Powers exercised

A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

1. section 138 (General rule-making power);
2. section 141 (Insurance business rules);
3. section 145 (Financial promotion rules);
4. section 146 (Money laundering rules);
5. section 147 (Control of information rules);
6. section 149 (Evidential provisions);
7. section 150(2) (Actions for damages);
8. section 156 (General supplementary powers); and
9. section 157(1) (Guidance).

B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force as follows:

1. Annex C and E on 31 December 2006;
3. The remainder of this instrument comes into force on 1 January 2007.

Amendments to the Integrated Prudential Sourcebook and the Senior Management Arrangement, Systems and Controls Sourcebook

D. (1) In relation to the “Amended text” in column (3) of the table in D(5), SYSC is amended in accordance with Annex A of this instrument.

(2) In relation to the “New text” indicated in column (3), SYSC is amended by inserting the provisions in Annex B to this instrument.

(3) In relation to the “Transferred, Amended and New text” in column (3), SYSC is amended by inserting the provisions in Annex C in this instrument (which has the effect of transferring the provisions in PRU identified in column (2), with amendments, to the location indicated in column (1) and inserting new text in Annex C).
(4) In relation to the “Transferred and Amended text” in column (3), SYSC is amended by inserting the provisions in Annex D in this instrument (which has the effect of transferring the provisions in PRU identified in column (2), with amendments, to the location indicated in column (1)).

(4) In relation to the “Transferred text” in column (3), SYSC is amended by inserting the provisions of Annex E in this instrument (which has the effect of transferring the provisions in SYSC and PRU identified in column (2), with necessary consequential changes, to the location indicated in column (1)).

(5) The table referred to is:

<table>
<thead>
<tr>
<th>(1) SYSC</th>
<th>(2) Current designation in PRU or SYSC (where applicable)</th>
<th>(3) Type of text</th>
<th>(4) Annex in this Instrument</th>
</tr>
</thead>
<tbody>
<tr>
<td>SYSC TP</td>
<td></td>
<td>New text</td>
<td>Annex B</td>
</tr>
<tr>
<td>SYSC 1</td>
<td>SYSC 1</td>
<td>Amended text</td>
<td>Annex A</td>
</tr>
<tr>
<td>SYSC 3</td>
<td>SYSC 3</td>
<td>Amended text</td>
<td>Annex A</td>
</tr>
<tr>
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<td></td>
<td>New text</td>
<td>Annex B</td>
</tr>
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<td>SYSC 5</td>
<td></td>
<td>New text</td>
<td>Annex B</td>
</tr>
<tr>
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<td></td>
<td>New text</td>
<td>Annex B</td>
</tr>
<tr>
<td>SYSC 7</td>
<td></td>
<td>New text</td>
<td>Annex B</td>
</tr>
<tr>
<td>SYSC 8</td>
<td></td>
<td>New text</td>
<td>Annex B</td>
</tr>
<tr>
<td>SYSC 10</td>
<td></td>
<td>New text</td>
<td>Annex B</td>
</tr>
<tr>
<td>SYSC 11</td>
<td>PRU 5.1</td>
<td>Transferred and Amended and New text</td>
<td>Annex C</td>
</tr>
<tr>
<td>SYSC 12</td>
<td>PRU 8.1</td>
<td>Transferred and Amended text</td>
<td>Annex D</td>
</tr>
<tr>
<td>SYSC 13</td>
<td>SYSC 3A</td>
<td>Transferred text</td>
<td>Annex E</td>
</tr>
<tr>
<td>SYSC 14 (except 14.1.65G)</td>
<td>PRU 1.4</td>
<td>Transferred text</td>
<td>Annex E</td>
</tr>
<tr>
<td>SYSC 14.1.65G</td>
<td>PRU 6.1.9G</td>
<td>Transferred text</td>
<td>Annex E</td>
</tr>
<tr>
<td>SYSC 15</td>
<td>PRU 3.1</td>
<td>Transferred text</td>
<td>Annex E</td>
</tr>
<tr>
<td>SYSC 16</td>
<td>PRU 4.1</td>
<td>Transferred text</td>
<td>Annex E</td>
</tr>
<tr>
<td>SYSC 17</td>
<td>PRU 7.1</td>
<td>Transferred text</td>
<td>Annex E</td>
</tr>
<tr>
<td>SYSC 18</td>
<td>SYSC 4</td>
<td>Transferred text</td>
<td>Annex E</td>
</tr>
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<td>SYSC Schedule 1</td>
<td>Amended text</td>
<td>Annex A</td>
</tr>
<tr>
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<td>SYSC Schedule 5</td>
<td>Amended text</td>
<td>Annex A</td>
</tr>
<tr>
<td>SYSC Schedule 6</td>
<td>SYSC Schedule 6</td>
<td>Amended text</td>
<td>Annex A</td>
</tr>
</tbody>
</table>

**Further amendments to SYSC**

E. SYSC is further amended by the provisions in Annex F to this instrument.

**Amendments to the Glossary**

F. The Glossary is amended by the provisions in Annex T to this instrument.
Amendments to the Handbook

G. The modules of the FSA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principles for Businesses sourcebook (PRIN)</td>
<td>Annex G</td>
</tr>
<tr>
<td>Threshold Conditions (COND)</td>
<td>Annex H</td>
</tr>
<tr>
<td>Conduct of Business sourcebook (COB)</td>
<td>Annex I</td>
</tr>
<tr>
<td>Insurance: Conduct of Business sourcebook (ICOB)</td>
<td>Annex J</td>
</tr>
<tr>
<td>Mortgages: Conduct of Business sourcebook (MCOB)</td>
<td>Annex K</td>
</tr>
<tr>
<td>Client Assets sourcebook (CASS)</td>
<td>Annex L</td>
</tr>
<tr>
<td>Market Conduct sourcebook (MAR)</td>
<td>Annex M</td>
</tr>
<tr>
<td>Training and Competence sourcebook (TC)</td>
<td>Annex N</td>
</tr>
<tr>
<td>Supervision manual (SUP)</td>
<td>Annex O</td>
</tr>
<tr>
<td>Enforcement manual (ENF)</td>
<td>Annex P</td>
</tr>
<tr>
<td>Credit Unions sourcebook (CRED)</td>
<td>Annex Q</td>
</tr>
<tr>
<td>Professional Firms sourcebook (PROF)</td>
<td>Annex R</td>
</tr>
<tr>
<td>Recognised Investment Exchanges and Recognised Clearing Houses sourcebook (REC)</td>
<td>Annex S</td>
</tr>
</tbody>
</table>

Citation

H. This instrument may be cited as the Senior Management Arrangements, Systems and Controls (Markets in Financial Instruments and Capital Requirements Directives) Instrument 2006.

By order of the Board
23 November 2006
Annex A

Senior Management Arrangements, Systems and Controls Handbook (SYSC)

In this Annex, underlining indicates new text and striking through indicates deleted text. Where an entire section of text is being inserted, the place where the change will be made is indicated and the text is not underlined.

1 Application and purpose

1.1 Application of SYSC 2 and SYSC 3

Purpose of this section

1.1.-2 G [deleted]

1.1.-1 G [deleted]

1.1.1 R Who?

SYSC 2 and SYSC 3 apply to every firm except that:

…

(c) SYSC 3 applies, but only with respect to the activities in SYSC 1.1.4 R; and

(5) for an authorised professional firm when carrying on non-mainstream regulated activities, SYSC 3.2.6A R to SYSC 3.2.6J G do not apply; and

(6) SYSC 3.2.23R to SYSC 3.2.36R apply only to a BIPRU firm.

…

1.2 Purpose of SYSC

1.2.1 G The purposes of SYSC are:

(1) to encourage firms' directors and senior managers to take appropriate practical responsibility for their firms' arrangements on matters likely to be of interest to the FSA because they impinge on the FSA's functions under the Act;

(2) to increase certainty by amplifying Principle 3, under which a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems; and

(3) to encourage firms to vest responsibility for effective and responsible organisation in specific directors and senior managers;
(4) to create a common platform of organisational and systems and controls requirements for firms subject to the CRD and/or MiFID; and

(5) to set out high-level organisational and systems and controls requirements for insurers.

1.2.2 G The main matters, referred to in SYSC 1.2.1G (1), which are likely to be of interest to the FSA are those which relate to confidence in the financial system; to the fair treatment of firms' customers; to the protection of consumers; and to the use of the financial system in connection with financial crime. The FSA is not primarily concerned with risks which threaten only the owners of a financial business except in so far as these risks may have an impact on those matters.

To be inserted after SYSC 1.2

1.3 Application of the common platform requirements

Who?

1.3.1 R The common platform requirements apply to a common platform firm unless provided otherwise in a specific rule.

1.3.1A G From 1 January 2007 until 1 November 2007, the application of the common platform requirements is limited by SYSC TP 1.

What?

1.3.2 R The common platform organisational requirements apply with respect to the carrying on of the following (unless provided otherwise within a specific rule):

(1) regulated activities;

(2) activities that constitute dealing in investments as principal, disregarding the exclusion in article 15 of the Regulated Activities Order (Absence of holding out etc); and

(3) ancillary activities.

1.3.3 G The application of the provisions on the conflicts of interest in SYSC 10 is set out in SYSC 10.1.1R and SYSC 10.2.1R.

1.3.4 R [To follow.]

1.3.5 R The common platform requirements on financial crime apply as set out in SYSC 1.3.2R, except that they do not apply:
with respect to:

(a) activities that constitute *dealing in investments as principal*, disregarding the exclusion in article 15 of the *Regulated Activities Order* (Absence of holding out etc); and

(b) ancillary activities; or

(2) in relation to the following *regulated activities*:

(a) general insurance business;

(b) insurance mediation activity in relation to a general insurance contract or pure protection contract;

(c) long-term insurance business which is outside the *Consolidated Life Directive* (unless it is otherwise one of the regulated activities specified in this rule);

(d) business relating to contracts which are within the *Regulated Activities Order* only because they fall within paragraph (e) of the definition of "contract of insurance" in article 3 of that Order;

(e) (i) arranging by the *Society of Lloyd's* of deals in general insurance contracts written at Lloyd's; and

(ii) managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's; and

(f) home finance mediation activity and administering a home finance transaction.

1.3.6 R The *common platform organisational requirements*, except the *common platform requirements on financial crime*, also apply with respect to the communication and approval of financial promotions which:

(1) if *communicated* by an *unauthorised person* without *approval* would contravene section 21(1) of the *Act* (Restrictions on financial promotion); and

(2) may be *communicated* by a *firm* without contravening section 238(1) of the *Act* (Restrictions on promotion of collective investment schemes).

1.3.7 R The *common platform organisational requirements*, except the *common platform requirements on financial crime*, also:

(1) apply with respect to the carrying on of *unregulated activities* in a *prudential context*; and
(2) take into account any activity of other members of a group of which the firm is a member.

1.3.8 G SYSC 1.3.7R(2) does not mean that inadequacy of a group member's systems and controls will automatically lead to a firm contravening any of the common platform organisational requirements. Rather, the potential impact of a group member's activities, including its systems and controls, and any systems and controls that operate on a group basis, will be relevant in determining the appropriateness of the firm's own systems and controls.

Where?

1.3.9 R The common platform requirements apply to a common platform firm in relation to activities carried on by it from an establishment in the United Kingdom.

1.3.10 R The common platform requirements, except the common platform requirements on financial crime, apply to a common platform firm in relation to passported activities carried on by it from a branch in another EEA State.

1.3.11 R The common platform organisational requirements, except the common platform requirements on financial crime, also apply in a prudential context to a UK domestic firm with respect to activities wherever they are carried on.

Actions for damages

1.3.12 R A contravention of a rule in the common platform requirements does not give rise to a right of action by a private person under section 150 of the Act (and each of those rules is specified under section 150(2) of the Act as a provision giving rise to no such right of action).

1.4 Application of SYSC 11 to SYSC 18

What?

1.4.1 G The application of each of chapters SYSC 11 to SYSC 18 is set out in those chapters.

Actions for damages

1.4.2 R A contravention of a rule in SYSC 11 to SYSC 18 does not give rise to a right of action by a private person under section 150 of the Act (and each of those rules is specified under section 150(2) of the Act as a provision giving rise to no such right of action).
To be inserted after SYSC 3.1.1R

3.1.1A R SYSC 3.1 and SYSC 3.2.1G to SYSC 3.2.22G apply to a BIPRU firm only to the extent that they do not conflict with SYSC 3.2.23R to SYSC 3.2.36R.

To be inserted after SYSC 3.2.5G

Organisation

...}

To be inserted after SYSC 3.2.22G

CRD requirements

(1) General organisation requirements

3.2.23 R A BIPRU firm must have robust governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and adequate internal control mechanisms, including sound administrative and accounting procedures.

[Note: article 22(1) of the Banking Consolidation Directive]

3.2.24 R The arrangements, processes and mechanisms referred to in SYSC 3.2.23R must be comprehensive and proportionate to the nature, scale and complexity of the BIPRU firm's activities. The technical criteria laid down in BIPRU 2.3.7R(1), BIPRU 9.1.6R, BIPRU 9.13.21R (Liquidity plans), BIPRU 10.12.3R (Concentration risk policies), SYSC 3.2.26R and SYSC 3.2.28R to SYSC 3.2.36R must be taken into account.

[Note: article 22(2) of the Banking Consolidation Directive]
3.2.25 R A BIPRU firm must ensure that its internal control mechanisms and administrative and accounting procedures permit the verification of its compliance with rules adopted in accordance with the Capital Adequacy Directive at all times.

[Note: article 35(1) second sentence of the Capital Adequacy Directive]

3.2.26 R A BIPRU firm must have contingency and business continuity plans in place aimed at ensuring its ability to operate on an ongoing basis and limit losses in the event of severe business disruption.

[Note: annex V paragraph 13 of the Banking Consolidation Directive]

3.2.27 R A credit institution must have at least two persons who effectively direct the business of the firm. These persons must be of sufficiently good repute and have sufficient experience to perform their duties.

[Note: article 11(1) of the Banking Consolidation Directive]

(2) Employees, agents and other relevant persons

3.2.28 R The governing body of a BIPRU firm must define arrangements concerning the segregation of duties in the organisation and the prevention of conflicts of interest.

[Note: annex V paragraph 1 of the Banking Consolidation Directive]

(3) Risk control

3.2.29 R The governing body of a BIPRU firm must approve and periodically review the strategies and policies for taking up, managing, monitoring and mitigating the risks the firm is or might be exposed to, including those posed by the macroeconomic environment in which it operates in relation to the status of the business cycle.

[Note: annex V paragraph 2 of the Banking Consolidation Directive]

3.2.30 R A BIPRU firm must base credit-granting on sound and well-defined criteria and clearly establish the process for approving, amending, renewing, and refinancing credits.

[Note: annex V paragraph 3 of the Banking Consolidation Directive]

3.2.31 R A BIPRU firm must operate through effective systems the ongoing administration and monitoring of its various credit risk-bearing portfolios and exposures, including for identifying and managing problem credits and for making adequate value adjustments and provisions.

[Note: annex V paragraph 4 of the Banking Consolidation Directive]
3.2.32 R A **BIPRU firm** must adequately diversify credit portfolios given its target markets and overall credit strategy.

[Note: annex V paragraph 5 of the *Banking Consolidation Directive*]

3.2.33 R A **BIPRU firm** must address and control by means of written policies and procedures the risk that recognised credit risk mitigation techniques used by it prove less effective than expected.

[Note: annex V paragraph 6 of the *Banking Consolidation Directive*]

3.2.34 R A **BIPRU firm** must implement policies and processes for the measurement and management of all material sources and effects of market risks.

[Note: annex V paragraph 10 of the *Banking Consolidation Directive*]

3.2.35 R A **BIPRU firm** must implement systems to evaluate and manage the risk arising from potential changes in interest rates as they affect a **BIPRU firm's** non-trading activities.

[Note: annex V paragraph 11 of the *Banking Consolidation Directive*]

3.2.36 R A **BIPRU firm** must implement policies and processes to evaluate and manage the exposure to operational risk, including to low-frequency high severity events. Without prejudice to the definition of *operational risk*, **BIPRU firms** must articulate what constitutes operational risk for the purposes of those policies and procedures.

[Note: annex V paragraph 12 of the *Banking Consolidation Directive*]
Schedule 1 to be amended as follows:

<table>
<thead>
<tr>
<th>Handbook reference</th>
<th>Subject of record</th>
<th>Contents of record</th>
<th>When record must be made</th>
<th>Retention period</th>
</tr>
</thead>
<tbody>
<tr>
<td>SYSC 10.1.6R</td>
<td>Conflict of interest</td>
<td>Kinds of service or activity carried out by or on behalf of the <em>firm</em> in which a conflict of interest entailing a material risk of damage to the interests of one or more <em>clients</em> has arisen or, in the case of an ongoing service or activity, may arise.</td>
<td>Not specified</td>
<td>5 years</td>
</tr>
<tr>
<td>SYSC 14.1.53R</td>
<td>Prudential risk management and systems and controls</td>
<td>Accounting and other records that are sufficient to enable the <em>firm</em> to demonstrate to the <em>FSA</em>: (1) that the <em>firm</em> is financially sound and has appropriate systems and controls; (2) the <em>firm's</em> financial position and exposure to risk (to a reasonable degree of accuracy); (3) the <em>firm's</em> compliance with the rules in <em>GENPRU</em>, <em>INSPRU</em> and</td>
<td>Not specified</td>
<td>3 years, or longer as appropriate</td>
</tr>
<tr>
<td></td>
<td></td>
<td>SYSC.</td>
<td></td>
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Schedule 5 to be amended as follows

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<th>Chapter/Appendix</th>
<th>Section/Annex</th>
<th>Right of action under section 150</th>
<th>For private person?</th>
<th>Removed?</th>
<th>For other person?</th>
</tr>
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<tbody>
<tr>
<td>All rules in SYSC 2 and SYSC 3</td>
<td></td>
<td></td>
<td>No</td>
<td>Yes SYSC 1.1.12R</td>
<td>No</td>
</tr>
<tr>
<td>SYSC 4 to SYSC 10</td>
<td></td>
<td></td>
<td>No</td>
<td>Yes SYSC 1.3.12R</td>
<td>No</td>
</tr>
<tr>
<td>SYSC 11 to SYSC 18</td>
<td></td>
<td></td>
<td>No</td>
<td>Yes SYSC 1.4.2R</td>
<td>No</td>
</tr>
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</table>
Schedule 6 to be amended as follows

Schedule 6  Rules that can be waived

G. The rules in SYSC can be waived by the FSA under section 148 of the Act (Modification or waiver of rules) in so far as this is compatible with the United Kingdom's responsibilities to implement the requirements of any European Directive.
Annex B

Senior Management Arrangements, Systems and Controls Handbook (SYSC)

In this Annex, all text in new is not underlined.

To be inserted in SYSC Transchedule

TP  Transitional provisions

TP 1  Common platform firms

Application

1.1 R *SYSC TP 1 applies to a common platform firm.*

Commencement and expiry of SYSC TP 1

1.2 R *SYSC TP 1 comes into force on 1 January 2007 and applies until 1 November 2007.*

Purpose

1.3 G From 1 November 2007, a firm must comply with the common platform requirements and SYSC 3 will cease to apply to it. However, until 1 November 2007, a firm may choose to comply with the specific parts of the common platform requirements instead of SYSC 3. The purpose of SYSC TP 1 is to give a firm the option of complying with the common platform requirements sooner than 1 November 2007.

1.4 G The ability to comply with the common platform requirements before 1 November 2007 does not apply to SYSC 9 (Record-keeping), SYSC 8.2 (Outsourcing of portfolio management for retail clients to a non-EEA State) or SYSC 8.3 (Guidance on outsourcing portfolio management for retail clients to a non-EEA State). All firms must continue to comply with the record-keeping requirements in SYSC 3.2.20R until 1 November 2007, when SYSC 9 will enter into force.

The decision to comply with the common platform requirements

1.5 R *SYSC 4 to 7, SYSC 8.1 and SYSC 10 do not apply to a firm unless it decides to comply with them sooner than 1 November 2007.*

1.6 R If a firm decides to comply with the common platform requirements in accordance with SYSC TP 1.5R:

(1) it must make a record of the date of the decision and the date from which it is to be effective; and
subject to SYSC TP 1.7R below, from the effective date, it must comply with SYSC 4 to 7, SYSC 8.1 and SYSC 10, and SYSC 3 will not apply to it.

1.7 R The following provisions in SYSC 3 will continue to apply to a firm that decides to comply with the common platform requirements before the 1 November 2007:

(1) SYSC 3.2.23R, SYSC 3.2.24R, SYSC 3.2.26R and SYSC 3.2.28R to SYSC 3.2.35R in so far as SYSC 12.1.13R applies to it; and

(2) SYSC 3.2.20R to SYSC 3.2.22G.

1.8 G The purpose of SYSC TP 1.7R is to ensure the effective operation of the provisions on consolidated risk management processes and internal control mechanisms in relation to a firm that decides to comply with the common platform requirements before 1 November 2007.

1.9 G A decision by a firm to comply with the common platform requirements must be made in relation to all of the common platform requirements. The firm may not 'cherry-pick'.

Definitions in SYSC TP1 and the common platform requirements

1.10 R The terms common platform firm and MiFID investment firm have effect in SYSC TP1 and the common platform requirements as if MiFID applied generally from 1 January 2007.
To be inserted after SYSC 3

4 General organisational requirements

4.1 General requirements

4.1.1 R A *common platform firm* must have robust governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and internal control mechanisms, including sound administrative and accounting procedures and effective control and safeguard arrangements for information processing systems.

[Note: article 22(1) of the *Banking Consolidation Directive*, article 13(5) second paragraph of *MiFID*]

4.1.2 R The arrangements, processes and mechanisms referred to in SYSC 4.1.1R must be comprehensive and proportionate to the nature, scale and complexity of the *common platform firm’s* activities and must take into account the specific technical criteria described in SYSC 4.1.7R, SYSC 5.1.7R and SYSC 7.

[Note: article 22(2) of the *Banking Consolidation Directive*]

4.1.3 R A *BIPRU firm* must ensure that its internal control mechanisms and administrative and accounting procedures permit the verification of its compliance with *rules* adopted in accordance with the *Capital Adequacy Directive* at all times.

[Note: article 35(1) final sentence of the *Capital Adequacy Directive*]

4.1.4 R A *common platform firm* must, taking into account the nature, scale and complexity of the business of the *firm*, and the nature and range of the *investment services and activities* undertaken in the course of that business:

1. establish, implement and maintain decision-making procedures and an organisational structure which clearly and in a documented manner specifies reporting lines and allocates functions and responsibilities;

2. establish, implement and maintain adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the *firm*; and

3. establish, implement and maintain effective internal reporting and communication of information at all relevant levels of the *firm*.

[Note: articles 5(1) final paragraph, 5(1)(a), 5(1)(c) and 5(1)(e) of the *MiFID implementing Directive*]

4.1.5 R A *MiFID investment firm* must establish, implement and maintain systems
and procedures that are adequate to safeguard the security, integrity and confidentiality of information, taking into account the nature of the information in question.

[Note: article 5(2) of the MiFID implementing Directive]

Business continuity

4.1.6 R A common platform firm must take reasonable steps to ensure continuity and regularity in the performance of its regulated activities. To this end the firm must employ appropriate and proportionate systems, resources and procedures.

[Note: article 13(4) of MiFID]

4.1.7 R A common platform firm must establish, implement and maintain an adequate business continuity policy aimed at ensuring, in the case of an interruption to its systems and procedures, that any losses are limited, the preservation of essential data and functions, and the maintenance of its regulated activities, or, where that is not possible, the timely recovery of such data and functions and the timely resumption of its regulated activities.

[Note: article 5(3) of the MiFID implementing Directive and annex V paragraph 13 of the Banking Consolidation Directive]

4.1.8 G The matters dealt with in a business continuity policy should include:

1. resource requirements such as people, systems and other assets, and arrangements for obtaining these resources;

2. the recovery priorities for the firm's operations;

3. communication arrangements for internal and external concerned parties (including the FSA, clients and the press);

4. escalation and invocation plans that outline the processes for implementing the business continuity plans, together with relevant contact information;

5. processes to validate the integrity of information affected by the disruption; and

6. regular testing of the business continuity policy in an appropriate and proportionate manner in accordance with SYSC 4.1.10R.
Accounting policies

4.1.9 R A common platform firm must establish, implement and maintain accounting policies and procedures that enable it, at the request of the FSA, to deliver in a timely manner to the FSA financial reports which reflect a true and fair view of its financial position and which comply with all applicable accounting standards and rules.

[Note: article 5(4) of the MiFID implementing Directive]

Regular monitoring

4.1.10 R A common platform firm must monitor and, on a regular basis, evaluate the adequacy and effectiveness of its systems, internal control mechanisms and arrangements established in accordance with SYSC 4.1.4R to SYSC 4.1.9R and take appropriate measures to address any deficiencies.

[Note: article 5(5) of the MiFID implementing Directive]

Audit committee

4.1.11 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) and provide an interface between management and external auditors. It should have an appropriate number of non-executive directors and it should have formal terms of reference.

4.2 Persons who effectively direct the business

4.2.1 R The senior personnel of a common platform firm must be of sufficiently good repute and sufficiently experienced as to ensure the sound and prudent management of the firm.

[Note: article 9(1) of MiFID and article 11(1) second paragraph of the Banking Consolidation Directive]

4.2.2 R A common platform firm must ensure that its management is undertaken by at least two persons meeting the requirements laid down in SYSC 4.2.1R.

[Note: article 9(4) first paragraph of MiFID and article 11(1) first paragraph of the Banking Consolidation Directive]

4.2.3 G In the case of a body corporate, the persons referred to in SYSC 4.2.2R should either be executive directors or persons granted executive powers by, and reporting immediately to, the governing body. In the case of a partnership, they should be active partners.

4.2.4 G At least two independent minds should be applied to both the formulation
and implementation of the policies of a common platform firm. Where a common platform firm nominates just two individuals to direct its business, the FSA will not regard them as both effectively directing the business where one of them makes some, albeit significant, decisions relating to only a few aspects of the business. Each should play a part in the decision-making process on all significant decisions. Both should demonstrate the qualities and application to influence strategy, day-to-day policy and its implementation. This does not require their day-to-day involvement in the execution and implementation of policy. It does, however, require involvement in strategy and general direction, as well as knowledge of, and influence on, the way in which strategy is being implemented through day-to-day policy.

4.2.5 G Where there are more than two individuals directing the business, the FSA does not regard it as necessary for all of these individuals to be involved in all decisions relating to the determination of strategy and general direction. However, at least two individuals should be involved in all such decisions. Both individuals' judgement should be engaged so that major errors leading to difficulties for the firm are less likely to occur. Similarly, each individual should have sufficient experience and knowledge of the business and the necessary personal qualities and skills to detect and resist any imprudence, dishonesty or other irregularities by the other individual. Where a single individual, whether a chief executive, managing director or otherwise, is particularly dominant in a firm this will raise doubts about whether SYSC 4.2.2R is met.

4.2.6 R If a common platform firm, other than a credit institution, is:

(1) a natural person; or

(2) a legal person managed by a single natural person;

it must have alternative arrangements in place which ensure sound and prudent management of the firm.

[Note: article 9(4) second paragraph of MiFID]

4.3 Responsibility of senior personnel

4.3.1 R A MiFID investment firm, when allocating functions internally, must ensure that senior personnel and, where appropriate, the supervisory function, are responsible for ensuring that the firm complies with its obligations under MiFID. In particular, senior personnel and, where appropriate, the supervisory function must assess and periodically review the effectiveness of the policies, arrangements and procedures put in place to comply with the firm's obligations under MiFID and take appropriate measures to address any deficiencies.

[Note: article 9(1) of the MiFID implementing Directive]

4.3.2 R A MiFID investment firm, must ensure:
(1) That its senior personnel receive on a frequent basis, and at least annually, written reports on the matters covered by SYSC 6.1.2R to 6.1.5R, SYSC 6.2.1R and SYSC 7.1.2R, SYSC 7.1.3R and SYSC 7.1.5R to SYSC 7.1.7R, indicating in particular whether the appropriate remedial measures have been taken in the event of any deficiencies; and

(2) The supervisory function, if any, must receive on a regular basis written reports on the same matters.

[Note: article 9(2) and article 9(3) of the MiFID implementing Directive]

4.3.3 G The supervisory function does not include a general meeting of the shareholders of a common platform firm, or equivalent bodies, but could involve, for example, a separate supervisory board within a two-tier board structure or the establishment of a non-executive committee of a single-tier board structure.

4.3.4 G SYSC 2, which sets out how certain functions in a firm should be allocated, does not affect the collective responsibility of the senior personnel of a MiFID investment firm under this section.
Employees, agents and other relevant persons

Skills, knowledge and expertise

5.1.1 R A common platform firm must employ personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them.

[Note: article 5(1)(d) of the MiFID implementing Directive]

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

5.1.3 G 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.

5.1.4 G The FSA’s requirements on firms with respect to the competence of individuals are in the Training and Competence sourcebook (TC).

5.1.5 G The requirements on firms with respect to approved persons are in Part V of the Act (Performance of regulated activities) and SUP 10.

Segregation of functions

5.1.6 R A common platform firm must ensure that the performance of multiple functions by its relevant persons does not and is not likely to prevent those persons from discharging any particular functions soundly, honestly and professionally.

[Note: article 5(1)(g) of the MiFID implementing Directive]

5.1.7 R The senior personnel of a common platform firm must define arrangements concerning the segregation of duties within the firm and the prevention of conflicts of interest.

[Note: annex V paragraph 1 of the Banking Consolidation Directive]

5.1.8 G The effective segregation of duties is an important element in the internal controls of a firm in the prudential context. In particular, it helps to ensure that no one individual is completely free to commit a firm’s assets or incur liabilities on its behalf. Segregation can also help to ensure that a firm’s governing body receives objective and accurate information on financial performance, the risks faced by the firm and the adequacy of its systems.
5.1.9 **G** A common platform firm should normally ensure that no single individual has unrestricted authority to do all of the following:

1. initiate a transaction;
2. bind the firm;
3. make payments; and
4. account for it.

5.1.10 **G** Where a common platform firm is unable to ensure the complete segregation of duties (for example, because it has a limited number of staff), it should ensure that there are adequate compensating controls in place (for example, frequent review of an area by relevant senior managers).

5.1.11 **G** Where a common platform firm outsources its internal audit function, it should take reasonable steps to ensure that every individual involved in the performance of this service is independent from the individuals who perform its external audit. This should not prevent services from being undertaken by a firm’s external auditors provided that:

1. the work is carried out under the supervision and management of the firm’s own internal staff; and
2. potential conflicts of interest between the provision of external audit services and the provision of internal audit are properly managed.

**Awareness of procedures**

5.1.12 **R** A common platform firm must ensure that its relevant persons are aware of the procedures which must be followed for the proper discharge of their responsibilities.

[Note: article 5(1)(b) of the MiFID implementing Directive]

**General**

5.1.13 **R** The systems, internal control mechanisms and arrangements established by a firm in accordance with this chapter must take into account the nature, scale and complexity of its business and the nature and range of investment services and activities undertaken in the course of that business.

[Note: article 5(1) final paragraph of the MiFID implementing Directive]

5.1.14 **R** A common platform firm must monitor and, on a regular basis, evaluate the adequacy and effectiveness of its systems, internal control mechanisms and arrangements established in accordance with this chapter, and take appropriate measures to address any deficiencies.

[Note: article 5(5) of the MiFID implementing Directive]
6 Compliance, internal audit and financial crime

6.1 Compliance

6.1.1 R A common platform firm must establish, implement and maintain adequate policies and procedures sufficient to ensure compliance of the firm including its managers, employees and appointed representatives with its obligations under the regulatory system.

[Note: article 13(2) of MiFID]

6.1.2 R A common platform firm must, taking into account the nature, scale and complexity of its business, and the nature and range of investment services and activities undertaken in the course of that business, establish, implement and maintain adequate policies and procedures designed to detect any risk of failure by the firm to comply with its obligations under the regulatory system, as well as associated risks, and put in place adequate measures and procedures designed to minimise such risks and to enable the FSA to exercise its powers effectively under the regulatory system and to enable any other competent authority to exercise its powers effectively under MiFID.

[Note: article 6(1) of the MiFID implementing Directive]

6.1.3 R A common platform firm must maintain a permanent and effective compliance function which operates independently and which has the following responsibilities:

(1) to monitor and, on a regular basis, to assess the adequacy and effectiveness of the measures and procedures put in place in accordance with SYSC 6.1.2R, and the actions taken to address any deficiencies in the firm's compliance with its obligations;

(2) to advise and assist the relevant persons responsible for carrying out regulated activities to comply with the firm's obligations under the regulatory system.

[Note: article 6(2) of the MiFID implementing Directive]

6.1.4 R In order to enable the compliance function to discharge its responsibilities properly and independently, a common platform firm must ensure that the following conditions are satisfied:

(1) the compliance function must have the necessary authority, resources, expertise and access to all relevant information;

(2) a compliance officer must be appointed and must be responsible for the compliance function and for any reporting as to compliance required by SYSC 4.3.2R;

(3) the relevant persons involved in the compliance functions must not be
involved in the performance of services or activities they monitor;

(4) the method of determining the remuneration of the relevant persons involved in the compliance function must not compromise their objectivity and must not be likely to do so.

[Note: article 6(3) first paragraph of the MiFID implementing Directive]

6.1.5 R A common platform firm need not comply with SYSC 6.1.4R(3) or SYSC 6.1.4R(4) if it is able to demonstrate that in view of the nature, scale and complexity of its business, and the nature and range of investment services and activities, the requirements under those rules are not proportionate and that its compliance function continues to be effective.

[Note: article 6(3) second paragraph of the MiFID implementing Directive]

6.2 Internal audit

6.2.1 R A common platform firm must, where appropriate and proportionate in view of the nature, scale and complexity of its business and the nature and range of investment services and activities undertaken in the course of that business, establish and maintain an internal audit function which is separate and independent from the other functions and activities of the firm and which has the following responsibilities:

(1) to establish, implement and maintain an audit plan to examine and evaluate the adequacy and effectiveness of the firm's systems, internal control mechanisms and arrangements;

(2) to issue recommendations based on the result of work carried out in accordance with (1);

(3) to verify compliance with those recommendations;

(4) to report in relation to internal audit matters in accordance with SYSC 4.3.2R.

[Note: article 8 of the MiFID implementing Directive]

6.3 Financial crime

6.3.1 R A common platform firm must ensure the policies and procedures established under SYSC 6.1.1R include systems and controls that:

(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.

6.3.2 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.

6.3.3 R A *common platform firm* must carry out regular assessment of the adequacy of these systems and controls to ensure that it continues to comply with SYSC 6.3.1R.

6.3.4 G A *common platform 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 6.1.1R and SYSC 6.3.1R to SYSC 6.3.10G are not relevant for the purposes of regulation 3(3) of the *Money Laundering Regulations*, section 330(8) of the Proceeds of Crime Act 2002 or section 21A(6) of the Terrorism Act 2000.

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

6.3.6 G In identifying its *money laundering* risk and in establishing the nature of these systems and controls, a *common platform 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.

6.3.7 G A *common platform 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 9);
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.

6.3.8 R A common platform 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

6.3.9 R A common platform firm must:

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

(2) ensure that its MLRO has a level of authority and independence within the firm and access to resources and information sufficient to enable him to carry out that responsibility.

6.3.10 G The job of the MLRO within a firm is to act as the focal point for all activity within the firm relating to anti-money laundering. The FSA expects that a firm's MLRO will be based in the United Kingdom.
7 Risk control

7.1 Risk control

7.1.1 G SYSC 4.1.1R requires a common platform firm to have effective processes to identify, manage, monitor and report the risks it is or might be exposed to.

7.1.2 R A common platform firm must establish, implement and maintain adequate risk management policies and procedures, including effective procedures for risk assessment, which identify the risks relating to the firm’s activities, processes and systems, and where appropriate, set the level of risk tolerated by the firm.

[Note: article 7(1)(a) of the MiFID implementing Directive, article 13(5) second paragraph of MiFID]

7.1.3 R A common platform firm must adopt effective arrangements, processes and mechanisms to manage the risk relating to the firm’s activities, processes and systems, in light of that level of risk tolerance.

[Note: article 7(1)(b) of the MiFID implementing Directive]

7.1.4 R The senior personnel of a common platform firm must approve and periodically review the strategies and policies for taking up, managing, monitoring and mitigating the risks the firm is or might be exposed to, including those posed by the macroeconomic environment in which it operates in relation to the status of the business cycle.

[Note: annex V paragraph 2 of the Banking Consolidation Directive]

7.1.5 R A common platform firm must monitor the following:

(1) the adequacy and effectiveness of the firm’s risk management policies and procedures;

(2) the level of compliance by the firm and its relevant persons with the arrangements, processes and mechanisms adopted in accordance with SYSC 7.1.3R;

(3) the adequacy and effectiveness of measures taken to address any deficiencies in those policies, procedures, arrangements, processes and mechanisms, including failures by the relevant persons to comply with such arrangements or processes and mechanisms or follow such policies and procedures.

[Note: article 7(1)(c) of the MiFID implementing Directive]

7.1.6 R A common platform firm must, where appropriate and proportionate in view of the nature, scale and complexity of its business and the nature and range of the investment services and activities undertaken in the course of that business, establish and maintain a risk management function that operates
independently and carries out the following tasks:

(1) implementation of the policies and procedures referred to in SYSC 7.1.2R to SYSC 7.1.5R; and

(2) provision of reports and advice to senior personnel in accordance with SYSC 4.3.2R.

[Note: MiFID implementing Directive article 7(2) first paragraph]

7.1.7 R Where a common platform firm is not required under SYSC 7.1.6R to maintain a risk management function that functions independently, it must nevertheless be able to demonstrate that the policies and procedures which it has adopted in accordance with SYSC 7.1.2R to SYSC 7.1.5R satisfy the requirements of those rules and are consistently effective.

[Note: article 7(2) second paragraph of the MiFID implementing Directive]

7.1.8 G SYSC 4.1.3R requires a BIPRU firm to ensure that its internal control mechanisms and administrative and accounting procedures permit the verification of its compliance with rules adopted in accordance with the Capital Adequacy Directive at all times. In complying with this obligation, a BIPRU firm should document the organisation and responsibilities of its risk management function and it should document its risk management framework setting out how the risks in the business are identified, measured, monitored and controlled.

Credit and counterparty risk

7.1.9 R A BIPRU firm must base credit-granting on sound and well-defined criteria and clearly establish the process for approving, amending, renewing, and re-financing credits.

[Note: annex V paragraph 3 of the Banking Consolidation Directive]

7.1.10 R A BIPRU firm must operate through effective systems the ongoing administration and monitoring of its various credit risk-bearing portfolios and exposures, including for identifying and managing problem credits and for making adequate value adjustments and provisions.

[Note: annex V paragraph 4 of the Banking Consolidation Directive]

7.1.11 R A BIPRU firm must adequately diversify credit portfolios given its target market and overall credit strategy.

[Note: annex V paragraph 5 of the Banking Consolidation Directive]

7.1.12 G The documentation maintained by a BIPRU firm under SYSC 4.1.3R should include its policy for credit risk, including its risk appetite and provisioning policy and should describe how it measures, monitors and controls that risk. This should include descriptions of the systems used to ensure that the
policy is correctly implemented.

Residual risk

7.1.13 R A BIPRU firm must address and control by means of written policies and procedures the risk that recognised credit risk mitigation techniques used by it prove less effective than expected.

[Note: annex V paragraph 6 of the Banking Consolidation Directive]

Market risk

7.1.14 R A BIPRU firm must implement policies and processes for the measurement and management of all material sources and effects of market risks.

[Note: annex V paragraph 10 of the Banking Consolidation Directive]

Interest rate risk

7.1.15 R A BIPRU firm must implement systems to evaluate and manage the risk arising from potential changes in interest rates as they affect a BIPRU firm's non-trading activities.

[Note: annex V paragraph 11 of the Banking Consolidation Directive]

Operational risk

7.1.16 R A BIPRU firm must implement policies and processes to evaluate and manage the exposure to operational risk, including to low-frequency high severity events. Without prejudice to the definition of operational risk, BIPRU firms must articulate what constitutes operational risk for the purposes of those policies and procedures.

[Note: annex V paragraph 12 of the Banking Consolidation Directive]
8 Outsourcing

8.1 General outsourcing requirements

8.1.1 R A common platform firm must:

(1) when relying on a third party for the performance of operational functions which are critical for the performance of regulated activities, listed activities or ancillary services (in this chapter "relevant services and activities") on a continuous and satisfactory basis, ensure that it takes reasonable steps to avoid undue additional operational risk;

(2) not undertake the outsourcing of important operational functions in such a way as to impair materially:

(a) the quality of its internal control; and

(b) the ability of the FSA to monitor the firm’s compliance with all obligations under the regulatory system and, if different, of a competent authority to monitor the firm's compliance with all obligations under MiFID.

[Note: article 13(5) first paragraph of MiFID]

8.1.2 G The application of SYSC 8.1 to relevant services and activities (see SYSC 8.1.1R(1)) is limited by SYSC 1.3 (Application of the common platform requirements).

8.1.3 G SYSC 4.1.1R requires a common platform firm to have effective processes to identify, manage, monitor and report risks and internal control mechanisms. Except in relation to those functions described in SYSC 8.1.5R, where a firm relies on a third party for the performance of operational functions which are not critical or important for the performance of relevant services and activities (see SYSC 8.1.1R(1)) on a continuous and satisfactory basis, it should take into account, in a manner that is proportionate given the nature, scale and complexity of the outsourcing, the rules in this section in complying with that requirement.

8.1.4 R For the purposes of this chapter an operational function is regarded as critical or important if a defect or failure in its performance would materially impair the continuing compliance of a common platform firm with the conditions and obligations of its authorisation or its other obligations under the regulatory system, or its financial performance, or the soundness or the continuity of its relevant services and activities.

[Note: article 13(1) of the MiFID implementing Directive]

8.1.5 R Without prejudice to the status of any other function, the following functions will not be considered as critical or important for the purposes of
this chapter:

(1) the provision to the firm of advisory services, and other services which do not form part of the relevant services and activities of the firm, including the provision of legal advice to the firm, the training of personnel of the firm, billing services and the security of the firm’s premises and personnel;

(2) the purchase of standardised services, including market information services and the provision of price feeds.

[Note: article 13(2) of the MiFID implementing Directive]

8.1.6 R If a common platform firm outsources critical or important operational functions or any relevant services and activities, it remains fully responsible for discharging all of its obligations under the regulatory system and must comply, in particular, with the following conditions:

(1) the outsourcing must not result in the delegation by senior personnel of their responsibility;

(2) the relationship and obligations of the firm towards its clients under the regulatory system must not be altered;

(3) the conditions with which the firm must comply in order to be authorised, and to remain so, must not be undermined;

(4) none of the other conditions subject to which the firm’s authorisation was granted must be removed or modified.

[Note: article 14(1) of the MiFID implementing Directive]

8.1.7 R A common platform firm must exercise due skill and care and diligence when entering into, managing or terminating any arrangement for the outsourcing to a service provider of critical or important operational functions or of any relevant services and activities.

[Note: article 14(2) first paragraph of the MiFID implementing Directive]

8.1.8 R A common platform firm must in particular take the necessary steps to ensure that the following conditions are satisfied:

(1) the service provider must have the ability, capacity, and any authorisation required by law to perform the outsourced functions, services or activities reliably and professionally;

(2) the service provider must carry out the outsourced services effectively, and to this end the firm must establish methods for assessing the standard of performance of the service provider;

(3) the service provider must properly supervise the carrying out of the outsourced functions, and adequately manage the risks associated
with the *outsourcing*;

(4) appropriate action must be taken if it appears that the service provider may not be carrying out the functions effectively and in compliance with applicable laws and regulatory requirements;

(5) the *firm* must retain the necessary expertise to supervise the *outsourced* functions effectively and manage the risks associated with the *outsourcing* and must manage those risks and must supervise those functions and manage those risks;

(6) the service provider must disclose to the *firm* any development that may have a material impact on its ability to carry out the *outsourced* functions effectively and in compliance with applicable laws and regulatory requirements;

(7) the *firm* must be able to terminate the arrangement for the *outsourcing* where necessary without detriment to the continuity and quality of its provision of services to *clients*;

(8) the service provider must co-operate with the FSA and any other relevant *competent authority* in connection with the *outsourced* activities;

(9) the *firm*, its auditors, the FSA and any other relevant *competent authority* must have effective access to data related to the *outsourced* activities, as well as to the business premises of the service provider; and the FSA and any other relevant *competent authority* must be able to exercise those rights of access;

(10) the service provider must protect any confidential information relating to the *firm* and its *clients*;

(11) the *firm* and the service provider must establish, implement and maintain a contingency plan for disaster recovery and periodic testing of backup facilities where that is necessary having regard to the function, service or activity that has been *outsourced*.

[Note: article 14(2) second paragraph of the *MiFID implementing Directive*]

8.1.9 R A *common platform firm* must ensure that the respective rights and obligations of the *firm* and of the service provider are clearly allocated and set out in a written agreement.

[Note: article 14(3) of the *MiFID implementing Directive*]

8.1.10 R If a *common platform firm* and the service provider are members of the same *group*, the *firm* may, for the purpose of complying with SYSC 8.1.7R to SYSC 8.1.11R and SYSC 8.2 and SYSC 8.3, take into account the extent to which the *common platform firm controls* the service provider or has the
ability to influence its actions.

[Note: article 14(4) of the MiFID implementing Directive]

8.1.11 R A common platform firm must make available on request to the FSA and any other relevant competent authority all information necessary to enable the FSA and any other relevant competent authority to supervise the compliance of the performance of the outsourced activities with the requirements of the regulatory system.

[Note: article 14(5) of the MiFID implementing Directive]

8.1.12 G As SUP 15.3.8G explains, a common platform firm should notify the FSA when it intends to rely on a third party for the performance of operational functions which are critical or important for the performance of relevant services and activities on a continuous and satisfactory basis.

[Note: recital 20 of the MiFID implementing Directive]
10.1 Conflicts of interest

Application

10.1.1 R This section applies to a common platform firm which provides services to its clients in the course of carrying on regulated activities or ancillary activities.

Requirements only apply if a service is provided

10.1.2 G The requirements in this section only apply where a service is provided by a common platform firm. The status of the client to whom the service is provided (as a retail client, professional client or eligible counterparty) is irrelevant for this purpose.

[Note: recital 25 of MiFID implementing Directive]

Identifying conflicts

10.1.3 R A common platform firm must take all reasonable steps to identify conflicts of interest between:

(1) the firm, including its managers, employees, appointed representatives or 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;

that arise, or may arise, in the course of the firm providing any service referred to in SYSC 10.1.1R.

[Note: article 18(1) of MiFID]

Types of conflicts

10.1.4 R For the purposes of identifying the types of conflict of interest that arise, or may arise, in the course of providing a service and whose existence may entail a material risk of damage to the interests of a client, a common platform firm must take into account, as a minimum, whether the firm or a relevant person, or a person directly or indirectly linked by control to the firm:

(1) is likely to make a financial gain, or avoid a financial loss, at the expense of the client;

(2) has an interest in the outcome of a service provided to the client or of a transaction carried out on behalf of the client, which is distinct from the client’s interest in that outcome;
has a financial or other incentive to favour the interest of another client or group of clients over the interests of the client;

(4) carries on the same business as the client; or

(5) receives or will receive from a person other than the client an inducement in relation to a service provided to the client, in the form of monies, goods or services, other than the standard commission or fee for that service.

The conflict of interest may result from the firm or person providing a service referred to in SYSC 10.1.1R or engaging in any other activity.

[Note: article 21 of MiFID implementing Directive]

10.1.5 G The circumstances which should be treated as giving rise to a conflict of interest should cover cases where there is a conflict between the interests of the firm or certain persons connected to the firm or the firm's group and the duty the firm owes to a client; or between the differing interests of two or more of its clients, to whom the firm owes in each case a duty. It is not enough that the firm may gain a benefit if there is not also a possible disadvantage to a client, or that one client to whom the firm owes a duty may make a gain or avoid a loss without there being a concomitant possible loss to another such client.

[Note: Recital 24 of MiFID implementing Directive]

Record of conflicts

10.1.6 R A common platform firm must keep and regularly update a record of the kinds of service or activity carried out by or on behalf of the firm in which a conflict of interest entailing a material risk of damage to the interests of one or more clients has arisen or, in the case of an ongoing service or activity, may arise.

[Note: article 23 of MiFID implementing Directive]

Managing conflicts

10.1.7 R A common platform firm must maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps to prevent conflicts of interest as defined in SYSC 10.1.3R from constituting or giving rise to a material risk of damage to the interests of its clients.

[Note: article 13(3) of MiFID]

Disclosure of conflicts

10.1.8 R (1) If arrangements made by a common platform firm under SYSC 10.1.7R to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of a client will be prevented, the firm must clearly disclose the general
nature and/or sources of conflicts of interest to the client before undertaking business for the client.

(2) The disclosure must:

(a) be made in a durable medium; and

(b) include sufficient detail, taking into account the nature of the client, to enable that client to take an informed decision with respect to the service in the context of which the conflict of interest arises.

[Note: article 18(2) of MiFID and article 22(4) of MiFID implementing Directive]

10.1.9 G Common platform firms should aim to identify and manage the conflicts of interest arising in relation to their various business lines and their group's activities under a comprehensive conflicts of interest policy. In particular, the disclosure of conflicts of interest by a firm should not exempt it from the obligation to maintain and operate the effective organisational and administrative arrangements under SYSC 10.1.7R. While disclosure of specific conflicts of interest is required by SYSC 10.1.8R, an over-reliance on disclosure without adequate consideration as to how conflicts may appropriately be managed is not permitted.

[Note: Recital 27 of MiFID implementing Directive]

Conflicts policy

10.1.10 R (1) A common platform firm must establish, implement and maintain an effective conflicts of interest policy that is set out in writing and is appropriate to the size and organisation of the firm and the nature, scale and complexity of its business.

(2) Where the common platform firm is a member of a group, the policy must also take into account any circumstances, of which the firm 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 22(1) of MiFID implementing Directive]

Contents of policy

10.1.11 R (1) The conflicts of interest policy must include the following content:

(a) it must identify in accordance with SYSC 10.1.3R and SYSC 10.1.4R, by reference to the specific services and activities carried out by or on behalf of the common platform firm, the circumstances which constitute or may give rise to a conflict of interest entailing a material risk of damage to the interests
of one or more clients; and

(b) it must specify procedures to be followed and measures to be adopted in order to manage such conflicts.

(2) The procedures and measures provided for in paragraph (1)(b) must:

(a) be designed to ensure that relevant persons engaged in different business activities involving a conflict of interest of the kind specified in paragraph (1)(a) carry on those activities at a level of independence appropriate to the size and activities of the common platform firm and of the group to which it belongs, and to the materiality of the risk of damage to the interests of clients; and

(b) include such of the following as are necessary and appropriate for the common platform firm to ensure the requisite degree of independence:

(i) effective procedures to prevent or control the exchange of information between relevant persons engaged in activities involving a risk of a conflict of interest where the exchange of that information may harm the interests of one or more clients;

(ii) the separate supervision of relevant persons whose principal functions involve carrying out activities on behalf of, or providing services to, clients whose interests may conflict, or who otherwise represent different interests that may conflict, including those of the firm;

(iii) the removal of any direct link between the remuneration of relevant persons principally engaged in one activity and the remuneration of, or revenues generated by, different relevant persons principally engaged in another activity, where a conflict of interest may arise in relation to those activities;

(iv) measures to prevent or limit any person from exercising inappropriate influence over the way in which a relevant person carries out services or activities; and

(v) measures to prevent or control the simultaneous or sequential involvement of a relevant person in separate services or activities where such involvement may impair the proper management of conflicts of interest.

(3) If the adoption or the practice of one or more of those measures and
procedures does not ensure the requisite level of independence, a common platform firm must adopt such alternative or additional measures and procedures as are necessary and appropriate for those purposes.

[Note: article 22(2) and (3) of MiFID implementing Directive]

10.1.12 G In drawing up a conflicts of interest policy which identifies circumstances which constitute or may give rise to a conflict of interest, a common platform firm should pay special attention to the activities of investment research and advice, proprietary trading, portfolio management and corporate finance business, including underwriting or selling in an offering of securities and advising on mergers and acquisitions. In particular, such special attention is appropriate where the firm or a person directly or indirectly linked by control to the firm performs a combination of two or more of those activities.

[Note: Recital 26 of MiFID implementing Directive]

Corporate finance

10.1.13 G This section is relevant to the management of a securities offering by a common platform firm.

10.1.14 G A common platform firm will wish to note that when carrying on a mandate to manage an offering of securities, the firm's duty for that business is to its corporate finance client (in many cases, the corporate issuer or seller of the relevant securities), but that its responsibilities to provide services to its investment clients are unchanged.

10.1.15 G Measures that a common platform firm might wish to consider in drawing up its conflicts of interest policy in relation to the management of an offering of securities include:

(1) at an early stage agreeing with its corporate finance client relevant aspects of the offering process such as the process the firm proposes to follow in order to determine what recommendations it will make about allocations for the offering; how the target investor group will be identified; how recommendations on allocation and pricing will be prepared; and whether the firm might place securities with its investment clients or with its own proprietary book, or with an associate, and how conflicts arising might be managed; and

(2) agreeing allocation and pricing objectives with the corporate finance client; inviting the corporate finance client to participate actively in the allocation process; making the initial recommendation for allocation to retail clients of the firm as a single block and not on a named basis; having internal arrangements under which senior personnel responsible for providing services to retail clients make the initial allocation recommendations for allocation to retail clients of the firm; and disclosing to the issuer details of the allocations
actually made.

[Note: The provisions in SYSC 10.1 also implement BCD article 22 and BCD Annex V paragraph 1]
10.2  Chinese walls

Application

10.2.1  R This section applies to a common platform firm.

Control of information

10.2.2  R (1) When a common platform firm establishes and maintains a Chinese wall (that is, an arrangement that requires information held by a person in the course of carrying on one part of the business to be withheld from, or not to be used for, persons with or for whom it acts in the course of carrying on another part of its business) it may:

(a) withhold or not use the information held; and

(b) for that purpose, permit persons employed in the first part of its business to withhold the information held from those employed in that other part of the business;

but only to the extent that the business of one of those parts involves the carrying on of regulated activities or ancillary activities.

(2) Information may also be withheld or not used by a common platform firm when this is required by an established arrangement maintained between different parts of the business (of any kind) in the same group. This provision does not affect any requirement to transmit or use information that may arise apart from the rules in COB or COBS.

(3) For the purpose of this rule, "maintains" includes taking reasonable steps to ensure that the arrangements remain effective and are adequately monitored, and must be interpreted accordingly.

(4) For the purposes of section 118A(5)(a) of the Act, behaviour conforming with paragraph (1) does not amount to market abuse.

Effect of rules

10.2.3  G SYSC 10.2.2R is made under section 147 of the Act (Control of information rules). It has the following effect:

(1) acting in conformity with SYSC 10.2.2R(1) provides a defence against proceedings brought under section 397(2) or (3) of the Act (Misleading statements and practices) – see sections 397(4) and (5)(c);

(2) behaviour in conformity with SYSC 10.2.2R(1) does not amount to market abuse (see SYSC 10.2.2R(4)); and

(3) acting in conformity with SYSC 10.2.2R(1) provides a defence for a firm against FSA enforcement action, or an action for damages under
section 150 of the Act, based on a breach of a relevant requirement to disclose or use this information.

Attribution of knowledge

10.2.4  R When any of the rules of COB, COBS or CASS apply to a common platform firm that acts with knowledge, the firm will not be taken to act with knowledge for the purposes of that rule if none of the relevant individuals involved on behalf of the firm acts with that knowledge as a result of arrangements established under SYSC 10.2.2R.

10.2.5  G When a common platform firm manages a conflict of interest using the arrangements in SYSC 10.2.2R which take the form of a Chinese wall, individuals on the other side of the wall will not be regarded as being in possession of knowledge denied to them as a result of the Chinese wall.
Annex C
Senior Management Arrangements, Systems and Controls Handbook (SYSC)

In this Annex, the place where the text is being inserted is indicated and the text is not underlined.

11 Liquidity risk systems and controls

11.1 Application

11.1.1 R SYSC 11 applies to:

(1) an insurer, unless it is an EEA deposit insurer or a Swiss general insurer;

(2) a BIPRU firm;

(3) an incoming EEA firm which:

   (a) is a full BCD credit institution; and

   (b) has a branch in the United Kingdom;

(4) a third country BIPRU firm which:

   (a) is a bank; and

   (b) has a branch in the United Kingdom.

[Note: first paragraph of article 41 of the Banking Consolidation Directive]

11.1.2 R If this chapter applies because the firm has a branch in the United Kingdom (see SYSC 11.1.1R(3) or SYSC 11.1.1R(4)), SYSC 11 applies only with respect to the branch.

11.1.3 R SYSC 11 applies to an incoming EEA firm only to the extent that the relevant matter is not reserved by the relevant Single Market Directive to the firm's Home State regulator.

11.1.4 R SYSC 11 does not apply to:

(1) a non-directive friendly society; or

(2) a UCITS qualifier; or

(3) an ICVC; or

(4) an incoming EEA firm (unless it has a branch in the United Kingdom - see SYSC 11.1.1R(3)); or

(5) an incoming Treaty firm.
11.1.5 R (1) SYSC 11.1.11R and SYSC 11.1.12R apply only to a BIPRU firm

(2) SYSC 11.1.26G to SYSC 11.1.32G do not apply to insurers.

11.1.6 R If a firm carries on:

(1) long-term insurance business; and

(2) general insurance business;

SYSC 11 applies separately to each type of business.

Purpose

11.1.7 G The purpose of SYSC 11 is to amplify GENPRU and SYSC in their specific application to liquidity risk and, in so doing, to indicate minimum standards for systems and controls in respect of that risk.

11.1.8 G Appropriate systems and controls for the management of liquidity risk will vary with the scale, nature and complexity of the firm's activities. Most of the material in SYSC 11 is, therefore, guidance. SYSC 11 lays out some of the main issues that the FSA expects a firm to consider in relation to liquidity risk. A firm should assess the appropriateness of any particular item of guidance in the light of the scale, nature and complexity of its activities as well as its obligations as set out in Principle 3 to organise and control its affairs responsibly and effectively.

11.1.9 G SYSC 11 addresses the need to have appropriate systems and controls to deal both with liquidity management issues under normal market conditions, and with stressed or extreme situations resulting from either general market turbulence or firm-specific difficulties.

11.1.10 G SYSC 11.1.11R and SYSC 11.1.12R implement the specific liquidity risk requirements of the BCD.

Requirements

11.1.11 R A BIPRU firm must have policies and processes for the measurement and management of its net funding position and requirements on an ongoing and forward looking basis. Alternative scenarios must be considered and the assumptions underpinning decisions concerning the net funding position must be reviewed regularly.

[Note: annex V paragraph 14 of the Banking Consolidation Directive]

11.1.12 R A BIPRU firm must have contingency plans in place to deal with liquidity crises.

[Note: annex V paragraph 15 of the Banking Consolidation Directive]

11.1.13 G An insurer is also required to comply with the requirements in relation to
liquidity risk set out in INSPRU 4.1.

11.1.14 G SYSC 4.1.1R requires a BIPRU firm to have effective processes to identify, manage, monitor and report the risks it is or might be exposed to. A BIPRU firm is required by SYSC 7.1.2R to establish, implement and maintain adequate risk management policies and procedures, including effective procedures for risk assessment. Liquidity risk is one of the risks covered by both of those requirements.

11.1.15 G A UK bank, a branch of an EEA bank and a branch of an overseas bank is required in IPRU(BANK) GN 3.4.3R to set out its policy on the management of its liquidity. Guidance on a bank's liquidity policy statement is given in IPRU(BANK) LM Section 10. Guidance on a bank's management of liquidity risk is given in IPRU(BANK) LM Sections 2 and 9.

11.1.16 G A building society is required by IPRU(BSOC) 5.2.7R to maintain a board-approved policy statement on liquidity. Guidance on a building society's liquidity policy statement is given in IPRU(BSOC) 5.2.8G and IPRU(BSOC) Annex 5B. Guidance on a building society's management of liquidity risk is given in IPRU(BSOC) Sections 5.3 to 5.8.

11.1.17 G High level requirements in relation to carrying out stress testing and scenario analysis are set out in GENPRU 1.2. In particular, GENPRU 1.2.42R requires a firm to carry out appropriate stress testing and scenario analysis. SYSC 11 gives guidance in relation to these tests in the case of liquidity risk.

Stress testing and scenario analysis

11.1.18 G The effect of GENPRU 1.2.30R, GENPRU 1.2.34R, GENPRU 1.2.37R(1) and GENPRU 1.2.42R is that, for the purposes of determining the adequacy of its overall financial resources, a firm must carry out appropriate stress testing and scenario analysis, including taking reasonable steps to identify an appropriate range of realistic adverse circumstances and events in which liquidity risk might occur or crystallise.

11.1.19 G GENPRU 1.2.40G and GENPRU 1.2.62G to GENPRU 1.2.78G give guidance on stress testing and scenario analysis, including on how to choose appropriate scenarios, but the precise scenarios that a firm chooses to use will depend on the nature of its activities. For the purposes of testing liquidity risk, however, a firm should normally consider scenarios based on varying degrees of stress and both firm-specific and market-wide difficulties. In developing any scenario of extreme market-wide stress that may pose systemic risk, it may be appropriate for a firm to make assumptions about the likelihood and nature of central bank intervention.

11.1.20 G A firm should review frequently the assumptions used in stress testing scenarios to gain assurance that they continue to be appropriate.

11.1.21 E (1) A scenario analysis in relation to liquidity risk required under GENPRU 1.2.42R should include a cash-flow projection for each
scenario tested, based on reasonable estimates of the impact (both on and off balance sheet) of that scenario on the firm’s funding needs and sources.

(2) Contravention of (1) may be relied on as tending to establish contravention of GENPRU 1.2.42R.

11.1.22 G In identifying the possible on and off balance sheet impact referred to in SYSC 11.1.21E(1), a firm may take into account:

(1) possible changes in the market’s perception of the firm and the effects that this might have on the firm’s access to the markets, including:

(a) (where the firm funds its holdings of assets in one currency with liabilities in another) access to foreign exchange markets, particularly in less frequently traded currencies;

(b) access to secured funding, including by way of repo transactions; and

(c) the extent to which the firm may rely on committed facilities made available to it;

(2) (if applicable) the possible effect of each scenario analysed on currencies whose exchange rates are currently pegged or fixed; and

(3) that:

(a) general market turbulence may trigger a substantial increase in the extent to which persons exercise rights against the firm under off balance sheet instruments to which the firm is party;

(b) access to OTC derivative and foreign exchange markets are sensitive to credit-ratings;

(c) the scenario may involve the triggering of early amortisation in asset securitisation transactions with which the firm has a connection; and

(d) its ability to securitise assets may be reduced.

Contingency funding plans

11.1.23 G GENPRU 1.2.26R states that a firm must at all times maintain overall financial resources adequate to ensure that there is no significant risk that its liabilities cannot be met as they fall due. GENPRU 1.2.42R(1)(b) provides that for the purposes of determining the adequacy of its overall financial resources, a firm must estimate the financial resources it would need in each of the circumstances and events considered in carrying out its stress testing and scenario analysis in order to, inter alia, meet its liabilities as they fall due.
A firm should have an adequately documented *contingency funding plan* for taking action to ensure, so far as it can, that, in each of the scenarios analysed under GENPRU 1.2.42R(1)(b), it would still have sufficient liquid financial resources to meet liabilities as they fall due.

The *contingency funding plan* should cover what events or circumstances will lead the firm to put into action any part of the plan.

The *contingency funding plan* of a firm described in SYSC 11.1.1R(2) to SYSC 11.1.1R(4) should cover the extent to which the actions in (1) include:

(a) selling, using as *collateral* in secured funding (including repo), or securitising, its assets;

(b) otherwise reducing its assets;

(c) modifying the structure of its liabilities or increasing its liabilities; and

(d) the use of committed facilities.

A firm's *contingency funding plan* should, where relevant, take account of the impact of stressed market conditions on:

(a) the behaviour of any credit-sensitive liabilities it has; and

(b) its ability to securitise assets.

A firm's *contingency funding plan* should contain administrative policies and procedures that will enable the firm to manage the plan's implementation effectively, including:

(a) the responsibilities of senior management;

(b) names and contact details of members of the team responsible for implementing the *contingency funding plan*;

(c) where, geographically, team members will be assigned;

(d) who within the team is responsible for contact with head office (if appropriate), analysts, investors, external auditors, press, significant client's, regulators, lawyers and others; and

(e) mechanisms that enable senior management and the *governing body* to receive management information that is both relevant and timely.

Contravention of any of (1) to (5) may be relied upon as tending to
establish contravention of GENPRU 1.2.30R(2)(c).

Documentation

11.1.25  GENPRU 1.2.60R requires a firm to document its assessment of the adequacy of its liquidity financial resources, how it intends to deal with those risks, and details of the stress tests and scenario analyses carried out and the resulting financial resources estimated to be required. Accordingly, a firm should document both its stress testing and scenario analysis (see SYSC 11.1.18G) and its contingency funding plan (see SYSC 11.1.23G).

Management information systems

11.1.26  A firm should have adequate information systems for controlling and reporting liquidity risk. The management information system should be used to check for compliance with the firm's established policies, procedures and limits.

11.1.27  Reports on liquidity risk should be provided on a timely basis to the firm's governing body, senior management and other appropriate personnel. The appropriate content and format of reports depends on a firm's liquidity management practices and the nature, scale and complexity of the firm's business. Reports to the firm's governing body may be less detailed and less frequent than reports to senior management with responsibility for managing liquidity risk.

11.1.28  The FSA would expect management information to normally contain the following:

- a cash-flow or funding gap report;
- a funding maturity schedule;
- a list of large providers of funding; and
- a limit monitoring and exception report.

11.1.29  When considering what else might be included in liquidity risk management information, a firm should consider other types of information that may be important for understanding its liquidity risk profile. This may include:

- asset quality and trends;
- any changes in the firm's funding strategy;
- earnings projections; and
- the firm's reputation in the market and the condition of the market itself.

Limit setting
A firm's senior management should decide what limits need to be set, in accordance with the nature, scale and complexity of its activities. The structure of limits should reflect the need for a firm to have systems and controls in place to guard against a spectrum of possible risks, from those arising in day-to-day liquidity risk management to those arising in stressed conditions.

A firm should periodically review and, where appropriate, adjust its limits when conditions or risk tolerances change.

Policy or limit exceptions should receive the prompt attention of the appropriate management and should be resolved according to processes described in approved policies.
Annex D

Senior Management Arrangements, Systems and Controls Handbook (SYSC)

In this Annex, the place where the text is being inserted is indicated and the text is not underlined.

12 Group risk systems and controls requirement

12.1 Application

12.1.1 R Subject to SYSC 12.1.2R to SYSC 12.1.4R, this section applies to each of the following which is a member of a group:

(1) a firm that falls into any one or more of the following categories:
   (a) a regulated entity;
   (b) an ELMI;
   (c) an insurer;
   (d) a BIPRU firm;
   (e) a non-BIPRU firm that is a parent financial holding company in a Member State and is a member of a UK consolidation group; and
   (f) a firm subject to the rules in IPRU(INV) Chapter 14.

(2) a UCITS firm, but only if its group contains a firm falling into (1); and

(3) the Society.

12.1.2 R Except as set out in SYSC 12.1.4R, this section applies with respect to different types of group as follows:

(1) SYSC 12.1.8R and SYSC 12.1.10R apply with respect to all groups, including FSA regulated EEA financial conglomerates, other financial conglomerates and groups dealt with in SYSC 12.1.13R to SYSC 12.1.16R;

(2) the additional requirements set out in SYSC 12.1.11R and SYSC 12.1.12R only apply with respect to FSA regulated EEA financial conglomerates; and

(3) the additional requirements set out in SYSC 12.1.13R to SYSC 12.1.16R only apply with respect to groups of the kind dealt with by whichever of those rules apply.

12.1.3 R This section does not apply to:
(1) an incoming EEA firm; or

(2) an incoming Treaty firm; or

(3) a UCITS qualifier; or

(4) an ICVC.

12.1.4 R (1) This rule applies in respect of the following rules:

(a) SYSC 12.1.8R(2);

(b) SYSC 12.1.10R(1), so far as it relates to SYSC 12.1.8R(2);

(c) SYSC 12.1.10R(2); and

(d) SYSC 12.1.11R to SYSC 12.1.15R.

(2) The rules referred to in (1):

(a) only apply with respect to a financial conglomerate if it an FSA regulated EEA financial conglomerate;

(b) (so far as they apply with respect to a group that is not a financial conglomerate) do not apply with respect to a group for which a competent authority in another EEA state is lead regulator;

(c) (so far as they apply with respect to a financial conglomerate) do not apply to a firm with respect to a financial conglomerate of which it is a member if the interest of the financial conglomerate in that firm is no more than a participation;

(d) (so far as they apply with respect to other groups) do not apply to a firm with respect to a group of which it is a member if the only relationship of the kind set out in paragraph (3) of the definition of group between it and the other members of the group is nothing more than a participation; and

(e) do not apply with respect to a third-country group.
12.1.5 G For the purpose of this section, a group is defined in the Glossary, and includes the whole of a firm’s group, including financial and non-financial undertakings. It also covers undertakings with other links to group members if their omission from the scope of group risk systems and controls would be misleading. The scope of the group systems and controls requirements may therefore differ from the scope of the quantitative requirements for groups.

Purpose

12.1.6 G The purpose of this chapter is to set out how the systems and control requirements imposed by SYSC (Senior Management Arrangements, Systems and Controls) apply where a firm is part of a group. If a firm is a member of a group, it should be able to assess the potential impact of risks arising from other parts of its group as well as from its own activities.

12.1.7 G This section implements articles 73(3) (Supervision on a consolidated basis of credit institutions) and 138 (Intra-group transactions with mixed activity holding companies) of the Banking Consolidation Directive, article 9 of the Financial Groups Directive (Internal control mechanisms and risk management processes) and article 8 of the Insurance Groups Directive (Intra-group transactions).

General rules

12.1.8 R A firm must:

(1) have adequate, sound and appropriate risk management processes and internal control mechanisms for the purpose of assessing and managing its own exposure to group risk, including sound administrative and accounting procedures; and

(2) ensure that its group has adequate, sound and appropriate risk management processes and internal control mechanisms at the level of the group, including sound administrative and accounting procedures.

12.1.9 G For the purposes of SYSC 12.1.8R, the question of whether the risk management processes and internal control mechanisms are adequate, sound and appropriate should be judged in the light of the nature, scale and complexity of the group’s business.

12.1.10 R The internal control mechanisms referred to in SYSC 12.1.8R must include:

(1) mechanisms that are adequate for the purpose of producing any data and information which would be relevant for the purpose of monitoring compliance with any prudential requirements (including any reporting requirements and any requirements relating to capital adequacy, solvency, systems and controls and large exposures):

(a) to which the firm is subject with respect to its membership of a group; or
(b) that apply to or with respect to that group or part of it; and

(2) mechanisms that are adequate to monitor funding within the group.

Financial conglomerates

12.1.11 R Where this section applies with respect to a financial conglomerate, the risk management processes referred to in SYSC 12.1.8R(2) must include:

(1) sound governance and management processes, which must include the approval and periodic review by the appropriate managing bodies within the financial conglomerate of the strategies and policies of the financial conglomerate in respect of all the risks assumed by the financial conglomerate, such review and approval being carried out at the level of the financial conglomerate;

(2) adequate capital adequacy policies at the level of the financial conglomerate, one of the purposes of which must be to anticipate the impact of the business strategy of the financial conglomerate on its risk profile and on the capital adequacy requirements to which it and its members are subject;

(3) adequate procedures for the purpose of ensuring that the risk monitoring systems of the financial conglomerate and its members are well integrated into their organisation; and

(4) adequate procedures for the purpose of ensuring that the systems and controls of the members of the financial conglomerate are consistent and that the risks can be measured, monitored and controlled at the level of the financial conglomerate.

12.1.12 R Where this section applies with respect to a financial conglomerate, the internal control mechanisms referred to in SYSC 12.1.8R(2) must include:

(1) mechanisms that are adequate to identify and measure all material risks incurred by members of the financial conglomerate and appropriately relate capital in the financial conglomerate to risks; and

(2) sound reporting and accounting procedures for the purpose of identifying, measuring, monitoring and controlling intra-group transactions and risk concentrations.

BIPRU firms and other firms to which BIPRU 8 applies

12.1.13 R If this rule applies under SYSC 12.1.14R to a firm, the firm must:

(1) comply with SYSC 12.1.8R(2) in relation to any UK consolidation group or non-EEA sub-group of which it is a member, as well as in relation to its group; and

(2) ensure that the risk management processes and internal control mechanisms at the level of any UK consolidation group or non-EEA...
sub-group of which it is a member comply with the obligations set out in the following provisions on a consolidated (or sub-consolidated) basis:

(a) SYSC 3.2.23R and SYSC 3.2.24R;
(b) SYSC 3.2.26R;
(c) SYSC 3.2.28R to SYSC 3.2.36R;
(d) SYSC 11.1.11R and SYSC 11.1.12R;
(e) BIPRU 2.3.7R(1);
(f) BIPRU 9.1.6R and BIPRU 9.13.21R (Liquidity plans);
(g) BIPRU 10.12.3R (Concentration risk policies).

[Note: article 73(3) of the Banking Consolidation Directive]

12.1.14 R SYSC 12.1.13R applies to a firm that is:

(1) an ELMI;
(2) a BIPRU firm; or
(3) a non-BIPRU firm that is a parent financial holding company in a Member State and is a member of a UK consolidation group.

12.1.15 R In the case of a firm that:

(1) is an ELMI or a BIPRU firm; and
(2) has a mixed-activity holding company as a parent undertaking;

the risk management processes and internal control mechanisms referred to in SYSC 12.1.8R must include sound reporting and accounting procedures and other mechanisms that are adequate to identify, measure, monitor and control transactions between the firm's parent undertaking mixed-activity holding company and any of the mixed-activity holding company's subsidiary undertakings.

Insurance undertakings

12.1.16 R In the case of an insurer that has a mixed-activity insurance holding company as a parent undertaking, the risk management processes and internal control mechanisms referred to in SYSC 12.1.8R must include sound reporting and accounting procedures and other mechanisms that are adequate to identify, measure, monitor and control transactions between the firm's parent undertaking mixed-activity insurance holding company and any of the mixed-activity insurance holding company's subsidiary undertakings.

12.1.17 G SYSC 12.1.16R cannot apply to a building society as it cannot have a mixed-
activity holding company as a parent undertaking. SYSC 12.1.16R cannot apply to a friendly society as it cannot have a mixed-activity insurance holding company as a parent undertaking.

Nature and extent of requirements and allocation of responsibilities within the group

12.1.18 G Assessment of the adequacy of a group's systems and controls required by this section will form part of the FSA's risk management process.

12.1.19 G The nature and extent of the systems and controls necessary under SYSC 12.1.8R(1) to address group risk will vary according to the materiality of those risks to the firm and the position of the firm within the group.

12.1.20 G In some cases the management of the systems and controls used to address the risks described in SYSC 12.1.8R(1) may be organised on a group-wide basis. If the firm is not carrying out those functions itself, it should delegate them to the group members that are carrying them out. However, this does not relieve the firm of responsibility for complying with its obligations under SYSC 12.1.8R(1). A firm cannot absolve itself of such a responsibility by claiming that any breach of that rule is caused by the actions of another member of the group to whom the firm has delegated tasks. The risk management arrangements are still those of the firm, even though personnel elsewhere in the firm's group are carrying out these functions on its behalf.

12.1.21 G SYSC 12.1.8R(1) deals with the systems and controls that a firm should have in respect of the exposure it has to the rest of the group. On the other hand, the purpose of SYSC 12.1.8R(2) and the rules in this section that amplify it is to require groups to have adequate systems and controls. However a group is not a single legal entity on which obligations can be imposed. Therefore the obligations have to be placed on individual firms. The purpose of imposing the obligations on each firm in the group is to make sure that the FSA can take supervisory action against any firm in a group whose systems and controls do not meet the standards in this section. Thus responsibility for compliance with the rules for group systems and controls is a joint one.

12.1.22 G If both a firm and its parent undertaking are subject to SYSC 12.1.8R(2), the FSA would not expect systems and controls to be duplicated. In this case, the firm should assess whether and to what extent it can rely on its parent's group risk systems and controls.
Annex E

Senior Management Arrangements, Systems and Controls Handbook (SYSC)

In this Annex, the place where the text is being inserted is indicated and the text is not underlined.

To be inserted after SYSC 12

13 Operational risk: systems and controls

13.1 Application

13.1.1 SYSC 13 applies to an insurer unless it is:

(1) a non-directive friendly society; or
(2) an incoming EEA firm; or
(3) an incoming Treaty firm.

13.1.2 SYSC 13 applies to:

(1) an EEA-deposit insurer; and
(2) a Swiss general insurer;

only in respect of the activities of the firm carried on from a branch in the United Kingdom.

13.1.3 SYSC 13 applies to a UK ISPV.

13.2 Purpose

13.2.1 SYSC 13 provides guidance on how to interpret SYSC 3.1.1R and SYSC 3.2.6R, which deal with the establishment and maintenance of systems and controls, in relation to the management of operational risk. Operational risk has been described by the Basel Committee on Banking Supervision as "the risk of loss, resulting from inadequate or failed internal processes, people and systems, or from external events". This chapter covers systems and controls for managing risks concerning any of a firm's operations, such as its IT systems and outsourcing arrangements. It does not cover systems and controls for managing credit, market, liquidity and insurance risk.

13.2.2 Operational risk is a concept that can have a different application for different firms. A firm should assess the appropriateness of the guidance in this chapter in the light of the scale, nature and complexity of its activities as well as its obligations as set out in Principle 3, to organise and control its affairs responsibly and effectively.
13.2.3 G A firm should take steps to understand the types of operational risk that are relevant to its particular circumstances, and the operational losses to which they expose the firm. This should include considering the potential sources of operational risk addressed in this chapter: people; processes and systems; external events.

13.2.4 G Operational risk can affect, amongst other things, a firm's solvency, or lead to unfair treatment of consumers or lead to financial crime. A firm should consider all operational risk events that may affect these matters in establishing and maintaining its systems and controls.

13.3 Other related Handbook sections

13.3.1 G The following is a non-exhaustive list of rules and guidance in the Handbook that are relevant to a firm's management of operational risk:

(1) SYSC 14 and INSINU 5.1 contain specific rules and guidance for the establishment and maintenance of operational risk systems and controls in a prudential context.

(2) COB contains rules and guidance that can relate to the management of operational risk; for example, COB 2 (Rules which apply to all firms conducting designated investment business), COB 3 (Financial promotion), COB 5 (Advising and selling), COB 7 (Dealing and managing) and COB 9 (Client assets).

13.4 Requirements to notify the FSA

13.4.1 G Under Principle 11 and SUP 15.3.1R, a firm must notify the FSA immediately of any operational risk matter of which the FSA would reasonably expect notice. SUP 15.3.8G provides guidance on the occurrences that this requirement covers, which include a significant failure in systems and controls and a significant operational loss.

13.4.2 G Regarding operational risk, matters of which the FSA would expect notice under Principle 11 include:

(1) any significant operational exposures that a firm has identified;

(2) the firm's invocation of a business continuity plan; and

(3) any other significant change to a firm's organisation, infrastructure or business operating environment.

13.5 Risk management terms

13.5.1 G In this chapter, the following interpretations of risk management terms apply:

(1) a firm's risk culture encompasses the general awareness, attitude and behaviour of its employees and appointed representatives to risk and
the management of risk within the organisation;

(2) operational exposure means the degree of operational risk faced by a firm and is usually expressed in terms of the likelihood and impact of a particular type of operational loss occurring (for example, fraud, damage to physical assets);

(3) a firm's operational risk profile describes the types of operational risks that it faces, including those operational risks within a firm that may have an adverse impact upon the quality of service afforded to its clients, and its exposure to these risks.

13.6 People

13.6.1 G A firm should consult SYSC 3.2.2G to SYSC 3.2.5G for guidance on reporting lines and delegation of functions within a firm and SYSC 3.2.13G to SYSC 3.2.14G for guidance on the suitability of employees and appointed representatives. This section provides additional guidance on management of employees and other human resources in the context of operational risk.

13.6.2 G A firm should establish and maintain appropriate systems and controls for the management of operational risks that can arise from employees. In doing so, a firm should have regard to:

(1) its operational risk culture, and any variations in this or its human resource management practices, across its operations (including, for example, the extent to which the compliance culture is extended to in-house IT staff);

(2) whether the way employees are remunerated exposes the firm to the risk that it will not be able to meet its regulatory obligations (see SYSC 3.2.18G). For example, a firm should consider how well remuneration and performance indicators reflect the firm's tolerance for operational risk, and the adequacy of these indicators for measuring performance;

(3) whether inadequate or inappropriate training of client-facing services exposes clients to risk of loss or unfair treatment including by not enabling effective communication with the firm;

(4) the extent of its compliance with applicable regulatory and other requirements that relate to the welfare and conduct of employees;

(5) its arrangements for the continuity of operations in the event of employee unavailability or loss;

(6) the relationship between indicators of 'people risk' (such as overtime, sickness, and employee turnover levels) and exposure to operational losses; and

(7) the relevance of all the above to employees of a third party supplier who are involved in performing an outsourcing arrangement. As
necessary, a firm should review and consider the adequacy of the staffing arrangements and policies of a service provider.

Employee responsibilities

13.6.3 G A firm should ensure that all employees are capable of performing, and aware of, their operational risk management responsibilities, including by establishing and maintaining:

(1) appropriate segregation of employees' duties and appropriate supervision of employees in the performance of their responsibilities (see SYSC 3.2.5G);

(2) appropriate recruitment and subsequent processes to review the fitness and propriety of employees (see SYSC 3.2.13G and SYSC 3.2.14G);

(3) clear policy statements and appropriate systems and procedures manuals that are effectively communicated to employees and available for employees to refer to as required. These should cover, for example, compliance, IT security and health and safety issues;

(4) training processes that enable employees to attain and maintain appropriate competence; and

(5) appropriate and properly enforced disciplinary and employment termination policies and procedures.

13.6.4 G A firm should have regard to SYSC 13.6.3G in relation to approved persons, people occupying positions of high personal trust (for example, security administration, payment and settlement functions); and people occupying positions requiring significant technical competence (for example, derivatives trading and technical security administration). A firm should also consider the rules and guidance for approved persons in other parts of the Handbook (including APER and SUP) and the rules and guidance on senior manager responsibilities in SYSC 2.1 (Apportionment of Responsibilities).

13.7 Processes and systems

13.7.1 G A firm should establish and maintain appropriate systems and controls for managing operational risks that can arise from inadequacies or failures in its processes and systems (and, as appropriate, the systems and processes of third party suppliers, agents and others). In doing so a firm should have regard to:

(1) the importance and complexity of processes and systems used in the end-to-end operating cycle for products and activities (for example, the level of integration of systems);

(2) controls that will help it to prevent system and process failures or identify them to permit prompt rectification (including pre-approval
or reconciliation processes);

(3) whether the design and use of its processes and systems allow it to comply adequately with regulatory and other requirements;

(4) its arrangements for the continuity of operations in the event that a significant process or system becomes unavailable or is destroyed; and

(5) the importance of monitoring indicators of process or system risk (including reconciliation exceptions, compensation payments for client losses and documentation errors) and experience of operational losses and exposures.

Internal documentation

13.7.2 G Internal documentation may enhance understanding and aid continuity of operations, so a firm should ensure the adequacy of its internal documentation of processes and systems (including how documentation is developed, maintained and distributed) in managing operational risk.

External documentation

13.7.3 G A firm may use external documentation (including contracts, transaction statements or advertising brochures) to define or clarify terms and conditions for its products or activities, its business strategy (for example, including through press statements), or its brand. Inappropriate or inaccurate information in external documents can lead to significant operational exposure.

13.7.4 G A firm should ensure the adequacy of its processes and systems to review external documentation prior to issue (including review by its compliance, legal and marketing departments or by appropriately qualified external advisers). In doing so, a firm should have regard to:

(1) compliance with applicable regulatory and other requirements (such as COB 3 (Financial promotion));

(2) the extent to which its documentation uses standard terms (that are widely recognised, and have been tested in the courts) or non-standard terms (whose meaning may not yet be settled or whose effectiveness may be uncertain);

(3) the manner in which its documentation is issued; and

(4) the extent to which confirmation of acceptance is required (including by customer signature or counterparty confirmation).

IT systems
13.7.5 G IT systems include the computer systems and infrastructure required for the automation of processes, such as application and operating system software; network infrastructure; and desktop, server, and mainframe hardware. Automation may reduce a firm's exposure to some 'people risks' (including by reducing human errors or controlling access rights to enable segregation of duties), but will increase its dependency on the reliability of its IT systems.

13.7.6 G A firm should establish and maintain appropriate systems and controls for the management of its IT system risks, having regard to:

1. its organisation and reporting structure for technology operations (including the adequacy of senior management oversight);
2. the extent to which technology requirements are addressed in its business strategy;
3. the appropriateness of its systems acquisition, development and maintenance activities (including the allocation of responsibilities between IT development and operational areas, processes for embedding security requirements into systems); and
4. the appropriateness of its activities supporting the operation of IT systems (including the allocation of responsibilities between business and technology areas).

Information security

13.7.7 G Failures in processing information (whether physical, electronic or known by employees but not recorded) or of the security of the systems that maintain it can lead to significant operational losses. A firm should establish and maintain appropriate systems and controls to manage its information security risks. In doing so, a firm should have regard to:

1. confidentiality: information should be accessible only to persons or systems with appropriate authority, which may require firewalls within a system, as well as entry restrictions;
2. integrity: safeguarding the accuracy and completeness of information and its processing;
3. availability and authentication: ensuring that appropriately authorised persons or systems have access to the information when required and that their identity is verified;
4. non-repudiation and accountability: ensuring that the person or system that processed the information cannot deny their actions.

13.7.8 G A firm should ensure the adequacy of the systems and controls used to protect the processing and security of its information, and should have regard to established security standards such as ISO17799 (Information
Operating processes and systems at separate geographic locations may alter a firm's operational risk profile (including by allowing alternative sites for the continuity of operations). A firm should understand the effect of any differences in processes and systems at each of its locations, particularly if they are in different countries, having regard to:

1. the business operating environment of each country (for example, the likelihood and impact of political disruptions or cultural differences on the provision of services);
2. relevant local regulatory and other requirements regarding data protection and transfer;
3. the extent to which local regulatory and other requirements may restrict its ability to meet regulatory obligations in the United Kingdom (for example, access to information by the FSA and local restrictions on internal or external audit); and
4. the timeliness of information flows to and from its headquarters and whether the level of delegated authority and the risk management structures of the overseas operation are compatible with the firm's head office arrangements.

The exposure of a firm to operational risk may increase during times of significant change to its organisation, infrastructure and business operating environment (for example, following a corporate restructure or changes in regulatory requirements). Before, during, and after expected changes, a firm should assess and monitor their effect on its risk profile, including with regard to:

1. untrained or de-motivated employees or a significant loss of employees during the period of change, or subsequently;
2. inadequate human resources or inexperienced employees carrying out routine business activities owing to the prioritisation of resources to the programme or project;
3. process or system instability and poor management information due to failures in integration or increased demand; and
4. inadequate or inappropriate processes following business re-engineering.

A firm should establish and maintain appropriate systems and controls for the management of the risks involved in expected changes, such as by
ensuring:

(1) the adequacy of its organisation and reporting structure for managing the change (including the adequacy of senior management oversight);

(2) the adequacy of the management processes and systems for managing the change (including planning, approval, implementation and review processes); and

(3) the adequacy of its strategy for communicating changes in systems and controls to its employees.

Unexpected changes and business continuity management

13.8.3 G SYSC 3.2.19G provides high level guidance on business continuity. This section provides additional guidance on managing business continuity in the context of operational risk.

13.8.4 G The high level requirement for appropriate systems and controls at SYSC 3.1.1R applies at all times, including when a business continuity plan is invoked. However, the FSA recognises that, in an emergency, a firm may be unable to comply with a particular rule and the conditions for relief are outlined in GEN 1.3 (Emergency).

13.8.5 G A firm should consider the likelihood and impact of a disruption to the continuity of its operations from unexpected events. This should include assessing the disruptions to which it is particularly susceptible (and the likely timescale of those disruptions) including through:

(1) loss or failure of internal and external resources (such as people, systems and other assets);

(2) the loss or corruption of its information; and

(3) external events (such as vandalism, war and "acts of God").

13.8.6 G A firm should implement appropriate arrangements to maintain the continuity of its operations. A firm should act to reduce both the likelihood of a disruption (including by succession planning, systems resilience and dual processing); and the impact of a disruption (including by contingency arrangements and insurance).

13.8.7 G A firm should document its strategy for maintaining continuity of its operations, and its plans for communicating and regularly testing the adequacy and effectiveness of this strategy. A firm should establish:

(1) formal business continuity plans that outline arrangements to reduce the impact of a short, medium or long-term disruption, including:

(a) resource requirements such as people, systems and other
assets, and arrangements for obtaining these resources;

(b) the recovery priorities for the firm's operations; and

(c) communication arrangements for internal and external concerned parties (including the FSA, clients and the press);

(2) escalation and invocation plans that outline the processes for implementing the business continuity plans, together with relevant contact information;

(3) processes to validate the integrity of information affected by the disruption;

(4) processes to review and update (1) to (3) following changes to the firm's operations or risk profile (including changes identified through testing).

13.8.8 G The use of an alternative site for recovery of operations is common practice in business continuity management. A firm that uses an alternative site should assess the appropriateness of the site, particularly for location, speed of recovery and adequacy of resources. Where a site is shared, a firm should evaluate the risk of multiple calls on shared resources and adjust its plans accordingly.

13.9 Outsourcing

13.9.1 G As SYSC 3.2.4G explains, a firm cannot contract out its regulatory obligations and should take reasonable care to supervise the discharge of outsourced functions. This section provides additional guidance on managing outsourcing arrangements (and will be relevant, to some extent, to other forms of third party dependency) in relation to operational risk. Outsourcing may affect a firm's exposure to operational risk through significant changes to, and reduced control over, people, processes and systems used in outsourced activities.

13.9.2 G Firms should take particular care to manage material outsourcing arrangements and, as SUP 15.3.8G(1)(e) explains, a firm should notify the FSA when it intends to enter into a material outsourcing arrangement.

13.9.3 G A firm should not assume that because a service provider is either a regulated firm or an intra-group entity an outsourcing arrangement with that provider will, in itself, necessarily imply a reduction in operational risk.

13.9.4 G Before entering into, or significantly changing, an outsourcing arrangement, a firm should:

(1) analyse how the arrangement will fit with its organisation and reporting structure; business strategy; overall risk profile; and ability to meet its regulatory obligations;
(2) consider whether the agreements establishing the arrangement will allow it to monitor and control its operational risk exposure relating to the outsourcing;

(3) conduct appropriate due diligence of the service provider's financial stability and expertise;

(4) consider how it will ensure a smooth transition of its operations from its current arrangements to a new or changed outsourcing arrangement (including what will happen on the termination of the contract); and

(5) consider any concentration risk implications such as the business continuity implications that may arise if a single service provider is used by several firms.

13.9.5 G In negotiating its contract with a service provider, a firm should have regard to:

(1) reporting or notification requirements it may wish to impose on the service provider;

(2) whether sufficient access will be available to its internal auditors, external auditors or actuaries (see section 341 of the Act) and to the FSA (see SUP 2.3.5R (Access to premises) and SUP 2.3.7R (Suppliers under material outsourcing arrangements);

(3) information ownership rights, confidentiality agreements and Chinese walls to protect client and other information (including arrangements at the termination of the contract);

(4) the adequacy of any guarantees and indemnities;

(5) the extent to which the service provider must comply with the firm's policies and procedures (covering, for example, information security);

(6) the extent to which a service provider will provide business continuity for outsourced operations, and whether exclusive access to its resources is agreed;

(7) the need for continued availability of software following difficulty at a third party supplier;

(8) the processes for making changes to the outsourcing arrangement (for example, changes in processing volumes, activities and other contractual terms) and the conditions under which the firm or service provider can choose to change or terminate the outsourcing arrangement, such as where there is:

(a) a change of ownership or control (including insolvency or
receivership) of the service provider or *firm*; or

(b) significant change in the business operations (including sub-contracting) of the service provider or *firm*; or

(c) inadequate provision of services that may lead to the *firm* being unable to meet its regulatory obligations.

13.9.6 G In implementing a relationship management framework, and drafting the service level agreement with the service provider, a *firm* should have regard to:

(1) the identification of qualitative and quantitative performance targets to assess the adequacy of service provision, to both the *firm* and its clients, where appropriate;

(2) the evaluation of performance through service delivery reports and periodic self certification or independent review by internal or external auditors; and

(3) remedial action and escalation processes for dealing with inadequate performance.

13.9.7 G In some circumstances, a *firm* may find it beneficial to use externally validated reports commissioned by the service provider, to seek comfort as to the adequacy and effectiveness of its systems and controls. The use of such reports does not absolve the *firm* of responsibility to maintain other oversight. In addition, the *firm* should not normally have to forfeit its right to access, for itself or its agents, to the service provider's premises.

13.9.8 G A *firm* should ensure that it has appropriate contingency arrangements to allow business continuity in the event of a significant loss of services from the service provider. Particular issues to consider include a significant loss of resources at, or financial failure of, the service provider, and unexpected termination of the outsourcing arrangement.

13.10 Insurance

13.10.1 G Whilst a *firm* may take out insurance with the aim of reducing the monetary impact of operational risk events, non-monetary impacts may remain (including impact on the *firm's* reputation). A *firm* should not assume that insurance alone can replace robust systems and controls.

13.10.2 G When considering utilising insurance, a *firm* should consider:

(1) the time taken for the insurer to pay claims (including the potential time taken in disputing cover) and the *firm's* funding of operations whilst awaiting payment of claims;

(2) the financial strength of the insurer, which may determine its ability to pay claims, particularly where large or numerous small claims are
made at the same time; and

(3) the effect of any limiting conditions and exclusion clauses that may restrict cover to a small number of specific operational losses and may exclude larger or hard to quantify indirect losses (such as lost business or reputational costs).
14 Prudential risk management and associated systems and controls

14.1 Application

14.1.1 R This section applies to an insurer unless it is:

(1) a non-directive friendly society; or

(2) an incoming EEA firm; or

(3) an incoming Treaty firm.

14.1.2 R This section applies to:

(1) an EEA-deposit insurer; and

(2) a Swiss general insurer;

only in respect of the activities of the firm carried on from a branch in the United Kingdom.

Purpose

14.1.3 G This section sets out some rules and guidance on the establishment and maintenance of systems and controls for the management of a firm's prudential risks. A firm's prudential risks are those that can reduce the adequacy of its financial resources, and as a result may adversely affect confidence in the financial system or prejudice consumers. Some key prudential risks are credit, market, liquidity, operational, insurance and group risk.

14.1.4 G The purpose of this section is to serve the FSA's regulatory objectives of consumer protection and market confidence. In particular, this section aims to reduce the risk that a firm may pose a threat to these regulatory objectives, either because it is not prudently managed, or because it has inadequate systems to permit appropriate senior management oversight and control of its business.

14.1.5 G Both adequate financial resources and adequate systems and controls are necessary for the effective management of prudential risks. A firm may hold financial resources to help alleviate the financial consequences of minor weaknesses in its systems and controls (to reflect possible impairments in the accuracy or timing of its identification, measurement, monitoring and control of certain risks, for example). However, financial resources cannot adequately compensate for significant weaknesses in a firm's systems and controls that could fundamentally undermine its ability to control its affairs effectively.
How to interpret this section

14.1.6 G This section is designed to amplify Principle 3 (Management and control) which requires that a firm take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. This section is also designed to be complementary to SYSC 2, SYSC 3 and SYSC 13 in that it contains some additional rules and guidance on senior management arrangements and associated systems and controls for firms that could have a significant impact on the FSA's objectives in a prudential context.

14.1.7 G In addition to supporting PRIN and SYSC 2, SYSC 3 and SYSC 13, this section lays the foundations for the more specific rules and guidance on the management of credit, market, liquidity, operational, insurance and group risks that are in SYSC 11, SYSC 12, SYSC 15, SYSC 16 and INSPRU 5.1. Many of the elements raised here in general terms are expanded upon in these sections.

14.1.8 G Appropriate systems and controls for the management of prudential risk will vary from firm to firm. Therefore, most of the material in this section is guidance. In interpreting this guidance, a firm should have regard to its own particular circumstances. Following from SYSC 3.1.2 G, this should include considering the nature, scale and complexity of its business, which may be influenced by factors such as:

1. the diversity of its operations, including geographical diversity;
2. the volume and size of its transactions; and
3. the degree of risk associated with each area of its operation.

14.1.9 G The guidance contained within this section is not designed to be exhaustive. When establishing and maintaining its systems and controls a firm should have regard not only to other parts of the Handbook, but also to material that is issued by other industry or regulatory bodies.

The role of systems and controls in a prudential context

14.1.10 G In a prudential context, a firm's systems and controls should provide its senior management with an adequate means of managing the firm. As such, they should be designed and maintained to ensure that senior management is able to make and implement integrated business planning and risk management decisions on the basis of accurate information about the risks that the firm faces and the financial resources that it has.

The prudential responsibilities of senior management and the apportionment of those responsibilities

14.1.11 G Ultimate responsibility for the management of prudential risks rests with a firm's governing body and relevant senior managers, and in particular with those individuals that undertake the firm's governing functions and the
apportionment and oversight function. In particular, these responsibilities should include:

1. over seeing the establishment of an appropriate business plan and risk management strategy;
2. overseeing the development of appropriate systems for the management of prudential risks;
3. establishing adequate internal controls; and
4. ensuring that the firm maintains adequate financial resources.

The delegation of responsibilities within the firm

14.1.12 Although authority for the management of a firm's prudential risks is likely to be delegated, to some degree, to individuals at all levels of the organisation, overall responsibility for this activity should not be delegated from its governing body and relevant senior managers.

14.1.13 Where delegation does occur, a firm should ensure that appropriate systems and controls are in place to allow its governing body and relevant senior managers to participate in and control its prudential risk management activities. The governing body and relevant senior managers should approve and periodically review these systems and controls to ensure that delegated duties are being performed correctly.

Firms subject to risk management on a group basis

14.1.14 Some firms organise the management of their prudential risks on a stand-alone basis. In some cases, however, the management of a firm's prudential risks may be entirely or largely subsumed within a whole group or sub-group basis.

1. The latter arrangement may still comply with the FSA's prudential policy on systems and controls if the firm's governing body formally delegates the functions that are to be carried out in this way to the persons or bodies that are to carry them out. Before doing so, however, the firm's governing body should have explicitly considered the arrangement and decided that it is appropriate and that it enables the firm to meet the FSA's prudential policy on systems and controls. The firm should notify the FSA if the management of its prudential risks is to be carried out in this way.

2. Where the management of a firm's prudential risks is largely, but not entirely, subsumed within a whole group or sub-group basis, the firm should ensure that any prudential issues that are specific to the firm are:
(a) identified and adequately covered by those to whom it has delegated certain prudential risk management tasks; or

(b) dealt with by the firm itself.

14.1.15 G Any delegation of the management of prudential risks to another part of a firm's group does not relieve it of responsibility for complying with the FSA's prudential policy on systems and controls. A firm cannot absolve itself of such a responsibility by claiming that any breach of the FSA's prudential policy on systems and controls is effected by the actions of a third party firm to whom the firm has delegated tasks. The risk management arrangements are still those of the firm, even though personnel elsewhere in the firm's group are carrying out these functions on its behalf. Thus any references in GENPRU, INSPRU or SYSC to what a firm, its personnel and its management should and should not do still apply, and do not need any adjustment to cover the situation in which risk management functions are carried out on a group-wide basis.

14.1.16 G Where it is stated in GENPRU, INSPRU or SYSC that a particular task in relation to a firm's systems and controls should be carried out by a firm's governing body this task should not be delegated to another part of its group. Furthermore, even where the management of a firm's prudential risks is delegated as described in SYSC 14.1.14G, responsibility for its effectiveness and for ensuring that it remains appropriate remains with the firm's governing body. The firm's governing body should therefore keep any delegation under review to ensure that delegated duties are being performed correctly.

Business planning and risk management

14.1.17 G Business planning and risk management are closely related activities. In particular, the forward-looking assessment of a firm's financial resources needs, and of how business plans may affect the risks that it faces, are important elements of prudential risk management. A firm's business planning should also involve the creation of specific risk policies which will normally outline a firm's strategy and objectives for, as appropriate, the management of its market, credit, liquidity, operational, insurance and group risks and the processes that it intends to adopt to achieve these objectives. SYSC 14.1.18R to SYSC 14.1.25G set out some rules and guidance relating to business planning and risk management in a prudential context (see also SYSC 3.2.17G, which states that a firm should plan its business appropriately).

14.1.18 R A firm must take reasonable steps to ensure the establishment and maintenance of a business plan and appropriate systems for the management of prudential risk.

14.1.19 R When establishing and maintaining its business plan and prudential risk management systems, a firm must document:
an explanation of its overall business strategy, including its business objectives;

(2) a description of, as applicable, its policies towards market, credit (including provisioning), liquidity, operational, insurance and group risk (that is, its risk policies), including its appetite or tolerance for these risks and how it identifies, measures or assesses, monitors and controls these risks;

(3) the systems and controls that it intends to use in order to ensure that its business plan and risk policies are implemented correctly;

(4) a description of how the firm accounts for assets and liabilities, including the circumstances under which items are netted, included or excluded from the firm's balance sheet and the methods and assumptions for valuation;

(5) appropriate financial projections and the results of its stress testing and scenario analysis (see GENPRU 1.2 (Adequacy of financial resources); and

(6) details of, and the justification for, the methods and assumptions used in financial projections and stress testing and scenario analysis.

14.1.20 G The prudential risk management systems referred to in SYSC 14.1.18R and SYSC 14.1.19R are the means by which a firm is able to:

(1) identify the prudential risks that are inherent in its business plan, operating environment and objectives, and determine its appetite or tolerance for these risks;

(2) measure or assess its prudential risks;

(3) monitor its prudential risks; and

(4) control or mitigate its prudential risks.

INSPRU 4.1.63E is an evidential provision relating to SYSC 14.1.18R concerning risk management systems in respect of liquidity risk arising from substantial exposures in foreign currencies.

14.1.21 G A firm should consider the relationship between its business plan, risk policies and the financial resources that it has available (or can readily access), recognising that decisions made in respect of one element may have consequences for the other two.

14.1.22 G A firm's business plan and risk management systems should be:

(1) effectively communicated so that all employees and contractors understand and adhere to the procedures related to their own responsibilities;
(2) regularly updated and revised, in particular when there is significant new information or when actual practice or performance differs materially from the documented strategy, policy or systems.

14.1.23 G The level of detail in a firm’s business plan and its approach to the design of its risk management systems should be appropriate to the scale and complexity of its operations, and the nature and degree of risk that it faces.

14.1.24 G A firm's business plan and systems documentation should be accessible to the firm's management in line with their respective responsibilities and, upon request, to the FSA.

14.1.25 G SYSC 14.1.19R(5) requires a firm to document its financial projections and the results of its stress testing and scenario analysis. Such financial projections, stress tests and scenario analysis should be used by a firm’s governing body and relevant senior managers when deciding upon how much risk the firm is willing to accept in pursuit of its business objectives and how risk limits should be set. Further rules and guidance on stress testing and scenario analysis are outlined in GENPRU 1.2 (Adequacy of financial resources) and SYSC 11 (Liquidity risk systems and controls).

Internal controls: introduction

14.1.26 G Internal controls should provide a firm with reasonable assurance that it will not be hindered in achieving its objectives, or in the orderly and legitimate conduct of its business, by events that may reasonably be foreseen. More specifically in a prudential context, internal controls should be concerned with ensuring that a firm’s business plan and risk management systems are operating as expected and are being implemented as intended. The following rule (SYSC 14.1.27R) reflects the importance of internal controls in a prudential context.

14.1.27 R A firm must take reasonable steps to establish and maintain adequate internal controls.

14.1.28 G The precise role and organisation of internal controls can vary from firm to firm. However, a firm’s internal controls should normally be concerned with assisting its governing body and relevant senior managers to participate in ensuring that it meets the following objectives:

- safeguarding both the assets of the firm and its customers, as well as identifying and managing liabilities;
- maintaining the efficiency and effectiveness of its operations;
- ensuring the reliability and completeness of all accounting, financial and management information; and
- ensuring compliance with its internal policies and procedures as well as all applicable laws and regulations.

14.1.29 G When determining the adequacy of its internal controls, a firm should
consider both the potential risks that might hinder the achievement of the objectives listed in SYSC 14.1.28G, and the extent to which it needs to control these risks. More specifically, this should normally include consideration of:

(1) the appropriateness of its reporting and communication lines (see SYSC 3.2.2G);

(2) how the delegation or contracting of functions or activities to employees, appointed representatives or other third parties (for example outsourcing) is to be monitored and controlled (see SYSC 3.2.3G to SYSC 3.2.4G, SYSC 14.1.12G to SYSC 14.1.16G and SYSC 14.1.33G; additional guidance on the management of outsourcing arrangements is also provided in SYSC 13.9);

(3) the risk that a firm's employees or contractors might accidentally or deliberately breach a firm's policies and procedures (see SYSC 13.6.3G);

(4) the need for adequate segregation of duties (see SYSC 3.2.5G and SYSC 14.1.30G to SYSC 14.1.33G);

(5) the establishment and control of risk management committees (see SYSC 14.1.34G to SYSC 14.1.37G);

(6) the need for risk assessment and the establishment of a risk assessment function (see SYSC 3.2.10G and SYSC 14.1.38G to SYSC 14.1.41G;

(7) the need for internal audit and the establishment of an internal audit function and audit committee (see SYSC 3.2.15G to SYSC 3.2.16G and SYSC 14.1.42G to SYSC 14.1.45G).

Internal controls: segregation of duties

14.1.30 G The effective segregation of duties is an important internal control in the prudential context. In particular, it helps to ensure that no one individual is completely free to commit a firm's assets or incur liabilities on its behalf. Segregation can also help to ensure that a firm's governing body receives objective and accurate information on financial performance, the risks faced by the firm and the adequacy of its systems. In this regard, a firm should ensure that there is adequate segregation of duties between employees involved in:

(1) taking on or controlling risk (which could involve risk mitigation);

(2) risk assessment (which includes the identification and analysis of risk); and

(3) internal audit.

14.1.31 G In addition, a firm should normally ensure that no single individual has
unrestricted authority to do all of the following:

(1) initiate a transaction;
(2) bind the firm;
(3) make payments; and
(4) account for it.

14.1.32 G Where a firm is unable to ensure the complete segregation of duties (for example, because it has a limited number of staff), it should ensure that there are adequate compensating controls in place (for example, frequent review of an area by relevant senior managers).

14.1.33 G Where a firm outsources a controlled function, such as internal audit, it should take reasonable steps to ensure that every individual involved in the performance of this service is independent from the individuals who perform its external audit. This should not prevent services from being undertaken by a firm's external auditors provided that:

(1) the work is carried out under the supervision and management of the firm's own internal staff; and
(2) potential conflicts of interest between the provision of external audit services and the provision of controlled functions are properly managed.

Internal controls: risk management committees

14.1.34 G In many firms, especially if there are multiple business lines, it is common for the governing body to delegate some tasks related to risk control and management to committees such as asset and liability committees (ALCO), credit risk committees and market risk committees.

14.1.35 G Where a firm decides to create one or more risk management committee(s), adequate internal controls should be put in place to ensure that these committees are effective and that their actions are consistent with the objectives outlined in SYSC 14.1.28G. This should normally include consideration of the following:

(1) setting clear terms of reference, including membership, reporting lines and responsibilities of each committee;
(2) setting limits on their authority;
(3) agreeing routine reporting and non-routine reporting escalation procedures;
(4) agreeing the minimum frequency of committee meetings; and
14.1.36 The decision to delegate risk management tasks, along with the terms of reference of the committees and their performance, should be reviewed periodically by the firm's governing body and revised as appropriate.

14.1.37 The effective use of risk management committees can help to enhance a firm's internal controls. In establishing and maintaining its risk management committees, a firm should consider:

1. Their membership, which should normally include relevant senior managers (such as the head of group risk, head of legal, and the heads of market, credit, liquidity and operational risk, etc.), business line managers, risk management personnel and other appropriately skilled people, for example, actuaries, lawyers, accountants, IT specialists, etc.;

2. Using these committees to:
   (i) inform the decisions made by a firm's governing body regarding its appetite or tolerance for risk taking;
   (ii) highlight risk management issues that may require attention by the governing body;
   (iii) consider risk at the firm-wide level and, within delegated limits, to determine the allocation of risk limits and financial resources across business lines; and
   (iv) consider how exposures may be unwound, hedged, or otherwise mitigated, as appropriate.

Internal controls: risk assessment

14.1.38 Risk assessment is the process through which a firm identifies and analyses (using both qualitative and quantitative methodologies) the risks that it faces. A firm's risk assessment activities should normally include consideration of:

1. Its total exposure to risk at the firm-wide level (that is, its exposure across business lines and risk categories);

2. Capital allocation and the need to calculate risk weighted returns for different business lines;

3. The potential correlations that can exist between the risks in different business lines; this should also include looking for risks to which a firm's business plan is particularly sensitive, such as interest rate risk, or multiple dealings with the same counterparty;

4. The use of stress tests and scenario analysis;
(5) whether there are risks inherent in the firm's business that are not being addressed adequately;

(6) the risk adjusted return that the firm is achieving; and

(7) the adequacy and timeliness of management information on market, credit, insurance, liquidity, operational and group risks from the business lines, including risk limit utilisation.

14.1.39 G In accordance with SYSC 3.2.10G a firm should consider whether it needs to set up a separate risk assessment function (or functions) that is responsible for assessing the risks that the firm faces and advising its governing body and senior managers on them.

14.1.40 G Where a firm does decide that it needs a separate risk assessment function, the employees or contractors that carry out this function should not normally be involved in risk taking activities such as business line management (see SYSC 14.1.30G to SYSC 14.1.33G on the segregation of duties).

14.1.41 G A summary of the results of the analysis undertaken by a firm's risk assessment function (including, where necessary, an explanation of any assumptions that were adopted) should normally be reported to relevant senior managers as well as to the firm's governing body.

Internal audit

14.1.42 G A firm should ensure that it has appropriate mechanisms in place to assess and monitor the appropriateness and effectiveness of its systems and controls. This should normally include consideration of:

(1) adherence to and effectiveness of, as appropriate, its market, credit, liquidity, operational, insurance, and group risk policies;

(2) whether departures and variances from its documented systems and controls and risk policies have been adequately documented and appropriately reported, including whether appropriate pre-clearance authorisation has been sought for material departures and variances;

(3) adherence to and effectiveness of its accounting policies, and whether accounting records are complete and accurate;

(4) adherence to and effectiveness of its management reporting arrangements, including the timeliness of reporting, and whether information is comprehensive and accurate; and

(5) adherence to FSA rules and regulatory prudential standards.

14.1.43 G In accordance with SYSC 3.2.15G and SYSC 3.2.16G, a firm should consider whether it needs to set up a dedicated internal audit function.

14.1.44 G Where a firm decides to set up an internal audit function, this function should provide independent assurance to its governing body, audit
committee or an appropriate senior manager of the integrity and effectiveness of its systems and controls.

14.1.45 G In forming its judgements, the person performing the internal audit function should test the practical operation of a firm's systems and controls as well as its accounting and risk policies. This should include examining the adequacy of supporting records.

Management information

14.1.46 G Many individuals, at various levels of a firm, need management information relating to their activities. However, SYSC 14.1.47G to SYSC 14.1.50G concentrates on the management information that should be available to those at the highest level of a firm, that is, the firm's governing body and relevant senior managers. In so doing SYSC 14.1.47G to SYSC 14.1.50G amplify SYSC 3.2.11G and SYSC 3.2.12G (which outline the FSA’s high level policy on senior management information) by providing some additional guidance on the management information that should be available in a prudential context.

14.1.47 G The role of management information should be to help a firm's governing body and senior managers to understand risk at a firm-wide level. In so doing, it should help them to:

(1) determine whether a firm is prudently managed with adequate financial resources;

(2) make the decisions that fall within their ambit (for example, the high level business plans, strategy and risk tolerances of the firm); and

(3) oversee the execution of tasks for which they are responsible.

14.1.48 G A firm should consider what information needs to be made available to its governing body and senior managers. Some possible examples include:

(1) firm-wide information such as the overall profitability and value of a firm and its total exposure to risk;

(2) reports from committees to which the governing body has delegated risk management tasks, if applicable;

(3) reports from a firm's internal audit and risk assessment functions, if applicable, including exception reports, where risk limits and policies have been breached or systems circumvented;

(4) financial projections under expected and abnormal (that is, stressed) conditions;

(5) reconciliation of actual profit and loss to previous financial projections and an analysis of any significant variances;

(6) matters which require a decision from the governing body or senior...
managers, for example a significant variation to a business plan, amendments to risk limits, the creation of a new business line, etc;

(7) compliance with FSA rules and regulatory prudential standards;

(8) risk weighted returns; and

(9) liquidity and funding requirements.

14.1.49 The management information that is provided to a firm's governing body and senior managers should have the following characteristics:

(1) it should be timely, its frequency being determined by factors such as:

(a) the volatility of the business in which the firm is engaged (that is, the speed at which its risks can change);

(b) any time constraints on when action needs to be taken; and

(c) the level of risk that the firm is exposed to, compared to its available financial resources and tolerance for risk;

(2) it should be reliable, having regard to the fact that it may be necessary to sacrifice a degree of accuracy for timeliness; and

(3) it should be presented in a manner that highlights any relevant issues on which those undertaking governing functions should focus particular attention.

14.1.50 The production of management and other information may require the collation of data from a variety of separate manual and automated systems. In such cases, responsibility for the integrity of the information may be spread amongst a number of operational areas. A firm should ensure that it has appropriate processes to validate the integrity of its information.

Record keeping

14.1.51 SYSC 3.2.20R requires a firm to take reasonable care to make and retain adequate records. The following policy on record keeping supplements SYSC 3.2.20R by providing some additional rules and guidance on record keeping in a prudential context. The purpose of this policy is to:

(1) facilitate the prudential supervision of a firm by ensuring that adequate information is available regarding its past/current financial situation and business activities (which includes the design and implementation of systems and controls); and

(2) help the FSA to satisfy itself that a firm is operating in a prudent manner and is not prejudicing the interests of its customers or market confidence.
In addition to the record keeping requirements in GENPRU, INSPRU and SYSC, a firm should remember that it may be obliged, under other applicable laws or regulations, to keep similar or additional records.

14.1.53 R (1) A firm must make and regularly update accounting and other records that are sufficient to enable the firm to demonstrate to the FSA:

(a) that the firm is financially sound and has appropriate systems and controls;

(b) the firm's financial position and exposure to risk (to a reasonable degree of accuracy); and

(c) the firm's compliance with the rules in GENPRU, INSPRU and SYSC.

(2) The records in (1) must be retained for a minimum of three years, or longer as appropriate.

14.1.54 G A firm should be able to make available the records described in SYSC 14.1.53 R within a reasonable timeframe when requested to do so by the FSA.

14.1.55 G The FSA recognises that not all records are specific to a particular point in time. As such, while it may be appropriate to update some records on a daily or continuous basis, for example expenditure and details of certain transactions, it may not be appropriate to update other records as regularly as this, for example those relating to its business plan and risk policies. A firm should decide how regularly it should update particular records.

14.1.56 G A firm should decide which records it needs to hold, noting that compliance with SYSC 14.1.53R does not require it to hold records on every single aspect of its activities. Some specific guidance on the types of records that a firm should hold is set out in each of the risk specific sections on systems and controls (see SYSC 11, SYSC 12, SYSC 14.1.65G, SYSC 15 to SYSC 17 and INSPRU 5.1).

14.1.57 G In deciding which records to hold, a firm should also take into account that failure to keep adequate records could make it harder for it to satisfy the FSA that it is compliant with the rules in GENPRU, INSPRU or SYSC, and to defend any enforcement action taken against it.

14.1.58 G A firm should keep the records required in GENPRU, INSPRU and SYSC in an appropriate format and language (in terms of format this could include holding them on paper or in electronic or some other form). However, whatever format or language a firm chooses, SYSC 3.2.20R requires that records be capable of being reproduced on paper and in English (except where they relate to business carried on from an establishment situated in a country where English is not an official language).

14.1.59 G In accordance with SYSC 3.2.20R, a firm should retain the records that it needs to comply with SYSC 14.1.53R for as long as they are relevant for the
purposes for which they were made.

14.1.60 R A firm must keep the records required in SYSC 14.1.53R in the United Kingdom, except where:

(1) they relate to business carried on from an establishment in a country or territory that is outside the United Kingdom; and

(2) they are kept in that country or territory.

14.1.61 R When a firm keeps the records required in SYSC 14.1.53R outside the United Kingdom, it must periodically send an adequate summary of those records to the United Kingdom.

14.1.62 G Where a firm outsources the storage of some or all of its records to a third party service provider, it should ensure that these records are readily accessible and can be reproduced within a reasonable time period. The firm should also ensure that these records are stored in compliance with the rules and guidance on record keeping in GENPRU, INSPRU or SYSC. Additional guidance on the management of outsourcing agreements is provided in SYSC 13.

14.1.63 G A firm may rely on records that have been produced by a third party (for example, another group company or an external agent, such as an outsource service provider). However where the firm does so it should ensure that these records are readily accessible and can be reproduced within a reasonable time period. The firm should also ensure that these records comply with the rules and guidance on record keeping in GENPRU, INSPRU or SYSC.

14.1.64 G In accordance with SYSC 3.2.21G, a firm should have adequate systems and controls for maintaining the security of its records so that they are reasonably safeguarded against loss, unauthorised access, alteration or destruction.

Operational risk

14.1.65 G As well as covering other types of risk, the rules and guidance set out in this chapter deal with a firm's approach to operational risk. In particular:

(1) SYSC 14.1.18R requires a firm to take reasonable steps to ensure that the risk management systems put in place to identify, assess, monitor and control operational risk are adequate for that purpose;

(2) SYSC 14.1.19R(2) requires a firm to document its policy for operational risk, including its risk appetite and how it identifies, assesses, monitors and controls that risk; and

(3) SYSC 14.1.27R requires a firm to take reasonable steps to establish and maintain adequate internal controls to enable it to assess and
monitor the effectiveness and implementation of its business plan and prudential risk management systems.
Credit risk management systems and controls

Application

15.1.1 G SYSC 15.1 applies to an insurer unless it is:

(1) a non-directive friendly society; or

(2) an incoming EEA firm; or

(3) an incoming Treaty firm.

15.1.2 G SYSC 15.1 applies to:

(1) an EEA-deposit insurer; and

(2) a Swiss general insurer;

only in respect of the activities of the firm carried on from a branch in the United Kingdom.

Purpose

15.1.3 G This section provides guidance on how to interpret SYSC 14 insofar as it relates to the management of credit risk.

15.1.4 G Credit risk is incurred whenever a firm is exposed to loss if another party fails to perform its financial obligations to the firm, including failing to perform them in a timely manner. It arises from both on and off balance sheet items. For contracts for traded financial instruments, for example the purchase and sale of securities or over the counter derivatives, risks may arise if the firm's counterparty does not honour its side of the contract. This constitutes counterparty risk, which can be considered a subset of credit risk. Another risk is issuer risk, which could potentially result in a firm losing the full price of a market instrument since default by the issuer could result in the value of its bonds or stocks falling to nil. In insurance firms, credit risk can arise from premium debtors, where cover under contracts of insurance may either commence before premiums become due or continue after their non-payment. Credit risk can also arise if a reinsurer fails to fulfil its financial obligation to repay a firm upon submission of a claim.

15.1.5 G Credit risk concerns the FSA in a prudential context because inadequate systems and controls for credit risk management can create a threat to the regulatory objectives of market confidence and consumer protection by:

(1) the erosion of a firm's capital due to excessive credit losses thereby threatening its viability as a going concern;

(2) an inability of a firm to meet its own obligations to depositors, policyholders or other market counterparties due to its capital
erosion.

15.1.6 G Appropriate systems and controls for the management of credit risk will vary with the scale, nature and complexity of the firm's activities. Therefore the material in this section is guidance. A firm should assess the appropriateness of any particular item of guidance in the light of the scale, nature and complexity of its activities as well as its obligations as set out in Principle 3 to organise and control its affairs responsibly and effectively.

Requirements

15.1.7 G High level requirements for prudential systems and controls, including those for credit risk, are set out in SYSC 14. In particular:

(1) SYSC 14.1.19R(2) requires a firm to document its policy for credit risk, including its risk appetite and how it identifies, measures, monitors and controls that risk;

(2) SYSC 14.1.19R(2) requires a firm to document its provisioning policy. Documentation should describe the systems and controls that it intends to use to ensure that the policy is correctly implemented;

(3) SYSC 14.1.18R requires it to establish and maintain risk management systems to identify, measure, monitor and control credit risk (in accordance with its credit risk policy), and to take reasonable steps to ensure that its systems are adequate for that purpose; or

(4) in line with SYSC 14.1.11G, the ultimate responsibility for the management of credit risk should rest with a firm's governing body. Where delegation of authority occurs the governing body and relevant senior managers should approve and periodically review systems and controls to ensure that delegated duties are being performed correctly.

Credit risk policy

15.1.8 G SYSC 14.1.18R requires a firm to establish, maintain and document a business plan and risk policies. They should provide a clear indication of the amount and nature of credit risk that the firm wishes to incur. In particular, they should cover for credit risk:

(1) how, with particular reference to its activities, the firm defines and measures credit risk;

(2) the firm's business aims in incurring credit risk including:

(a) identifying the types and sources of credit risk to which the firm wishes to be exposed (and the limits on that exposure) and those to which the firm wishes not to be exposed (and how that is to be achieved, for example how exposure is to be avoided or mitigated);
(b) specifying the level of diversification required by the firm and the firm's tolerance for risk concentrations (and the limits on those exposures and concentrations); and

c) drawing the distinction between activities where credit risk is taken in order to achieve a return (for example, lending) and activities where credit exposure arises as a consequence of pursuing some other objective (for example, the purchase of a derivative in order to mitigate market risk);

(3) how credit risk is assessed both when credit is granted or incurred and subsequently, including how the adequacy of any security and other risk mitigation techniques is assessed;

(4) the detailed limit structure for credit risk which should:

(a) address all key risk factors, including intra-group exposures and indirect exposures (for example, exposures held by related and subsidiary undertakings);

(b) be commensurate with the volume and complexity of activity; and

(c) be consistent with the firm's business aims, historical performance, and its risk appetite;

(5) procedures for:

(a) approving new or additional exposures to counterparties;

(b) approving new products and activities that give rise to credit risk;

(c) regular risk position and performance reporting;

(d) limit exception reporting and approval; and

(e) identifying and dealing with the problem exposures caused by the failure or downgrading of a counterparty;

(6) the methods and assumptions used for the stress testing and scenario analysis required by GENPRU 1.2 (Adequacy of financial resources), including how these methods and assumptions are selected and tested; and

(7) the allocation of responsibilities for implementing the credit risk policy and for monitoring adherence to, and the effectiveness of, the policy.
Counterparty assessment

15.1.9 G The firm should make a suitable assessment of the risk profile of the counterparty. The factors to be considered will vary according to both the type of credit and the counterparty being considered. This may include:

1. the purpose of the credit, the duration of the agreement and the source of repayment;
2. an assessment and continuous monitoring of the credit quality of the counterparty;
3. an assessment of the claims payment record where the counterparty is a reinsurer;
4. an assessment of the nature and amount of risk attached to the counterparty in the context of the industrial sector or geographical region or country in which it operates, as well as the potential impact on the counterparty of political, economic and market changes; and
5. the proposed terms and conditions attached to the granting of credit, including ongoing provision of information by the counterparty, covenants attached to the facility as well as the adequacy and enforceability of collateral, security and guarantees.

15.1.10 G It is important that sound and legally enforceable documentation is in place for each agreement that gives rise to credit risk as this may be called upon in the event of a default or dispute. A firm should therefore consider whether it is appropriate for an independent legal opinion to be sought on documentation used by the firm. Documentation should normally be in place before the firm enters into a contractual obligation or releases funds.

15.1.11 G Where premium payments are made via brokers or intermediaries, the firm should describe how it monitors and controls its exposure to those brokers and intermediaries. In particular, the policy should identify whether the risk of default by the broker or intermediary is borne by the firm or the policyholder.

15.1.12 G Any variation from the usual credit policy should be documented.

15.1.13 G A firm involved in loan syndications or consortia should not rely on other parties' assessment of the credit risks involved. It will remain responsible for forming its own judgement on the appropriateness of the credit risk thereby incurred with reference to its stated credit risk policy. Similarly a firm remains responsible for assessing the credit risk associated with any insurance or reinsurance placed on its behalf by other parties.

15.1.14 G Where a credit scoring approach or other counterparty assessment process is used, the firm should periodically assess the particular approach taken in the light of past and expected future counterparty performance and ensure that any statistical process is adjusted accordingly to ensure that the business
written complies with the firm's risk appetite.

15.1.15 G In assessing its contingent exposure to a counterparty, the firm should identify the amount which would be due from the counterparty if the value, index or other factor upon which that amount depends were to change.

Credit risk measurement

15.1.16 G A firm should measure its credit risk using a robust and consistent methodology which should be described in its credit risk policy; the appropriate method of measurement will depend upon the nature of the credit product provided. The firm should consider whether the measurement methodologies should be backtested and the frequency of such backtesting.

15.1.17 G A firm should also be able to measure its credit exposure across its entire portfolio or within particular categories such as exposures to particular industries, economic sectors or geographical areas.

15.1.18 G Where a firm is a member of a group that is subject to consolidated reporting, the group should be able to monitor credit exposures on a consolidated basis. See SYSC 12, INSRU 6.1 and GENPRU 3.

15.1.19 G A firm should have the capability to measure its credit exposure to individual counterparties on at least a daily basis.

Risk monitoring

15.1.20 G A firm should implement an effective system for monitoring its credit risk which should be described in its credit risk policy.

15.1.21 G A firm should have a system of management reporting which provides clear, concise, timely and accurate credit risk reports to relevant functions within the firm. The reports could cover exceptions to the firm's credit risk policy, non-performing exposures and changes to the level of credit risk within the firm's credit portfolio. A firm should have procedures for taking appropriate action according to the information within the management reports, such as a review of counterparty limits, or of the overall credit policy.

15.1.22 G Individual credit facilities and overall limits should be periodically reviewed in order to check their appropriateness for both the current circumstances of the counterparty and the firm's current internal and external economic environment. The frequency of review should be appropriate to the nature of the facility.

15.1.23 G A firm should utilise appropriate stress testing and scenario analysis of credit exposures to examine the potential effects of economic or industry downturns, market events, changes in interest rates, changes in foreign exchange rates, changes in liquidity conditions and changes in levels of insurance losses where relevant.
Problem exposures

15.1.24 G A firm should have systematic processes for the timely identification, management and monitoring of problem exposures. These processes should be described in the credit risk policy.

15.1.25 G A firm should have adequate procedures for recovering exposures in arrears or that have had provisions made against them. A firm should allocate responsibility, either internally or externally, for its arrears management and recovery.

Provisioning

15.1.26 G SYSC 14.1.19R(2) requires a firm to document its provisioning policy. A firm's provisioning policy can be maintained either as a separate document or as part of its credit risk policy.

15.1.27 G At intervals that are appropriate to the nature, scale and complexity of its activities a firm should review and update its provisioning policy and associated systems.

15.1.28 G In line with SYSC 15.1.6G, the FSA recognises that the frequency with which a firm reviews its provisioning policy once it has been established will vary from firm to firm. However, the FSA expects a firm to review at least annually whether its policy remains appropriate for the business it undertakes and the economic environment in which it operates.

15.1.29 G In line with SYSC 14.1.12G, the provisioning policy referred to in SYSC 15.1.26G must be approved by the firm's governing body or another appropriate body to which the firm's governing body has delegated this responsibility.

15.1.30 G In line with SYSC 14.1.24G, the FSA may request a firm to provide it with a copy of its current provisioning policy.

15.1.31 G Provisions may be general (against the whole of a given portfolio), specific (against particular exposures identified as bad or doubtful) or both. The FSA expects contingent liabilities (for example guarantees) and anticipated losses to be recognised in accordance with accepted accounting standards at the relevant time, such as those embodied in the Financial Reporting Standards issued by the Accounting Standards Board.

Risk mitigation

15.1.32 G A firm may choose to use various credit risk mitigation techniques including the taking of collateral, the use of letters of credit or guarantees, or counterparty netting agreements to manage and control their counterparty exposures. The use of such techniques does not obviate the need for thorough credit analysis and procedures. The reliance placed by a firm on risk mitigation should be described in the credit risk policy.
15.1.33 G A firm should consider the legal and financial ability of a guarantor to fulfil the guarantee if called upon to do so.

15.1.34 G A firm should monitor the validity and enforceability of its collateral arrangements.

15.1.35 G The firm should analyse carefully the protection afforded by risk mitigants such as netting agreements or credit derivatives, to ensure that any residual risk is identified, measured, monitored and controlled.

Record keeping

15.1.36 G Prudential records made under SYSC 14.1.53R should include appropriate records of:

(1) credit exposures, including aggregations of credit exposures, as appropriate, by:

(a) groups of connected counterparties; or

(b) types of counterparty as defined, for example, by the nature or geographical location of the counterparty;

(2) credit decisions, including details of the decision and the facts or circumstances upon which it was made; and

(3) information relevant to assessing current counterparty and risk quality.

15.1.37 G Credit records should be retained as long as they are needed for the purpose described in SYSC 15.1.36G (subject to the minimum three year retention period). In particular, a firm should consider whether it is appropriate to retain information regarding counterparty history such as a record of credit events as well as a record indicating how credit decisions were taken.
16.1 Application

16.1.1 SYSC 16.1 applies to an insurer unless it is:

(1) a non-directive friendly society; or

(2) an incoming EEA firm; or

(3) an incoming Treaty firm.

16.1.2 SYSC 16.1 applies to:

(1) an EEA-deposit insurer; and

(2) a Swiss general insurer;

only in respect of the activities of the firm carried on from a branch in the United Kingdom.

Firms should also see GENPRU 1.2 (GENPRU 1.2.64G to GENPRU 1.2.78G) and INSPRU 3.1.

Purpose

16.1.4 (1) The purpose of this section is to amplify SYSC 14 insofar as it relates to market risk.

(2) Market risk includes equity, interest rate, foreign exchange (FX), commodity risk and interest rate risk on long-term insurance contracts. The price of financial instruments may also be influenced by other risks such as spread risk, basis risk, correlation, specific risk and volatility risk.

(3) This section does not deal with the risk management of market risk in a group context. A firm that is a member of a group should also read SYSC 12 (Group risk systems and controls) which outlines the FSA’s requirements for the risk management of market risk within a group.

(4) Appropriate systems and controls for the management of market risk will vary with the scale, nature and complexity of the firm’s activities. Therefore the material in this section is guidance. A firm should assess the appropriateness of any particular item of guidance in the light of the scale, nature and complexity of its activities as well as its obligations as set out in Principle 3 to organise and control its affairs responsibly and effectively.
Requirements

16.1.5 G  High level requirements for prudential systems and controls, including those for market risk, are set out in SYSC 14. In particular:

(1) SYSC 14.1.19R(2) requires a firm to document its policy for market risk, including its risk appetite and how it identifies, measures, monitors and controls that risk;

(2) SYSC 14.1.19R(4) requires a firm to document its asset and liability recognition policy. Documentation should describe the systems and controls that it intends to use to comply with the policy;

(3) SYSC 14.1.19R requires a firm to establish and maintain risk management systems to identify, measure, monitor and control market risk (in accordance with its market risk policy), and to take reasonable steps to establish systems adequate for that purpose; and

(4) In line with SYSC 14.1.11G, the ultimate responsibility for the management of market risk should rest with a firm’s governing body. Where delegation of authority occurs the governing body and relevant senior managers should approve and adequately review systems and controls to check that delegated duties are being performed correctly.

Market risk policy

16.1.6 G  SYSC 14 requires a firm to establish, maintain and document a business plan and risk policies. They should provide a clear indication of the amount and nature of market risk that the firm wishes to incur. In particular, they should cover for market risk:

(1) how, with particular reference to its activities, the firm defines and measures market risk;

(2) the firm's business aims in incurring market risk including:

(a) identifying the types and sources of market risk to which the firm wishes to be exposed (and the limits on that exposure) and those to which the firm wishes not to be exposed (and how that is to be achieved, for example how exposure is to be avoided or mitigated); and

(b) specifying the level of diversification required by the firm and the firm's tolerance for risk concentrations (and the limits on those exposures and concentrations).

16.1.7 G  The market risk policy of a firm should be endorsed by the firm's governing body and implemented by its senior management, who should take adequate steps to disseminate the policy and train the relevant staff such that they can effectively implement the policy.
The market risk policy of a firm should enforce the risk management and control principles and include detailed information on:

1. The financial instruments, commodities, assets and liabilities (and mismatches between assets and liabilities) that a firm is exposed to and the limits on those exposures;
2. The firm's investment strategy as applicable between each insurance fund;
3. Activities that are intended to hedge or mitigate market risk including mismatches caused by for example differences in the assets and liabilities and maturity mismatches; and
4. The methods and assumptions used for measuring linear, non-linear and geared market risk including the rationale for selection, ongoing validation and testing. Methods might include stress testing and scenario analysis, asset/liability analysis, correlation analysis, Value-at-Risk (VaR) and options such as delta, gamma, vega, rho and theta. Exposure to non-linear or geared market risk is typically through the use of derivatives.

Risk identification

A firm should have in place appropriate risk reporting systems that enable it to identify the types and amount of market risk to which it is, and potentially could be, exposed. The information that systems should capture may include but is not limited to:

1. Position information which may include a description of individual financial instruments and their cash flows; and
2. Market data which may consist of raw time series of market rates, index levels and prices and derived time series of benchmark yield curves, spreads, implied volatilities, historical volatilities and correlations.

Risk measurement

Having identified the market risk that the firm is exposed to on at least a daily basis, a firm should be able to measure and manage that market risk on a consistent basis. This may be achieved by:

1. Regularly stress testing all or parts of the firm's portfolio to estimate potential economic losses in a range of market conditions including abnormal markets. Corporate level stress test results should be discussed regularly by risk monitors, senior management and risk takers, and should guide the firm's market risk appetite (for example, stress tests may lead to discussions on how best to unwind or hedge a position), and influence the internal capital allocation process;
(2) measuring the firm's exposure to particular categories of market risk (for example, equity, interest rate, foreign exchange and commodities) as well as across its entire portfolio of market risks;

(3) analysing the impact that new transactions or businesses may have on its market risk position on an on-going basis; and

(4) regularly backtesting realised results against internal model generated market risk measures in order to evaluate and assess its accuracy. For example, a firm should keep a database of daily risk measures such as VaR and options such as delta, gamma, vega, rho and theta, and use these to back test predicted profit and loss against actual profit and loss for all trading desks and business units, and monitor the number of exceptions from agreed confidence bands.

Valuation

16.1.11 G A firm should take reasonable steps to establish systems and control procedures such that the firm complies with the requirements of GENPRU 1.3 (Valuation).

16.1.12 G The systems and controls referred to in SYSC 16.1.11G should include the following:

(1) the department responsible for the validation of the value of assets and liabilities should be independent of the business trading area, and should be adequately resourced by suitably qualified staff. The department should report to a suitably qualified individual, independent from the business trading area, who has sufficient authority to enforce the systems and controls policies and any alterations to valuation treatments where necessary;

(2) all valuations should be checked and validated at appropriate intervals. Where a firm has chosen not to validate all valuations on a daily basis this should be agreed by senior management;

(3) a firm should establish a review procedure to check that the valuation procedures are followed and are producing valuations in compliance with the requirements in this section. The review should be undertaken by suitably qualified staff independent of the business trading area, on a regular and ad hoc basis. In particular, this review procedure should include:

(a) the quality and appropriateness of the price sources used;

(b) valuation reserves held; and

(c) the valuation methodology employed for each product and consistent adherence to that methodology;

(4) where a valuation is disputed and the dispute cannot be resolved in a timely manner it should be reported to senior management. It should
continue to be reported to senior management until agreement is reached;

(5) where a firm is marking positions to market it should take reasonable steps to establish a price source that is reliable and appropriate to enable compliance with the provisions in this section on an ongoing basis;

(6) a firm should document its policies and procedures relating to the entire valuation process. In particular, the following should be documented:

(a) the valuation methodologies employed for all product categories;

(b) details of the price sources used for each product;

(c) the procedures to be followed where a valuation is disputed;

(d) the valuation adjustment and reserving policies;

(e) the level at which a difference between a valuation assigned to an asset or liability and the valuation used for validation purposes will be reported on an exceptions basis and investigated;

(f) where a firm is using its own internal estimate to produce a valuation, it should document in detail the process followed in order to produce the valuation; and

(g) the review procedures established by a firm in relation to the requirements of this section should be adequately documented and include the rationale for the policy;

(7) a firm should maintain records which demonstrate:

(a) senior management's approval of the policies and procedures established; and

(b) management sign-off of the reviews undertaken in accordance with SYSC 16.1.11G.

Risk monitoring

16.1.13 G Risk monitoring is the operational process by which a firm monitors compliance with defined policies and procedures of the market risk policy. The firm's risk monitoring system should be independent of the employees who are responsible for exposing the firm to market risk.

16.1.14 G The market risk policy of a firm may require the production of market risk reports at various levels within the firm. These reports should provide sufficiently accurate market risk data to relevant functions within the firm,
and should be timely enough to allow any appropriate remedial action to be proposed and taken, for example:

(1) at a firm wide level, a market risk report may include information:
   (a) summarising and commenting on the total market risk that a firm is exposed to and market risk concentrations by business unit, asset class and country;
   (b) on VaR reports against risk limits by business unit, asset class and country;
   (c) commenting on significant risk concentrations and market developments; and
   (d) on market risk in particular legal entities and geographical regions;

(2) at the business unit level, a market risk report may include information summarising market risk by currency, trading desk, maturity or duration band, or by instrument type;

(3) at the trading desk level, a market risk report may include detailed information summarising market risk by individual trader, instrument, position, currency, or maturity or duration band; and

(4) all risk data should be readily reconcilable back to the prime books of entry with a fully documented audit trail.

16.1.15 G Risk monitoring may also include information on:

(1) the procedures for taking appropriate action in response to the information within the market risk reports;

(2) ensuring that there are controls and procedures for identifying and reporting trades and positions booked at off-market rates;

(3) the process for new product approvals;

(4) the process for dealing with situations (authorised and unauthorised) where particular market risk exposures exceed predetermined risk limits and criteria; and

(5) the periodic review of the risk monitoring process in order to check its suitability for both current market conditions and the firm's overall risk appetite.

16.1.16 G Risk monitoring should be subject to periodic independent review by suitably qualified staff.
Risk control

16.1.17  G Risk control is the independent monitoring, assessment and supervision of business units within the defined policies and procedures of the market risk policy. This may be achieved by:

1. setting an appropriate market risk limit structure to control the firm's exposure to market risk; for example, by setting out a detailed market risk limit structure at the corporate level, the business unit level and the trading desk level which addresses all the key market risk factors and is commensurate with the volume and complexity of activity that the firm undertakes;

2. setting limits on risks such as price or rate risk, as well as those factors arising from options such as delta, gamma, vega, rho and theta;

3. setting limits on net and gross positions, market risk concentrations, the maximum allowable loss (also called "stop-loss"), VaR, potential risks arising from stress testing and scenario analysis, gap analysis, correlation, liquidity and volatility; and

4. considering whether it is appropriate to set intermediate (early warning) thresholds that alert management when limits are being approached, triggering review and action where appropriate.

Record keeping

16.1.18  G High level requirements for record keeping are set out in SYSC 14.

16.1.19  G In relation to market risk, a firm should retain appropriate prudential records of:

1. off and on market trades in financial instruments;

2. the nature and amounts of off and on balance sheet exposures, including the aggregation of exposures;

3. trades in financial instruments and other assets and liabilities; and

4. methods and assumptions used in stress testing and scenario analysis and in VaR models.

16.1.20  G A firm should keep a data history to enable it to perform back testing of methods and assumptions used for stress testing and scenario analysis and for VaR models.
17 Insurance risk systems and controls

17.1 Application

17.1.1 G SYSC 17.1 applies to an insurer unless it is:

(1) a non-directive friendly society; or

(2) an incoming EEA firm; or

(3) an incoming Treaty firm.

17.1.2 G SYSC 17.1 applies to:

(1) an EEA-deposit insurer; and

(2) a Swiss general insurer;

only in respect of the activities of the firm carried on from a branch in the United Kingdom.

Purpose

17.1.3 G This section provides guidance on how to interpret SYSC 14 (Prudential risk management and associated systems and controls) in so far as it relates to the management of insurance risk. Insurance risk refers to fluctuations in the timing, frequency and severity of insured events, relative to the expectations of the firm at the time of underwriting. Insurance risk can also refer to fluctuations in the timing and amount of claim settlements. For general insurance business some specific examples of insurance risk include variations in the amount or frequency of claims or the unexpected occurrence of multiple claims arising from a single cause. For long-term insurance business examples include variations in the mortality and persistency rates of policyholders, or the possibility that guarantees could acquire a value that adversely affects the finances of a firm and its ability to treat its policyholders fairly consistent with the firm's obligations under Principle 6. More generally, insurance risk includes the potential for expense overruns relative to pricing or provisioning assumptions.

17.1.4 G Insurance risk concerns the FSA in a prudential context because inadequate systems and controls for its management can create a threat to the regulatory objectives of market confidence and consumer protection. Inadequately managed insurance risk may result in:

(1) the inability of a firm to meet its contractual insurance liabilities as they fall due; and

(2) the inability of a firm to treat its policyholders fairly consistent with the firm's obligations under Principle 6 (for example, in relation to bonus payments).
17.1.5 G Guidance on the application of this section to a firm that is a member of a group is provided in SYSC 12 (Group risk systems and controls).

17.1.6 G The guidance contained within this section should be read in conjunction with the rest of SYSC.

17.1.7 G Appropriate systems and controls for the management of insurance risk will vary with the scale, nature and complexity of a firm's activities. Therefore, the material in this section is guidance. A firm should assess the appropriateness of any particular item of guidance in the light of the scale, nature and complexity of its activities as well as its obligations, as set out in Principle 3, to organise and control its affairs responsibly and effectively.

General requirements

17.1.8 G High level rules and guidance for prudential systems and controls for insurance risk are set out in SYSC 14. In particular:

(1) SYSC 14.1.18R requires a firm to take reasonable steps to establish and maintain a business plan and appropriate risk management systems;

(2) SYSC 14.1.19R(2) requires a firm to document its policy for insurance risk, including its risk appetite and how it identifies, measures, monitors and controls that risk; and

(3) SYSC 14.1.27R requires a firm to take reasonable steps to establish and maintain adequate internal controls to enable it to assess and monitor the effectiveness and implementation of its business plan and prudential risk management systems.

Insurance risk policy

17.1.9 G A firm's insurance risk policy should outline its objectives in carrying out insurance business, its appetite for insurance risk and its policies for identifying, measuring, monitoring and controlling insurance risk. The insurance risk policy should cover any activities that are associated with the creation or management of insurance risk. For example, underwriting, claims management and settlement, assessing technical provisions in the balance sheet, risk mitigation and risk transfer, record keeping and management reporting. Specific matters that should normally be in a firm's insurance risk policy include:

(1) a statement of the firm's willingness and capacity to accept insurance risk;

(2) the classes and characteristics of insurance business that the firm is prepared to accept;

(3) the underwriting criteria that the firm intends to adopt, including how these can influence its rating and pricing decisions;
(4) its approach to limiting significant aggregations of insurance risk, for example, by setting limits on the amount of business that can be underwritten in one region or with one policyholder;

(5) where relevant, the firm's approach to pricing long-term insurance contracts, including the determination of the appropriate level of any reviewable premiums;

(6) the firm's policy for identifying, monitoring and managing risk when it has delegated underwriting authority to another party (additional guidance on the management of outsourcing arrangements is provided in SYSC 13.9);

(7) the firm's approach to managing its expense levels, including acquisition costs, recurring costs, and one-off costs, taking account of the margins available in both the prices for products and in the technical provisions in the balance sheet;

(8) the firm's approach to the exercise of any discretion (e.g. on charges or the level of benefits payable) that is available in its long-term insurance contracts, in the context also of the legal and regulatory constraints existing on the application of this discretion;

(9) the firm's approach to the inclusion of options within new long-term insurance contracts and to the possible exercise by policyholders of options on existing contracts;

(10) the firm's approach to managing persistency risk;

(11) the firm's approach to managing risks arising from timing differences in taxation or from changes in tax laws;

(12) the firm's approach to the use of reinsurance or the use of some other means of risk transfer;

(13) how the firm intends to assess the effectiveness of its risk transfer arrangements and manage the residual or transformed risks (for example, how it intends to handle disputes over contract wordings, potential payout delays and counterparty performance risks);

(14) a summary of the data and information to be collected and reported on underwriting, claims and risk control (including internal accounting records), management reporting requirements and external data for risk assessment purposes;

(15) the risk measurement and analysis techniques to be used for setting underwriting premiums, technical provisions in the balance sheet, and assessing capital requirements; and

(16) the firm's approach to stress testing and scenario analysis, as required by GENPRU 1.2 (Adequacy of financial resources), including the methods adopted, any assumptions made and the use that is to be
made of the results.

17.1.10 G Further, more detailed, guidance is given in SYSC 17.1.11G to SYSC 17.1.37G on the identification, measurement, monitoring and control (including the use of reinsurance and other forms of risk transfer) of insurance risk. A firm should consider what additional material to that set out above should be included in its insurance risk policy on each of these for its various activities.

Risk identification

17.1.11 G A firm should seek to identify the causes of fluctuations in the occurrence, amount and timing of its insurance liabilities. A firm should also seek to identify aggregations of risk that may give rise to large single or multiple claims.

17.1.12 G The identification of insurance risk should normally include:

(1) in connection with the firm's business plan:
   (a) processes for identifying the types of insurance risks that may be associated with a new product and for comparing the risk types that are present in different classes of business (in order to identify possible aggregations in particular insurance risks); and
   (b) processes for identifying business environment changes (for example landmark legal rulings) and for collecting internal and external data to test and modify business plans;

(2) at the point of sale, processes for identifying the underwriting risks associated with a particular policyholder or a group of policyholders (for example, processes for identifying potential claims for mis-selling and for collecting information on the claims histories of policyholders, including whether they have made any potentially false or inaccurate claims, to identify possible adverse selection or moral hazard problems);

(3) after the point of sale, processes for identifying potential and emerging claims for the purposes of claims management and claims provisioning; this could include:
   (a) identifying possible judicial rulings;
   (b) keeping up to date with developments in market practice; and
   (c) collecting information on industry wide initiatives and settlements.

17.1.13 G A firm should also identify potential pricing risks, where the liabilities or costs arising from the sale of a product may not be as expected.
Risk measurement

17.1.14 **G** A firm should have in place appropriate systems for collecting the data it needs to measure insurance risk. At a minimum this data should be capable of allowing a firm to evaluate the types of claims experienced, claims frequency and severity, expense levels, persistency levels and, where relevant, potential changes in the value of guarantees and options in long-term insurance contracts.

17.1.15 **G** A firm should ensure that the data it collects and the measurement methodologies that it uses are sufficient to enable it to evaluate, as appropriate:

1. its exposure to insurance risk at all relevant levels, for example, by contract, policyholder, product line or insurance class;
2. its exposure to insurance risk across different geographical areas and time horizons;
3. its total, firm-wide, exposure to insurance risk and any other risks that may arise out of the contracts of insurance that it issues;
4. how changes in the volume of business (for example via changes in premium levels or the number of new contracts that are underwritten) may influence its exposure to insurance risk;
5. how changes in policy terms may influence its exposure to insurance risk; and
6. the effects of specific loss scenarios on the insurance liabilities of the firm.

17.1.16 **G** A firm should hold data in a manner that allows for it to be used in a flexible way. For example, data should be sufficiently detailed and disaggregated so that contract details may be aggregated in different combinations to assess different risks.

17.1.17 **G** A firm should be able to justify its choice of measurement methodologies. This justification should normally be documented.

17.1.18 **G** A firm should periodically review the appropriateness of the measurement methodologies that it uses. This could, for example, include back testing (that is, by comparing actual versus expected results) and updating for changes in market practice.

17.1.19 **G** A firm should ensure that it has access to the necessary skills and resources that it needs to measure insurance risk using its chosen methodology.

17.1.20 **G** When measuring its insurance risks, a firm should consider how emerging experience could be used to update its underwriting process, in particular in relation to contract terms and pricing and also its assessment of the technical
provisions in the balance sheet.

17.1.21 G A firm should have the capability to measure its exposure to insurance risk on a regular basis. In deciding on the frequency of measurement, a firm should consider:

(1) the time it takes to acquire and process all necessary data;

(2) the speed at which exposures could change; and

(3) that it may need to measure its exposure to certain types of insurance risk on a daily basis (for example, weather catastrophes).

Risk monitoring

17.1.22 G A firm should provide regular and timely information on its insurance risks to the appropriate level of management. This could include providing reports on the following:

(1) a statement of the firm's profits or losses for each class of business that it underwrites (with an associated analysis of how these have arisen for any long-term insurance contracts), including a variance analysis detailing any deviations from budget or changes in the key performance indicators that are used to assess the success of its business plan for insurance;

(2) the firm's exposure to insurance risk at all relevant levels (see SYSC 17.1.15G(1)), as well as across different geographical areas and time zones (see SYSC 17.1.15G(2)), also senior management should be kept informed of the firm's total exposure to insurance risk (see SYSC 17.1.15G(3));

(3) an analysis of any internal or external trends that could influence the firm's exposure to insurance risk in the future (e.g. new weather patterns, socio-demographic changes, expense overruns etc);

(4) any new or emerging developments in claims experience (e.g. changes in the type of claims, average claim amounts or the number of similar claims);

(5) the results of any stress testing or scenario analyses;

(6) the amount and details of new business written and the amount of business that has lapsed or been cancelled;

(7) identified fraudulent claims;

(8) a watch list, detailing, for example, material/catastrophic events that could give rise to significant numbers of new claims or very large claims, contested claims, client complaints, legal and other developments;
the performance of any reinsurance/risk transfer arrangements; and

progress reports on matters that have previously been referred under escalation procedures (see SYSC 17.1.23G).

17.1.23 G A firm should establish and maintain procedures for the escalation of appropriate matters to the relevant level of management. Such matters may include:

1. any significant new exposures to insurance risk, including for example any landmark rulings in the courts;

2. a significant increase in the size or number of claims;

3. any breaches of the limits set out in SYSC 17.1.27G and SYSC 17.1.28G, in particular senior management should be informed where any maximum limits have been breached (see SYSC 17.1.29G); and

4. any unauthorised deviations from its insurance risk policy (including those by a broker, appointed representative or other delegated authority).

17.1.24 G A firm should regularly monitor the effectiveness of its analysis techniques for setting provisions for claims on general insurance contracts.

17.1.25 G A firm should have appropriate procedures in place to allow managers to monitor the application (and hence the effect) of its reinsurance programme. This would include, for a general insurer, procedures for monitoring how its reinsurance programme affects the gross provisions that it makes for outstanding claims (including claims that are incurred but not reported).

Risk control

17.1.26 G A firm should take appropriate action to ensure that it is not exposed to insurance risk in excess of its risk appetite. In so doing, the firm should be both reactive, responding to actual increases in exposure, and proactive, responding to potential future increases. Being proactive should involve close co-ordination between the processes of risk control, risk identification and risk measurement, as potential future exposures need to be identified and understood before effective action can be taken to control them.

17.1.27 G A firm should consider setting limits for its exposure to insurance risk, which trigger action to be taken to control exposure. Periodically these limits should be amended in the light of new information (e.g. on the expected number or size of claims). For example, limits could be set for:

1. the firm's aggregate exposure to a single source of insurance risk or for events that may be the result of a number of different sources;
the firm's exposure to specific geographic areas or any other groupings of risks whose outcomes may be positively correlated;

(3) the number of fraudulent claims;

(4) the number of very large claims that could arise;

(5) the number of unauthorised deviations from its insurance risk policy;

(6) the amount of insurance risk than can be transferred to a particular reinsurer;

(7) the level of expenses incurred in respect of each relevant business area; and

(8) the level of persistency by product line or distribution channel.

17.1.28 G A firm should also consider setting individual underwriting limits for all employees and agents that have the authority to underwrite insurance risk. This could include both monetary limits and limits on the types of risk that they can underwrite. Where individual underwriting limits are set, the firm should ensure that they are adhered to.

17.1.29 G In addition to setting some 'normal' limits for insurance risk, a firm should consider setting some maximum limits, beyond which immediate, emergency action should be taken. These maximum limits could be determined through stress testing and scenario analysis.

17.1.30 G A firm should pay close attention to the wording of its policy documentation to ensure that these wordings do not expose it to more, or higher, claims than it is expecting. In so doing, the firm should consider:

(1) whether it has adequate in-house legal resources;

(2) the need for periodic independent legal review of policy documentation;

(3) the use of standardised documentation and referral procedures for variation of terms;

(4) reviewing the documentation used by other insurance companies;

(5) revising documentation for new policies in the light of past experience; and

(6) the operation of law in the jurisdiction of the policyholder.

17.1.31 G A firm should ensure that it has appropriate systems and controls for assessing the validity of claims. This could involve consideration of the evidence that will be required from policyholders and how this evidence is to be tested as well as procedures to determine when experts such as loss
adjusters, lawyers or accountants should be used.

17.1.32 G Particular care should be taken to ensure that a firm has appropriate systems and controls to deal with large claims or large groups of claims that could significantly deplete its financial resources. This should include systems to ensure that senior management (that is, the governing body and relevant senior managers) is involved in the processing of such claims from the outset.

17.1.33 G A firm should consider how it intends to use reinsurance or some other form of insurance risk transfer agreement to help to control its exposure to insurance risk. Additional guidance on the use of reinsurance/risk transfer is provided below.

Reinsurance and other forms of risk transfer

17.1.34 G Before entering into or significantly changing a reinsurance agreement, or any other form of insurance risk transfer agreement, a firm should:

(1) analyse how the proposed reinsurance/risk transfer agreement will affect its exposure to insurance risk, its underwriting strategy and its ability to meet its regulatory obligations;

(2) ensure there are adequate legal checking procedures in respect of the draft agreement;

(3) conduct an appropriate due diligence of the reinsurer's financial stability (that is, solvency) and expertise; and

(4) understand the nature and limits of the agreement (particular attention should be given to the wording of contracts to ensure that all of the required risks are covered, that the level of available cover is appropriate, and that all the terms, conditions and warranties are unambiguous and understood).

17.1.35 G In managing its reinsurance agreements, or any other form of insurance risk transfer agreement, a firm should have in place appropriate systems that allow it to maintain its desired level of cover. This could involve systems for:

(1) monitoring the risks that are covered (that is, the scope of cover) by these agreements and the level of available cover;

(2) keeping underwriting staff informed of any changes in the scope or level of cover;

(3) properly co-ordinating all reinsurance/risk transfer activities so that, in aggregate, the desired level and scope of cover is maintained;

(4) ensuring that the firm does not become overly reliant on any one reinsurer or other risk transfer provider; or
conducting regular stress testing and scenario analysis to assess the resilience of its reinsurance and risk transfer programmes to catastrophic events that may give rise to large and or numerous claims.

17.1.36 G In making a claim on a reinsurance contract (that is, its reinsurance recoveries) or some other risk transfer contract a firm should ensure:

1. that it is able to identify and recover any money that it is due in a timely manner; and

2. that it makes adequate financial provision for the risk that it is unable to recover any money that it expected to be due, as a result of either a dispute with or a default by the reinsurer/risk transfer provider. Additional guidance on credit risk in reinsurance/risk transfer contracts is provided in INSPRU 2.1 (Credit risk in insurance).

17.1.37 G Where the planned level or scope of cover from a reinsurance/risk transfer contract is not obtained, a firm should consider revising its underwriting strategy.

Record keeping

17.1.38 G The FSA's high level rules and guidance for record keeping are outlined in SYSC 3.2.20R (Records). Additional rules and guidance in relation to the prudential context are set out in SYSC 14.1.51G to SYSC 14.1.64G. In complying with these rules and guidance, a firm should retain an appropriate record of its insurance risk management activities. This may, for example, include records of:

1. each new risk that is underwritten (noting that these records may be held by agents or cedants, rather than directly by the firm provided that the firm has adequate access to those records);

2. any material aggregation of exposure to risk from a single source, or of the same kind or to the same potential catastrophe or event;

3. each notified claim including the amounts notified and paid, precautionary notices and any re-opened claims;

4. policy and contractual documents and any relevant representations made to policyholders;

5. other events or circumstances relevant to determining the risks and commitments that arise out of contracts of insurance (including discretionary benefits and charges under any long-term insurance contracts);

6. the formal wordings of reinsurance contracts; and
(7) any other relevant information on the firm's reinsurance or other risk-transfer arrangements, including the extent to which they:

(a) have been exhausted by recoveries on paid claims; and

(b) will be exhausted by recoveries on reported claims and, to the extent known, on incurred but not reported claims.

17.1.39 G A firm should retain its underwriting and claims histories for as long as they may be needed to inform pricing or provisioning decisions.
18 Guidance on Public Interest Disclosure Act: whistleblowing

18.1 Application

18.1.1 This chapter is relevant to every firm to the extent that the Public Interest Disclosure Act 1998 ("PIDA") applies to it.

Purpose

18.1.2 (1) The purposes of this chapter are:

(a) to remind firms of the provisions of PIDA; and

(b) to encourage firms to consider adopting and communicating to workers appropriate internal procedures for handling workers' concerns as part of an effective risk management system.

(2) In this chapter "worker" includes, but is not limited to, an individual who has entered into a contract of employment.

18.1.3 The guidance in this chapter concerns the effect of PIDA in the context of the relationship between firms and the FSA. It is not comprehensive guidance on PIDA itself.

18.2 Practical measures

Effect of Public Interest Disclosure Act 1998

18.2.1 (1) Under PIDA, any clause or term in an agreement between a worker and his employer is void in so far as it purports to preclude the worker from making a protected disclosure (that is, "blow the whistle").

(2) In accordance with section 1 of PIDA:

(a) a protected disclosure is a qualifying disclosure which meets the relevant requirements set out in that section;

(b) a qualifying disclosure is a disclosure, made in good faith, of information which, in the reasonable belief of the worker making the disclosure, tends to show that one or more of the following (a "failure") has been, is being, or is likely to be, committed:

(i) a criminal offence; or

(ii) a failure to comply with any legal obligation; or

(iii) a miscarriage of justice; or
(iv) the putting of the health and safety of an individual in danger; or

(v) damage to the environment; or

(vi) deliberate concealment relating to any of (i) to (v);

it is immaterial whether the relevant failure occurred, occurs or would occur in the United Kingdom or elsewhere, and whether the law applying to it is that of the United Kingdom or of any other country or territory.

Internal procedures

18.2.2 G (1) Firms are encouraged to consider adopting (and encouraged to invite their appointed representatives to consider adopting) appropriate internal procedures which will encourage workers with concerns to blow the whistle internally about matters which are relevant to the functions of the FSA.

(2) Smaller firms may choose not to have as extensive procedures in place as larger firms. For example, smaller firms may not need written procedures. The following is a list of things that larger and smaller firms may want to do.

(a) For larger firms, appropriate internal procedures may include:

(i) a clear statement that the firm takes failures seriously (see SYSC 18.2.1G(2)(b));

(ii) an indication of what is regarded as a failure;

(iii) respect for the confidentiality of workers who raise concerns, if they wish this;

(iv) an assurance that, where a protected disclosure has been made, the firm will take all reasonable steps to ensure that no person under its control engages in victimisation;

(v) the opportunity to raise concerns outside the line management structure, such as with the Compliance Director, Internal Auditor or Company Secretary;

(vi) penalties for making false and malicious allegations;

(vii) an indication of the proper way in which concerns may be raised outside the firm if necessary (see (3));

(viii) providing access to an external body such as an independent charity for advice;
(ix) making whistleblowing procedures accessible to staff of key contractors; and

(x) written procedures.

(b) For smaller firms, appropriate internal procedures may include:

(i) telling workers that the firm takes failures seriously (see SYSC 18.2.1G(2)(b)) and explaining how wrongdoing affects the organisation;

(ii) telling workers what conduct is regarded as failure;

(iii) telling workers who raise concerns that their confidentiality will be respected, if they wish this;

(iv) making it clear that concerned workers will be supported and protected from reprisals;

(v) nominating a senior officer as an alternative route to line management and telling workers how they can contact that individual in confidence;

(vi) making it clear that false and malicious allegations will be penalised by the firm;

(vii) telling workers how they can properly blow the whistle outside the firm if necessary (see (3));

(viii) providing access to an external body for advice such as an independent charity for advice; and

(ix) encouraging managers to be open to concerns.

(3) (a) Firms should also consider telling workers (through the firm’s internal procedures, or by means of an information sheet available from the FSA’s website, or by some other means) that they can blow the whistle to the FSA, as the regulator prescribed in respect of financial services and markets matters under PIDA.

(b) The FSA will give priority to live concerns or matters of recent history, and will emphasise that the worker’s first port of call should ordinarily be the firm (see Frequently Asked Questions on http://www.fsa.gov.uk/Pages/Doing/Contact/WhistleFAQ/index.shtml).

(c) For the FSA’s treatment of confidential information, see SUP 2.2.4G.
Link to fitness and propriety

18.2.3 G The FSA would regard as a serious matter any evidence that a firm had acted to the detriment of a worker because he had made a protected disclosure (see SYSC 18.2.1G(2)) about matters which are relevant to the functions of the FSA. Such evidence could call into question the fitness and propriety of the firm or relevant members of its staff, and could therefore, if relevant, affect the firm's continuing satisfaction of threshold condition 5 (Suitability) or, for an approved person, his status as such.
Annex F

Senior Management Arrangements, Systems and Controls Handbook (SYSC) coming into force on 1 November 2007

In this Annex, underlining indicates new text and striking through indicates deleted text. In this Annex where an entire section is being deleted, the place where the change will be made is indicated and the text will not be struck through.

Amend SYSC 1.1 as follows

1.1 Application of SYSC 2 and SYSC 3

....

1.1.1 R Who?

SYSC 2 and SYSC 3 apply to every firm except that:

...

(6) SYSC 3.2.23R to SYSC 3.2.36R apply only to a BIPRU firm for a common platform firm, SYSC 3 does not apply.

...

1.3.1A G From 1 January 2007 until 1 November 2007, the application of the common platform requirements is limited by SYSC TP 1. [deleted]

...

1.3.4 R [To follow.] The provisions on record-keeping in SYSC 9 apply as set out in SYSC 1.3.2R, except that they only apply to the carrying on of ancillary activities that are performed in relation to:

(1) designated investment business;

(2) home finance activity; and

(3) insurance mediation activity.
Amend SYSC 3 as follows

3.1.1A  R  [deleted]

3.2.23R  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]

Amend SYSC 12 as follows

12.1.13  R  If this *rule* applies under SYSC 12.1.14R to a *firm*, the *firm* must:

(1)  …; and

(2)  ensure that the risk management processes and internal control mechanisms at the level of any *UK consolidation group* or *non-EEA sub-group* of which it is a member comply with the obligations set out in the following provisions on a consolidated (or sub-consolidated) basis:
(a) SYSC 3.2.23R and SYSC 3.2.24R, SYSC 4.1.1R and SYSC 4.1.2R;
(b) SYSC 3.2.26R, SYSC 4.1.7R;
(c) SYSC 3.2.28R to SYSC 3.2.36R, SYSC 5.1.7R;
(d) SYSC 11.1.11R and SYSC 11.1.12R, SYSC 7;
(e) BIPRU 2.3.7R(1), SYSC 11.1.11R and SYSC 11.1.12R;
(f) BIPRU 9.1.6R and BIPRU 9.13.21R (Liquidity plans), BIPRU 2.3.7R(1);
(g) BIPRU 10.12.3R (Concentration risk policies), BIPRU 9.1.6R and BIPRU 9.13.21R (Liquidity plans);
(h) BIPRU 10.12.3R (Concentration risk policies).
Annex G

Principles for Businesses sourcebook (PRIN)

In this Annex, underlining indicates new text and striking through indicates deleted text.

... 1.2.5 G A firm is therefore not required to classify its clients (because COB 4.1.4 R does not apply) and may choose to comply with Principles 6, 7, 8 and 9 as if all its clients were customers. Alternatively, it may choose to distinguish between market counterparties and customers in complying with those Principles. But, in that case, the firm would need to classify any client treated as a market counterparty. In doing this, the requirements in SYSC will apply, including the requirement to establish appropriate systems and controls (SYSC 3.1.1 R) and the requirement to make and retain adequate records (SYSC 3.2.20 R). In classifying its market counterparties, it would be open to such a firm, although not obligatory, to permit intermediate customers to opt up to market counterparty status in accordance with COB 4.1.12 R. It would also have to treat a market counterparty as a customer if the firm had chosen to treat the client as a private customer in the circumstances set out in COB 4.1.14 R.

...
Annex H

Threshold Conditions (COND)

In this Annex, underlining indicates new text and striking through indicates deleted text.

…

2.4.4(2)  G  (2)  …

(d) whether the firm has taken reasonable steps to identify and measure any risks of regulatory concern that it may encounter in conducting its business (see COND 2.4.6 G) and has installed appropriate systems and controls and appointed appropriate human resources to measure them prudently at all times; see SYSC 3.1 (Systems and Controls), and SYSC 3.2 (Areas covered by systems and controls) and SYSC 4.1.1R (Organisational requirements); and

…

2.4.5  G  In complying with SYSC 3.1.1 R (Systems and controls), a firm should plan its business appropriately so that it is able to identify, measure and manage the likely risks of regulatory concern it will face (SYSC 3.2.17 G (Business strategy) and SYSC 7 (Risk control)).

…

2.4.6  G  (3)  The FSA would expect the level of detail in a firm's business plan or strategy plan in (2) to be appropriate to the complexity of the firm's proposed regulated activities and unregulated activities and the risks of regulatory concern it is likely to face (see SYSC 3.2.11 G (Management information) and SYSC 7 (Risk control). Notes on the contents of a business plan are given in the business plan section of the application pack for Part IV permission. A firm requiring specific guidance on the contents and level of detail of its business plan should contact the Corporate Authorisation department (see AUTH 3: Applications for Part IV permission), or, if relevant, its usual supervisory contact at the FSA, or seek professional assistance.

…

2.5.6  G  In determining whether a firm will satisfy, and continue to satisfy, threshold condition 5 in respect of conducting its business with integrity and in compliance with proper standards, the relevant matters, as referred to in COND 2.5.4 G (2), may include but are not limited to whether:

…

(6) the firm has taken reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements
and standards under the regulatory system that apply to the firm and the regulated activities for which it has, or will have, permission (see SYSC 3.2.6 R to SYSC 3.2.8 R (Compliance) and SYSC 6.1.1 to SYSC 6.1.5);

2.5.7 G In determining whether a firm will satisfy and continue to satisfy threshold condition 5 in respect of having competent and prudent management and exercising due skill, care and diligence, relevant matters, as referred to in COND 2.5.4 G (2), may include, but are not limited to whether:

(3) the governing body of the firm is organised in a way that enables it to address and control the regulated activities of the firm, including those carried on by managers to whom particular functions have been delegated (see SYSC 2.1 (Apportionment of responsibilities) and SYSC 3.2 (Areas covered by systems and controls) and SYSC 4.1.1 (General organisational requirements));

(5) the firm has made arrangements to put in place an adequate system of internal control to comply with the requirements and standards under the regulatory system (see SYSC 3.1 (Systems and Controls) and SYSC 4.1 (General organisational requirements));

(6) the firm has approached the control of financial and other risk in a prudent manner (for example, by not assuming risks without taking due account of the possible consequences) and has taken reasonable care to ensure that robust information and reporting systems have been developed, tested and properly installed (see SYSC 3.2.10G (Risk assessment) and SYSC 7.1 (Risk control));

(8) the firm has developed human resources policies and procedures that are reasonably designed to ensure that it employs only individuals who are honest and committed to high standards of integrity in the conduct of their activities (see, for example, SYSC 3.2.13G (Employees and agents) and SYSC 5.1 (Employees, agents and other relevant persons));

(10) the firm has in place systems and controls against money laundering of the sort described in SYSC 3.2.6 R to SYSC 3.2.6J G and SYSC 6.3 (Financial crime);
Annex I

Conduct of Business sourcebook (COB)

In this Annex, underlining indicates new text and striking through indicates deleted text.

---

2.4.1A R This section does not apply to a common platform firm if SYSC 10.2 (Chinese walls) applies to the firm.

---

5.10.1A R This section does not apply to a common platform firm if SYSC 10.1 (conflicts of interest) applies to the firm.

---

Application

7.1.1 R (1) This section applies to a firm when it is conducting designated investment business with or for a customer.

(2) COB 7.1.4 E (1) do not apply in relation to investment research (see COB 7.3 (Dealing ahead of investment research)).

(3) This section does not apply to a common platform firm if SYSC 10.1 (conflicts of interest) applies to the firm.
Annex J

Insurance: Conduct of Business sourcebook (ICOB)

In this Annex, underlining indicates new text and striking through indicates deleted text.

...  

1.2.2 G  ...  

(3) Firms which outsource regulated activities are reminded of the guidance on outsourcing in SYSC 3.2.4 G and the rules in SYSC 8.

...  

7.4.7A R  ICOB 7.4.5R to ICOB 7.4.7G do not apply to a common platform firm if SYSC 10.1 (conflicts of interest) applies to the firm.

...  

Summary of Handbook provisions for insurance intermediaries

Annex 2  High level standards  Senior management arrangements, Systems and Controls, SYSC  

Applications in respect of (1) and (2), except SYSC 3.2.6A R to SYSC 3.2.6J G1 and SYSC 4-10

...  

3.3.9 G  (1) A firm is reminded that non-investment financial promotions (including those which are exempt) may be subject to more general rules including Principle 7 (Communications with clients), SYSC 3 (Systems and controls) ICOB 2.2.3 R (Clear, fair and not misleading communication) and ICOB 5 (Product disclosure).

...
Annex K

Mortgages: Conduct of Business sourcebook (MCOB)

In this Annex, underlining indicates new text and striking through indicates deleted text.

...

1.2.1A  G  Firms which outsource regulated activities are reminded of the guidance on outsourcing in SYSC 3.2.4G and SYSC 8.

...

3.2.8  G  Firms are reminded that qualifying credit promotions (including those which are exempt) may be subject to more general rules, including Principle 7 (Communications with clients), SYSC 3 to SYSC 10 (Systems and controls) and MCOB 2.2.6 R (Clear, fair and not misleading communication).

...

4.3.3  G  SYSC 3.2.6 R and SYSC 6.1.1R (Compliance) require a firm (including a common platform firm) to 'take reasonable care to establish, implement and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system'. In meeting this requirement in relation to MCOB 4.3.2 R, a firm which states that it provides a service based on a limited number of mortgage lenders (see MCOB 4.3.1 R (1)(b)) should have adequate systems and controls in place to monitor whether business is actually placed with those mortgage lenders.

...

13.3.8  G  Firms that propose to outsource aspects of customer relationships (including debt collection) should note that, as set out in SYSC 3.2.4 G(1) and SYSC 8, the FSA will continue to hold them responsible for the way in which this work is carried on.

...
Annex L

Client Assets sourcebook (CASS)

In this Annex, underlining indicates new text and striking through indicates deleted text.

... 2.2.20  G  A firm that holds safe custody investments with a custodian or recommends custodians to private customers, is expected to establish and maintain a system for assessing the appropriateness of its selection of the custodian and to assess the continued appointment of that custodian periodically as often as is reasonable in the relevant market. In order to comply with SYSC 3.2.20R and SYSC 9 (Records), the firm is also expected to make and retain a record of the grounds on which it satisfies itself as to the appropriateness of its selection or, following a periodic assessment, continued appropriateness of the custodian.

...
3.6.1 G (1) …

(2) *MAR 3.6* also provides additional *guidance* on the record-keeping requirements of *SYSC 3.2.20* and *SYSC 9* (Records).

…

3.6.6 G If the records identified in *MAR 3.6.3G* are substituted by written or electronic confirmations produced in accordance with *SYSC 3.2.20* and *SYSC 9* (Records), then that confirmation may be an adequate record of the transaction.

…
1.1.4 G  Principle 3 is amplified in SYSC. A firm must take reasonable care to establish and maintain such systems and controls as are appropriate to its business (SYSC 3.1.1R and SYSC 4.1.1R to SYSC 4.1.5R). Also, a firm’s systems and controls should enable it to satisfy itself of the suitability of anyone who acts for it (SYSC 3.2.13G and SYSC 5.1.2G). This would include the competence of the individual for the role.
Annex O

Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text.

Rules which can be waived (see SUP 8.2.6 G)

<table>
<thead>
<tr>
<th>8.2.7</th>
<th>G</th>
<th>Rules</th>
<th>Section of the Act or other provision under which rules are made</th>
<th>Chapters of the Handbook where such rules appear (Note 1)</th>
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Money laundering rules | Section 146 | SYSC 3.2 and SYSC 6.3

10.7.13A G A firm's obligations in respect of its money laundering reporting officer are set out in SYSC 3.2.6L R and SYSC 6.3.9R.

10.12.3 G … See also SYSC 3.2.4G and SYSC 8.1.1R, and for insurers SYSC 3A.9 13.9.

10.12.4 G Outsourcing arrangements Submitting form

(i) … Responsibility for (as opposed to the performance of) any activity outsourced to B will remain with A. See SYSC 3.2.4G and SYSC 8.

12.6.7 G The senior management of a firm should be aware that the activities of appointed representatives are an integral part of the business that they manage. The responsibility for the control and monitoring of the activities of appointed representatives rests with the senior management of the firm. Guidance is set out in SYSC SYSC 3 on delegation (for example, SYSC SYSC 3.2.3 G and SYSC 3.2.4 G) and in the Statements of Principle and Code of Practice for Approved Persons in APER (for example, APER 4.5 and APER 4.6).

...
Application of the handbook to incoming EEA firms

13A G
Annex 1

(1) Module of Handbook

(2) Potential application to an incoming EEA firm with respect to activities carried on from an establishment of the firm (or its appointed representative) in the United Kingdom

(3) Potential application to an incoming EEA firm with respect to activities carried on other than from an establishment of the firm (or its appointed representative) in the United Kingdom

SYSC

SYSC 1 contains application provisions only. SYSC 2 and SYSC 3 apply as set out in SYSC 1.1.1 R (1):
(1) SYSC 2.1.1 R (1) and SYSC 2.1.2 G do not apply;
(2) …
(3) SYSC 3 applies, but only in so far as responsibility for the matter in question is not reserved by a European Community instrument to the firm's Home State regulator. SYSC 1.1.7 R (Where?) further restricts the territorial application of SYSC 1 to SYSC 3 for an incoming EEA firm. Further guidance is contained in SYSC 2.1.6 G, Question 12.
SYSC 4 SYSC 18 applies to the extent that the Public Interest Disclosure Act 1998 applies to the firm.
Annex P

Enforcement manual (ENF)

In this Annex, underlining indicates new text and striking through indicates deleted text.

... 11.5.2 G However, in some cases, it will not be appropriate to take disciplinary measures against a firm for the actions of an approved person (for example, if the firm can show that it took all reasonable steps to prevent the breach). In other cases, it may be appropriate for the FSA to take action against both the firm and the approved person. For example, a firm may have breached the rule requiring it to take reasonable care to establish and maintain such systems and controls as are appropriate to its business SYSC 3.1.1 R or SYSC 4.1.1R), and an approved person may have taken advantage of those deficiencies to front run orders or misappropriate assets.

... 11.7.1 G In a number of circumstances the regulatory system requires a firm to take reasonable care in relation to particular behaviour. For example, Principle 3 requires a firm to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems, and SYSC 3.1.1 R (taken with SYSC 3.1.2 G) and SYSC 4.1.1R (taken with 4.1.2G) requires a firm to take reasonable care to establish and maintain such systems and controls as are appropriate to the nature, scale and complexity of its business.

... 11.9.1 G The FSA's money laundering rules are set out in SYSC 3.2 and SYSC 6.3 (Financial crime) The FSA, when considering whether to take disciplinary action in respect of a breach of those rules, will have regard to whether a firm has followed relevant provisions in the Joint Money Laundering Steering Group's Guidance Notes for the Financial Sector.
Annex Q

Credit Unions sourcebook (CRED)

In this Annex, underlining indicates new text and striking through indicates deleted text.

... 

4.1.3 G  SYSC 1 to SYSC 3 apply to all credit unions in respect of the carrying on of their regulated activities and unregulated activities in a prudential context. SYSC 4 SYSC 18 applies to all credit unions without restriction.

... 

4.1.8 G  SYSC 4 SYSC 18 reminds firms of the provisions of the Public Interest Disclosure Act 1998 and encourages them to consider adopting appropriate internal whistleblowing procedures. This applies equally to credit unions but is not the subject of further guidance in this chapter.

...
Annex R

Professional Firms sourcebook (PROF)

In this Annex, underlining indicates new text and striking through indicates deleted text.

...

5.3.4 G SYSC 3.2.6A R to SYSC 3.2.6J G and SYSC 6.3 (Financial crime), in relation to money laundering, do not apply to authorised professional firms when carrying on non-mainstream regulated activities.

...

128
Annex S

Recognised Investment Exchanges and Recognised Clearing Houses sourcebook (REC)

In this Annex, underlining indicates new text and striking through indicates deleted text.

...

2.5A.6 G (2) In considering appropriate internal procedures, UK recognised bodies may find the guidance provided to firms in SYSC 18.2.2G(2) and (3) 4.2.2 G(2) and (3) helpful.

...
Annex T

Glossary of Definitions

In this Annex, underlining indicates new text and striking through indicates deleted text.

**ancillary service** any of the services listed in Section B of Annex I to MiFID.

**broker** (in MAR, SYSC and INSINU) any person when dealing as agent.

**collateral**

(2) …

(3) (in INSINU and SYSC)

(a) …


**client**

(1) (except in PROF; in relation to a regulated mortgage contract and SYSC 10) any person with or for whom a firm conducts or intends to conduct designated investment business or any other regulated activity; and:

…

(3A) (in SYSC 10) any person to whom a common platform firm provides, or intends to provide, a service in the course of carrying on a regulated activity for that person, but does not include:

(a) a trust beneficiary; or

(b) a corporate finance contact; or

(c) a venture capital contact;

(4) (in relation to a regulated mortgage contract, except in PROF and SYSC 10) the individual or trustee who is the borrower or potential borrower under that contract.

**common platform firm** a firm that is:

(a) a BIPRU firm; or

(b) an exempt CAD firm; or

(c) a UK MiFID investment firm which falls within the definition of ‘local firm’ in article 3.1P of the Capital Adequacy Directive.
common platform organisational requirements  SYSC 4 to SYSC 9.

common platform record-keeping requirements  SYSC 9.

common platform requirements  SYSC 4 to SYSC 10.

common platform requirements on financial crime  SYSC 6.3.

competent authority (1) (in relation to the functions referred to in Part VI of the Act: admission to an official listing):

(a) the authority designated under Schedule 8 to the Act (Transfer of functions under Part VI (Official listing)) as responsible for performing those functions under the Act admitting securities to, and for removing securities from, the official list; for the time being, the FSA in its capacity as such; or

(b) an authority exercising functions corresponding to those functions under the laws of in (a) in another EEA State.

(2) (in relation to the exercise of an EEA right) a competent authority for the purposes of the relevant Single Market Directive.

(3) …

conflicts of interest policy the policy established and maintained in accordance with SYSC 10.1.10R.

control (1) (except for a common platform firm) (in relation to the acquisition, increase or reduction of control of a firm) the relationship between a person and the firm or other undertaking of which the person is a controller.

(2) (for a common platform firm) control as defined in article 1 of Directive 83/349/EEC.

[Note: article 4 (1)(30) of MiFID]

---

1 This definition is based on the definition contained in the CRD (Consequential Amendments) Instrument 2006 which was consulted on in the consultation paper Strengthening Capital Standards 2 (CP 06/3)
(a) paper; or

(b) (in accordance with article 2(f) of the Distance Marketing Directive and article 2(12) of the Insurance Mediation Directive) any instrument which enables the recipient to store information addressed personally to him in a way accessible for future reference for a period of time adequate for the purposes of the information and which allows the unchanged reproduction of the information stored; this includes, in particular, floppy disks, CD-ROMs, DVDs and the hard drive of the recipient's computer on which the electronic mail is stored, but not Internet websites unless they fulfill the criteria in this definition.

(in relation to MiFID business or equivalent business of a third country investment firm, if the relevant rule implements the MiFID implementing Directive) the instrument used must be:

(i) appropriate to the context in which the business is to be carried on; and

(ii) chosen by the consumer when offered the choice between that instrument and paper.

[Note: article 2(f) and Recital 20 of the Distance Marketing Directive, article 2(12) of the Insurance Mediation Directive and article 2(2) of the MiFID implementing Directive]

eligible counterparty means a market counterparty.

equivalent business of a third country investment firm the business of a third country investment firm carried on from an establishment in the United Kingdom that would be MiFID business if that firm were a MiFID investment firm.

financial instrument ... (2) (for the purposes of BIPRU and GENPRU) an instrument listed in Section B of the Annex to the ISD; and

(3) (for the common platform requirements) any of the instruments specified in Section C of Annex I of MiFID.

group ... (5) (in relation to a common platform firm) means the group of which that firm forms a part, consisting of a parent undertaking, its subsidiaries and the entities in which the parent undertaking or its subsidiaries hold a participation, as well as undertakings linked to each other by a relationship within the meaning of article 12(1) of

[Note: article 2(5) of the MiFID implementing Directive]

investment service

(1) …

(2) (for the common platform requirements) any of the services and activities listed in Section A of Annex I to MiFID involving the provision of a service in relation to a financial instrument.

investment services and activities; or

any of the services and activities listed in Section A of Annex I to MiFID relating to any financial instrument.

investment services or activities; or

investment services and/or activities

MiFID


See also MiFID Regulation and MiFID implementing Directive.

MiFID business

investment services and activities and, where relevant, ancillary services carried on by a MiFID investment firm.

MiFID implementing Directive


MiFID investment firm

(in summary) a firm to which MiFID applies including, for some purposes only, a credit institution and UCITS investment firm.

(in full) a firm which is:

(1) an investment firm with its head office in the EEA (or, if it has a registered office, that office);

(2) a BCD credit institution (only when providing an investment service or activity in relation to the rules implementing the articles referred to in article 1(2) of MiFID);

(3) a UCITS investment firm (only when providing the services referred to in article 5(3) of the UCITS Directive in relation to the rules implementing the articles of MiFID referred to in article 5(4) of that Directive);
unless, and to the extent that, MiFID does not apply to it as a result of article 2 (Exemptions) or article 3 (Optional exemptions) of MiFID.

MiFID Regulation


outsourcing

(1) (except in SYSC 8) the use of a person to provide customised services to a firm other than:

(a) a member of the firm’s governing body acting in his capacity as such; or

(b) an individual employed by a firm under a contract of service.

(2) (in SYSC 8) an arrangement of any form between a firm and a service provider by which that service provider performs a process, a service or an activity which would otherwise be undertaken by the firm itself.

[Note: article 2(6) of the MiFID implementing Directive]

professional client

means an intermediate customer.

regulatory system

the arrangements for regulating a firm or other person in or under the Act, including the threshold conditions, the Principles and other rules, the Statements of Principle, codes and guidance and including any relevant directly applicable provisions of a European Regulation such as those contained in the MiFID Regulation.

relevant person

(1) (in COMP) a person for claims against whom the compensation scheme provides cover, as defined in COMP 6.2.1R.

(2) any of the following:

(a) a director, partner or equivalent, manager or appointed representative (or where applicable, tied agent) of the firm;

(b) a director, partner or equivalent, or manager of any appointed representative (or where applicable, tied agent) of the firm;

(c) an employee of the firm or of an appointed representative (or where applicable, tied agent) of the firm; as well as any other natural person whose
services are placed at the disposal and under the control of the firm or a tied agent of the firm and who is involved in the provision by the firm of regulated activities;

(d) a natural person who is involved in the provision of services to the firm or its appointed representative (or where applicable, tied agent) under an outsourcing arrangement for the purpose of the provision by the firm of regulated activities.

[Note: article 2(3) of the MiFID implementing Directive]

retail client means a private customer.

senior personnel those persons who effectively direct the business of the firm, which could include a firm’s governing body and other persons who effectively direct the business of the firm.

supervisory function any function within a common platform firm that is responsible for the supervision of its senior personnel.

third country investment firm a firm which would be a MiFID investment firm if it had its head office in the EEA.

tied agent a person who, under the full and unconditional responsibility of only one MiFID investment firm on whose behalf it acts, promotes investment services and/or ancillary services to clients or prospective clients, receives and transmits instructions or orders from the client in respect of investment services or financial instruments, places financial instruments and/or provides investment advice to clients or prospective clients in respect of those financial instruments or investment services.

[Note: article 4(1)(25) of MiFID]