the articles of the IDD Regulation (see the provisions marked with the status letters “UK”) are reproduced in this section for those insurers for information only.

3.3.3 R (1) To the extent that the IDD Regulation does not apply, provisions in this section marked with the status letters “UK” apply to the insurer as if they were rules.

(2) References in Column (1) to a word or phrase used in the IDD Regulation have, for the purpose of ■ SYSC 3.3.3R(1) above, the meaning indicated in Column (2) of the table below:

(1)	(2)
“customer”	Client
“insurance-based investment products”	Policies
“insurance distribution activities”	insurance distribution activities
“insurance intermediary”	insurance intermediary
“insurance undertakings”	Insurer
“relevant person”	any of the following:
	(a) a director, partner or equivalent, or manager of the insurance intermediary or insurer;
	(b) an employee of the insurance intermediary or insurer, as well as any other natural person

(c)		whose services are placed at the disposal and under the control of the <i>insurance intermediary</i> or <i>insurer</i> and who is involved in the <i>insurance distribution activities</i> ; and
		a natural person who is directly involved in the provision of services to the <i>insurance intermediary</i> or <i>insurer</i> under an outsourcing agreement for the purpose of the carrying on by the <i>insurance intermediary</i> or <i>insurer</i> of <i>insurance distribution activities</i> .
"remuneration"	Remuneration	
"shall"	Must	

- 3.3.4G
- The effect of ■ SYSC 3.3.3R is that:
- (1)

the provisions marked "UK" apply as *rules* to an *insurer* when carrying on *insurance distribution activities* other than *insurance distribution* in relation to *insurance-based investment products*;
- (2)

where ■ SYSC 3.3.3R applies, an *insurer* is required to read the provisions marked "UK" as though the application of those provisions is not limited to the distribution of *insurance-based investment products*; and
- (3)

the scope of the application of the *IDD Regulation* is extended from *insurance distribution* to *insurance distribution activities*.

Identifying conflicts

- 3.3.5R
- A *firm* must take all appropriate steps to identify conflicts of interest that arise between:
- (1)

the *firm*, including its managers, employees and *appointed representatives* (or where applicable, *tied agents*), or any *person* directly or indirectly linked to them by *control*, and a *client* of the *firm*; or
- (2)

one *client* of the *firm* and another *client*.

[Note: article 28(1) of the *IDD*]

- 3.3.6R
- 3(1)For the purposes of identifying, in accordance with [■ SYSC 3.3.5R, ■ SYSC 3.3.13R, ■ SYSC 10.1.3R and ■ SYSC 10.1.8R], in so far as those rules apply to the insurance-based investment products, the types of conflicts of interest that arise in the course of carrying out any insurance distribution activities related to insurance-based investment products and which entail a risk of damage to the interests of a customer, insurance intermediaries and insurance undertakings shall assess whether they, a relevant person or any person directly or indirectly linked to them by control, have an interest in the outcome

		<p>of the insurance distribution activities, which meets the following criteria:</p> <ul style="list-style-type: none">it is distinct from the customer's or potential customer's interest in the outcome of the insurance distribution activities;it has the potential to influence the outcome of the distribution activities to the detriment of the customer. <p>Insurance intermediaries and insurance undertakings shall proceed in the same way for the purposes of identifying conflicts of interest between one customer and another.</p>
3.3.7	UK	<p>3(2) For the purposes of the assessment pursuant to paragraph 1, insurance intermediaries and insurance undertakings shall take into account, by way of minimum criteria, the following situations:</p> <ul style="list-style-type: none">(a) the insurance intermediary or insurance undertaking, a relevant person or any person directly or indirectly linked to them by control is likely to make a financial gain, or avoid a financial loss, to the potential detriment of the customer;(b) the insurance intermediary or insurance undertaking, a relevant person or any person directly or indirectly linked to them by control has a financial or other incentive to favour the interest of another customer or group of customers over the interest of the customer;(c) the insurance intermediary or insurance undertaking, a relevant person or any person directly or indirectly linked by control to an insurance intermediary or an insurance undertaking is substantially involved in the management or development of insurance-based investment products, in particular where such a person has an influence on the pricing of those products or their distribution costs. <p>[Note: article 3 of the <i>IDD Regulation</i>]</p>
3.3.8	R	<p>Managing conflicts</p> <p>A <i>firm</i> must maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest identified under ■ SYSC 3.3.5R from adversely affecting the interests of its <i>clients</i>.</p> <p>[Note: article 27 of the <i>IDD</i>]</p>
3.3.9	R	<p>Proportionality</p> <p>The arrangements in ■ SYSC 3.3.8R must be proportionate to the activities performed, the <i>policies</i> sold and the type of <i>insurance distributor</i> the <i>firm</i> is or uses.</p> <p>[Note: article 27 of the <i>IDD</i>]</p>
3.3.10	UK	<p>Conflicts policy</p> <p>4(1)For the purposes of [■ SYSC 3.3.8R, ■ SYSC 3.3.9R, ■ SYSC 10.1.3R, ■ SYSC 10.1.7R and ■ SYSC 10.1.7AR], in so far as those rules apply to insurance-based investment products, insurance intermediaries and</p>

insurance undertakings shall be expected to establish, implement and maintain an effective conflicts of interest policy set out in writing and appropriate to their size and organisation and the nature, scale and complexity of their business.

Where the insurance intermediary or insurance undertaking is a member of a group, the policy shall also take into account any circumstances, of which the insurance intermediary or insurance undertaking is or should be aware, which may give rise to a conflict of interest arising as a result of the structure and business activities of other members of the group.

[Note: article 4(1) of the *IDD Regulation*]

Contents of policy

3.3.11 UK

4(2) The conflicts of interest policy established in accordance with paragraph 1 shall include the following content:

- with reference to the specific insurance distribution activities carried out, the circumstances which constitute or may give rise to a conflict of interest entailing a risk of damage to the interests of one or more customers;
- procedures to be followed and measures to be adopted in order to manage such conflicts and prevent them from damaging the interests of the customer.

[Note: article 4(2) of the *IDD Regulation*]

3.3.12 UK

5(1) The procedures and measures referred to in Article 4(2)(b) shall be appropriate to the size and activities of the insurance intermediary or insurance undertaking and of the group to which they may belong, and to the risk of damage to the interests of the customer.

The procedures to be followed and measures to be adopted in accordance with Article 4(2)(b) shall include, where appropriate, the following:

- effective procedures to prevent or control the exchange of information between relevant persons engaged in activities involving a risk of conflict of interest where the exchange of that information may damage the interests of one or more customers;
- the separate supervision of relevant persons whose principal functions involve carrying out activities on behalf of, or providing services, to customers whose interests may conflict, or who otherwise represent different interests that may conflict, including those of the insurance intermediary or insurance undertaking;
- the removal of any direct link between payments, including remuneration, to relevant persons engaged in one activity and payments, including remuneration, to different relevant persons principally engaged in another activity, where a conflict of interest may arise in relation to those activities;
- measures to prevent or limit any person from exercising inappropriate influence over the way in which insurance

distribution activities are carried out by the insurance intermediary or insurance undertaking or their managers or employees or any person directly or indirectly linked to them by control;

measures to prevent or control the simultaneous or sequential involvement of a relevant person in separate insurance distribution activities where such involvement may impair the proper management of conflicts of interest;

a gifts and benefits policy which determines clearly under which conditions gifts and benefits can be accepted or granted and which steps are to be taken when accepting and granting gifts and benefits.

5(2) Where insurance intermediaries and insurance undertakings can demonstrate that the measures and procedures referred to in paragraph 1 are not appropriate to ensure that the insurance distribution activities are carried out in accordance with the best interest of the customer and are not biased due to conflicting interests of the insurance intermediary, the insurance undertaking or another customer, insurance intermediaries and insurance undertakings shall adopt adequate alternative measures and procedures for that purpose.

[Note: article 5 of the *IDD Regulation*]

Disclosure of conflicts

3.3.13

R

- (1) If arrangements made under ■SYSC 3.3.8R are not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of a *client* will be prevented, the *firm* must:
 - (a) clearly disclose to the *client* the general nature or sources of the conflicts of interest (or both); and
 - (b) include sufficient detail in the disclosure, taking into account the nature of the *client*, to enable that *client* to take an informed decision with respect to the *insurance distribution activities* in the context of which the conflict of interest arises.
- (2) The disclosure must be made:
 - (a) in a *durable medium*; and
 - (b) in good time before the conclusion of the *contract of insurance*.

[Note: article 28(2) and (3) of the *IDD*]

3.3.14

UK

6(1) Insurance intermediaries and insurance undertakings shall avoid over-reliance on disclosure to ensure that disclosure to customers, pursuant to [■SYSC 3.3.13R] and [■SYSC 10.1.8R], in so far as those rules apply to insurance-based investment products, is a measure of last resort that can be used only where the effective organisational and administrative arrangements established by the insurance intermediary or insurance undertaking to prevent or manage conflicts of interest in accordance with [■SYSC 3.3.8R, ■SYSC 3.3.9R, ■SYSC 10.1.3R, ■SYSC 10.1.7R, ■SYSC 10.1.7AR], in so far as these rules apply to insurance-based investment products are not sufficient to

ensure, with reasonable confidence, that risks of damage to the interests of the customer will be prevented.

6(2) For the purposes of a disclosure of conflicts of interest insurance intermediaries and insurance undertakings shall do all of the following:

provide a specific description of the conflict of interest in question;

explain the general nature and sources of the conflict of interest;

explain the risks to the consumer that arise as a result of the conflict of interest and the steps undertaken to mitigate those risks;

clearly state that the organisational and administrative arrangements established by the insurance intermediary or insurance undertaking to prevent or manage the conflict of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of the customer will be prevented.

[Note: article 6 of the *IDD Regulation*]

Review of conflicts policy

3.3.15 UK

7(1) For the purposes of 3.3.8, [■ SYSC 3.3.9R, ■ SYSC 10.1.3R, ■ SYSC 10.1.7R and ■ SYSC 10.1.7AR], in so far as those rules apply to insurance-based investment products, insurance intermediaries and insurance undertakings shall assess and periodically review, on an at least annual basis, the conflicts of interest policy established in accordance with Article 4 and take all appropriate measures to address any deficiencies.

[Note: article 7(1) of the *IDD Regulation*]

Record keeping

3.3.16 UK

7(2) Insurance intermediaries and insurance undertakings shall keep and regularly update a record of the situations in which a conflict of interest entailing a risk of damage to the interests of a customer has arisen or, in the case of an ongoing service or activity may arise.

Senior management of the insurance intermediary or insurance undertaking shall receive on a frequent basis, and at least annually, written reports on the situations referred to in the first subparagraph.

[Note: article 7(2) of the *IDD Regulation*]

3.3.17 R

A firm carrying on *insurance distribution activities* in relation to *insurance-based investment products* must retain its records relating to:

- (1) suitability (■ COBS 9A); and
- (2) appropriateness (■ COBS 10A),

for a period of at least five years.

3.3.18 G

- (1) ■ COBS 9A.4 and ■ COBS 10A.7 (record keeping and retention periods for suitability and appropriateness records) reproduce certain record keeping requirements of the *IDD Regulation* (and apply these requirements to *firms* not in scope of the *IDD Regulation*). They specify information which should be recorded by *firms* carrying on *insurance distribution* in relation to *insurance-based investment products* and for how long the records must be retained.
- (2) For the purposes of ■ SYSC 3.3.17R, a *firm* will need to consider whether the requirement in article 19 of the *IDD Regulation* (or in ■ COBS 9A.4.3UK or 10A.7.2UK for any *firm* to whom the *IDD Regulation* does not apply) means that a record needs to be retained for longer than five years.

3.3.19 UK

19(4) The records shall be retained in a medium that allows the storage of information in a way accessible for future reference by the FCA. The FCA shall be able to access them readily, to reconstitute each element in a clear and accurate manner and to identify easily any changes, corrections or other amendments, and the contents of the records prior to such modifications.

[Note: article 19(4) of the *IDD Regulation*]

3.4 SRD requirements

Application

3.4.1

R

This section applies to:

- (a) a *UK insurer*; and
- (b) a *UK pure reinsurer*,

doing *long-term insurance business*.

3.4.2

R

The *rules* in this section apply to the extent that a *firm* is investing (or has invested), directly or through an *SRD asset manager*, in shares traded on a *regulated market*.

3.4.3

G

The defined term *regulated market* has an extended meaning for the purposes of this section. The definition includes certain markets situated outside the *United Kingdom*.

Engagement policy and disclosure of information

3.4.4

R

A *firm* must either:

- (1) (a) develop and publicly disclose an *engagement policy* that meets the requirements of ■ SYSC 3.4.5R (an “*engagement policy*”); and
- (b) publicly disclose on an annual basis how its *engagement policy* has been implemented, in a way that meets the requirements of ■ SYSC 3.4.6R; or
- (2) publicly disclose a clear and reasoned explanation of why it has chosen not to comply with any of the requirements imposed by (1).

[**Note:** article 3g(1) and (1)(a) of *SRD*]

3.4.5

R

The *engagement policy* must describe how the *firm*:

- (1) integrates shareholder engagement in its investment strategy;
- (2) monitors investee companies on relevant matters, including:
 - (a) strategy;
 - (b) financial and non-financial performance and risk;

- (c) capital structure; and
- (d) social and environmental impact and corporate governance;
- (3) conducts dialogues with investee companies;
- (4) exercises voting rights and other rights attached to *shares*;
- (5) cooperates with other shareholders;
- (6) communicates with relevant stakeholders of the investee companies; and
- (7) manages actual and potential conflicts of interests in relation to the *firm's* engagement.

[Note: article 3g(1)(a) of *SRD*]

3.4.6

R

- (1) The annual disclosure must include a general description of voting behaviour, an explanation of the most significant votes and the use of the services of *proxy advisors*.
- (2) (a) Subject to (b), a *firm* must publicly disclose how it has cast votes in the general meetings of companies in which it holds *shares*.
(b) A *firm* is not required to disclose votes that are insignificant due to the subject matter of the vote or the size of the holding in the company.

[Note: article 3g(1)(b) of *SRD*]

3.4.7

R

- (1) The applicable disclosures or information referred to in ■SYSC 3.4.4R to ■SYSC 3.4.6R must be made available free of charge on the *firm's* website.
- (2) Where an *SRD asset manager* implements the engagement policy, including voting, on behalf of a *firm*, the *firm* must make a reference as to where such voting information has been published by the *SRD asset manager*.

[Note: article 3g(2) of *SRD*]

Investment strategy and arrangements with SRD asset managers

3.4.8

R

A *firm* must disclose publicly how the main elements of its equity investment strategy are consistent with the profile and duration of its liabilities, in particular long-term liabilities, and how they contribute to the medium- to long-term performance of its assets.

[Note: article 3h(1) of *SRD*]

3.4.9

R

- (1) Where an *SRD asset manager* invests on behalf of a *firm*, whether on a discretionary client-by-client basis or through a collective investment undertaking, the *firm* must publicly disclose the following information regarding its arrangement with the *SRD asset manager*:

- (a) how the arrangement with the *SRD asset manager* incentivises the *SRD asset manager* to align its investment strategy and decisions with the profile and duration of the liabilities of the *firm*, in particular long-term liabilities;
 - (b) how that arrangement incentivises the *SRD asset manager* to make investment decisions based on assessments of medium- to long-term financial and non-financial performance of the investee company, and to engage with investee companies in order to improve their performance in the medium- to long-term;
 - (c) how the method and time horizon of the evaluation of the *SRD asset manager's* performance and the remuneration for asset management services are in line with the profile and duration of the liabilities of the *firm*, in particular its long-term liabilities, taking into account its absolute long-term performance;
 - (d) how the *firm* monitors portfolio turnover costs incurred by the *SRD asset manager* and how it defines and monitors a targeted portfolio turnover or turnover range; and
 - (e) the duration of the arrangement with the *SRD asset manager*.
- (2) Where the arrangement with the *SRD asset manager* does not contain one or more such elements, the *firm* must give a clear and reasoned explanation why this is the case.

[Note: article 3h(2) of *SRD*]

3.4.10

R

The information referred to in ■ SYSC 3.4.8R and ■ SYSC 3.4.9R must:

- (1) be made available, free of charge, on the *firm's* website; and
- (2) be updated annually, unless there is no material change.

[Note: article 3h(3), first paragraph of *SRD*]