



Chapter 2

Authorised and Approved Persons

9-11 Questions

Further information

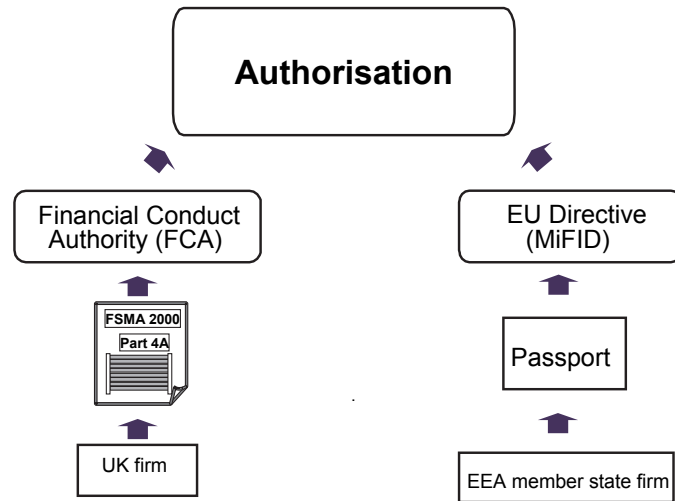
Powers of the FCA

Recognition	Of other bodies: e.g. London Stock Exchange
Authorisation	Of financial institutions (firms)
Approval	Of individuals



2. Authorised Persons

Summary



2. Authorised Persons

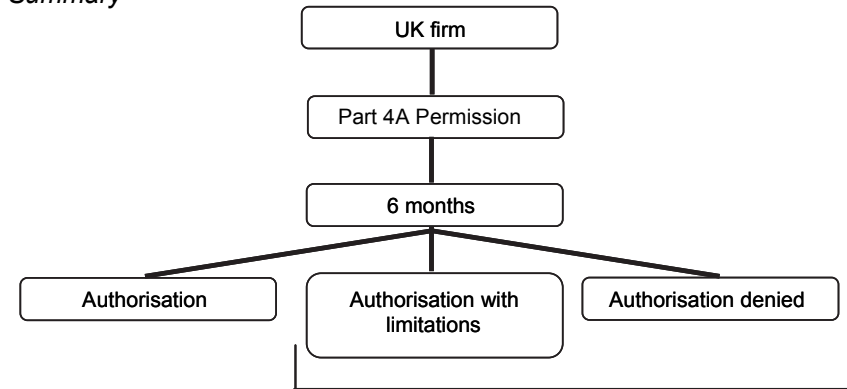
Part 4A permission – Threshold conditions

- These represent the minimum requirements

	FCA firms	Dual-regulated firms
Legal status	N/A	PRA
Location of offices	FCA	PRA
Effective supervision	FCA	FCA and PRA
Appropriate resources	FCA	N/A
Appropriate non-financial resources	N/A	FCA
Prudent conduct	N/A	PRA
Fitness and propriety	FCA	FCA and PRA
Business model	FCA	FCA and PRA

Further information

Summary



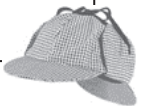
Firms may appeal through the Tribunal Service

Note: authorisation is not blanket permission. A firm will seek permission to perform specific activities in specific investments. Their authorisation will apply to those applied for.



Hints

Applications for dual-regulated firms are made to the PRA.



3. Markets in Financial Instruments Directive (MiFID)

The legal status of EU directives

- Aimed at the harmonisation of laws of the EU member states
- Series of directives issued under article 58 of the European Treaty
- If necessary, member states required to amend their laws to comply with them
- EU regulations are a more direct form of EU law
 - Once passed have legal force in member states

Background to MiFID

- To create a common market with harmonised rules in which the financial industry can exist
- Allows firms within the EEA to open branches and cross-border sell throughout the EEA without the need for licensing in each separate jurisdiction (passporting)
- European economic area (EEA) = EU countries + Norway + Iceland + Liechtenstein (examiner will not test which countries are in the EEA)

Further information

Harmonisation

The Financial Services Action Plan (FSAP) consists of EU directives and regulations.

The FSAP has three specific objectives:

- To create a single EU wholesale market.
- To achieve open and secure retail markets.
- To create state of the art prudential rules and structures of supervision.

Regulations are the most direct form of EU law - as soon as they are passed, they have binding legal force throughout every Member State, on a par with national laws. They are different from directives, which are addressed to national authorities, who must then take action to make them part of national law.

Directives can be implemented by primary legislation, or by the more recent tendency of delegated legislation under section 2(2) of the European Community Act (1972).



3. Markets in Financial Instruments Directive (MiFID)

Scope

- The types of business that can be passported under MiFID:
 - Core activities
 - Reception and transmission of orders
 - Execution of orders
 - Portfolio management
 - Investment advice
 - Underwriting and placing
 - Operating an MTF
 - Ancillary services include:
 - Safekeeping and administration
 - Loans to carry out transactions
 - Investment research and financial analysis

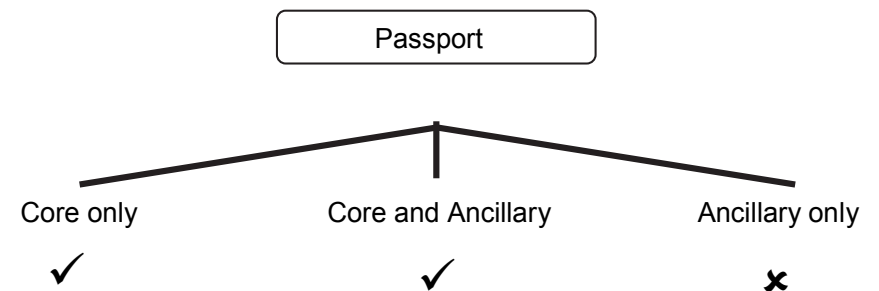
Further information

Ancillary Services

- Safekeeping and administration of financial instruments for the accounts of clients, including custodianship and related services such as cash /collateral management.
- Granting credits or loans to an investor to allow the investor to execute a transaction, where the firm granting the credit or loan is involved in the transaction.
- Advice to undertakings on capital structure, industrial strategy and related matters, and advice and services relating to mergers and the purchase of undertakings.
- Foreign exchange services where these are connected to the provision of investment services.
- Investment research and financial analysis or other forms of general recommendation relating to transactions in financial instruments
- Services relating to underwriting.

Further information

Summary



3. Markets in Financial Instruments Directive (MiFID)

- MiFID covers these investments:
 - Transferrable securities
 - Units in collective investment schemes
 - Money market instruments
 - Derivatives on securities, currencies, interest rates or yields
 - Commodity derivatives (traded on regulated market or MTF)
 - Credit derivatives
 - Financial CFD
 - Exotic derivatives (e.g. weather, carbon emissions etc.)

Hints

Trading in tangible assets (commodity trading) cannot be passported.



Keeping on target

Which **one** of the following is the **best** description of the purpose of the MiFID legislation?

- A: To avoid repetition when issuing offering proposals across multiple EEA member states
- B: To harmonise the trading rules in EEA member states
- C: To facilitate the marketing and sale of unit trusts and ICVCs across the EEA
- D: To create a single market across the EEA



3. Markets in Financial Instruments Directive (MiFID)

Responsibilities of respective regulators

- Home state regulator:
 - Authorisation
 - Fitness and propriety
 - Conduct of business in home state
 - Cross-border services
 - Prudential supervision (capital adequacy)
 - Client assets
- Host state regulator:
 - Conduct of business in host state when performed from a branch in the host state (for MiFID business, these rules should be the same)
 - Any other rules required by the host state, such as approved persons

Links

Responsibilities of respective regulators

Authorised	Branch	Client	COBS
UK	UK	UK	UK
UK	UK	France	UK
UK	France	France	France
UK	France	Germany	UK

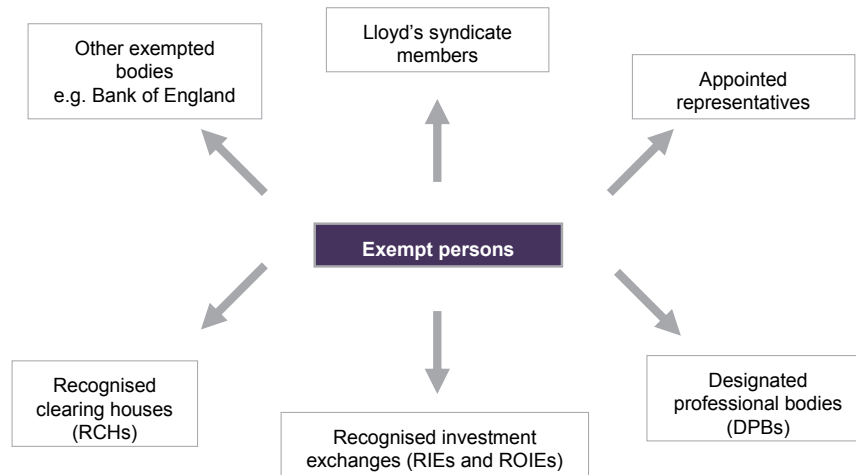


Answer to the question on the previous slide:

B: To harmonise the trading rules in EEA member states

4. Exempt Persons

Exempt persons: summary



Further information

Designated professional bodies (DPBs) include:

- Accountants
- Lawyers

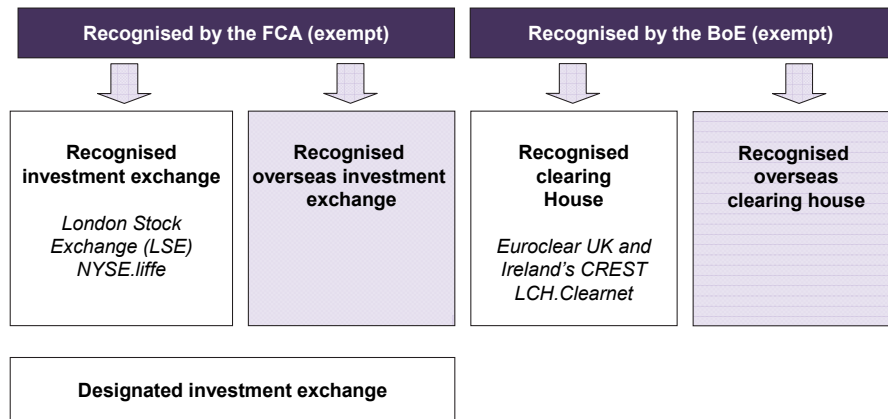
Remember that the members of these bodies are exempt if the activity is incidental and they are not separately remunerated for that activity.

Appointed representatives

Although appointed representatives do not require authorisation, any individual involved may require approval from the regulators if they are fulfilling a controlled function.



4. Exempt Persons



Further information

RIEs/RCHs

The FSA 2012 gave responsibility for regulating settlement systems and RCHs (collectively known as Financial Market Infrastructures (FMIs)) to the Bank of England.

The Bank of England will focus its regulation of FMIs on managing systemic risk.

To be recognised a body must:

- Have sufficient resources, act with integrity and cooperate with regulators
- Conduct business in an orderly manner and monitor and record transactions
- Have procedures for defaults
- Have complaint handling arrangements



Hints

Institutions providing both exchange services and central counterparty systems will be regulated jointly.



5. Principles for Businesses

Principles for businesses (PRIN)

1. Integrity
2. Skill, care and diligence
3. Management and control
4. Financial prudence
5. Market conduct
6. Customers' interests
7. Communications with clients
8. Conflicts of interest
9. Customers: relationship of trust
10. Clients' assets
11. Relations with regulators

Hints

The Principles for Businesses represent the fundamental obligations of firms under the regulatory system. A breach of the Principles will call into question the firm's fitness and propriety in relation to the Threshold Conditions.

Note:

Customer – retail client and professional client

Client – retail client, professional client and eligible counterparty

We will discuss these terms in chapter 3



Keeping on target

Principles for businesses

Which of the FCA's 'principles for businesses' states: "a firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment"?

- A. Principle 5: market conduct
- B. Principle 6: customers' interests
- C. Principle 8: conflicts of Interest
- D. Principle 9: customers: relationship of trust



5. Principles for Businesses

Senior management arrangements, systems and controls (SYSC)

- The Senior management arrangements, systems and controls sourcebook (SYSC) of the FCA Handbook is guidance on Principle 3
- Main rules:
 - SYSC 4: General organisational requirements
 - Apportionment of significant responsibilities among directors and senior management, with clear and transparent lines of responsibility
 - SYSC 5: Employees, agents and other relevant persons
 - Skills, knowledge and expertise of persons appointed are suitable for the roles they perform
 - SYSC 6: Compliance, internal audit and financial crime
 - A firm must take reasonable care to establish and maintain systems and controls that are appropriate to the business
 - SYSC 18: Whistleblowing
 - Reminds firms of their responsibilities under the Public Interest Disclosure Act 1998 (PIDA 1998)

Further information

The SYSC sourcebook applies to common platform firms. A common platform firm is one that is covered by either the capital requirements directive (CRD), MiFID or both.

The five main purposes of the SYSCs are:

1. To encourage directors and senior managers to take responsibility for their firm's arrangements
2. To amplify principle for businesses 3 – management and control
3. To encourage firms to vest responsibility for an effective and responsible organisation in specific directors and managers
4. To create a common platform of systems and controls for all CRD and MiFID firms ('common platform firms')
5. To set out high-level systems and control requirements for insurers and other firms covered by the SYSC requirements



Answer to question on previous slide:

D: Principle 9: customers: relationship of trust.

6.1. Controlled Functions

Controlled functions

Significant influence functions

- Governing functions
 - E.g. Director, Non-Executive Directors, Chief Executive, Partner
- Required functions
 - E.g. Compliance oversight, Money Laundering Reporting Officer (MLRO), CASS operational oversight, actuarial function (PRA firms)
- Systems and controls function
 - E.g. Finance officer, risk assessment and internal audit
- Significant management function
 - E.g. Head of equities, head of settlement, prop traders

Customer function

- E.g. Investment adviser, corporate finance adviser, pension transfer specialist, customer trading

Further information

For dual-regulated firms, the FCA and PRA share oversight of controlled functions.

The FCA will oversee most roles. The PRA will have some say on all significant influence functions, but will have specific oversight of:

- PRA-governing functions:
 - 2. Non-executive director function (PRA)
 - 3. Chief executive function
- PRA-required functions
 - 12. Actuarial function
 - 12A. With-profits actuary function
 - 12B. Lloyd's actuary function
 - 28 Systems and controls function



Hints

Customer function refers to client facing roles:

- Dealing with retail and professional clients
- Dealing with the assets of retail and professional clients



6.2. Approved Persons

Approved Persons

Fit and proper test

- Honesty, integrity and reputation
 - Employment history
 - Criminal convictions
 - Breaches of FCA/PRA rules
 - Complaints
- Competence and capability
 - Exam success
 - Experience and training
- Financial soundness
 - Bankruptcy

Form A

- The responsibility of the **firm**, not the individual
- States function
- Signed by applicant

Hints

If the FCA/PRA receives insufficient information about the applicant they will continue to process the application, but will ask for further clarification



Keeping on target

Several county court judgments have been suffered by Janice McTaggart, and she has also failed her IAD UK Regulations and Professional Integrity exam three times.

Which of the following might be a reason Janice could fail the fit and proper person test? She is:

- A. A dishonest criminal
- B. A financially unsound criminal
- C. Incapable, and financially unsound
- D. Dishonest and incapable



7. Training and Competence (TC) and the Retail Distribution Review (RDR)

Training and Competence

- Background
 - SYSC 3 covers the overall requirements for ensuring that employees meet high-level competency requirements
- General requirements of T&C sourcebook
 - Employees of firms carrying on activities with or for retail customers must demonstrate competence
 - May require examination success
 - Firm responsible for making ultimate assessment of competence
 - Employees must be supervised by a competent supervisor
 - Competence must be regularly reviewed to ensure they remain competent
- Particular roles where examinations are always necessary
 - Each module of an appropriate examination must be passed before:
 - Performing certain advising and dealing activities
 - Acting as a broker fund adviser
 - Advising on syndicate participation at Lloyd's
 - Acting as a pension transfer specialist

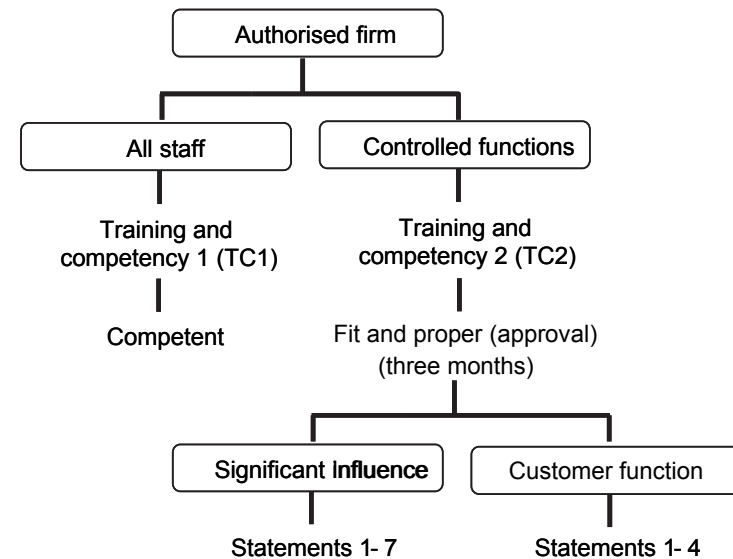
FitchLearning

www.fitchlearning.com

Further information

The FCA has set down deadlines for proving competence through exam success. This is 30 months.

The FCA has also set out proposals to eliminate grandfathering – the process whereby qualifications in a previous regime may exempt a person from those in a current regime.



Answer to the question on the previous slide:

C: Incapable, and financially unsound

7. Training and Competence (TC) and the Retail Distribution Review (RDR)

Retail Distribution Review (RDR)

Professionalism standards for retail investment advisers

- Four main improvements:
 1. Ethical standards
 2. A higher level of qualification
 3. Continuous professional development (CPD)
 - 35 hours per year
 - 21 hours structured learning
 4. Statement of professional standing (SPS)
 - Awarded by accredited bodies

7. Training and Competence (TC) and the Retail Distribution Review (RDR)

Retail Distribution Review (RDR)

- Firms making personal recommendations must be either:
 - Independent
 - Restricted
- Advisers must disclose to the client in good time before providing a service or the client is bound by any agreement
 - Their status
 - The cost of the service it is providing
- Remuneration
 - Adviser charges agreed in advance with the client 'as early as practicable' in a durable medium or via a website
 - Clients can choose to pay the adviser charge upfront or have it deducted from their investment
 - No commissions from the product provider permitted

8. Statements of Principle

Code of practice – ALL approved persons

Statements of principle that apply to all approved persons

1. Act with integrity
 - A breach would be to deliberately mislead by act or omission
2. Act with due skill, care and diligence
 - A breach would be to act without full understanding, without adhering to processes or where regulatory approval has not been gained
3. Observe proper standards of market conduct
 - A breach would be a failure to comply with the Code of Market Conduct
4. Deal with the FCA and other regulators in an open and co-operative way
 - A breach would be a failure to inform the FCA of anything of a nature that it would reasonably expect to be informed

Further information

An individual who breaches one or more of the statements of principle can be disciplined without the firm as a whole being disciplined

Examples of breaches of the statements of principle:

Statement 1:

Deliberately misleading (or attempting to mislead) a client, the firm (including the firm's auditors or appointed actuary) or the FCA by either act or omission, e.g.

- Falsifying documents
- Misleading a client about the risks of an investment
- Misleading a client about the charges or surrender penalties of investment products
- Misleading a client about the likely performance of investment products by providing inappropriate projections of future investment returns
- Mismarking the value of investments or trading positions

Statement 2:

In the opinion of the FCA, any of the following is a failure to comply with the requirement for an approved person to **act with due skill, care and diligence in carrying out his controlled function**, e.g.:

- Failing to explain the risks of an investment to a customer
- Failing to disclose details of the charges or surrender penalties of investment products
- Recommending an investment to a customer, or carrying out a discretionary transaction for a customer, where he does not have reasonable grounds to believe that it is suitable for that customer



8. Statements of Principle

Code of practice – SIF approved persons only

Statements of principle that apply to significant influence functions only

5. Ensure that the business of the firm is organised so that it can be controlled effectively
 - A breach would be a failure to make clear reporting lines and job descriptions or a failure to ensure suitability of employees
6. Exercise due skill, care and diligence in managing the business of the firm
 - A breach would be a failure to understand their role or the delegation of a role to someone without the necessary competence
7. Ensure that the business of the firm complies with the relevant requirements and standards of the regulatory system
 - Mainly ensured through a competent compliance department

Further information

Examples of breaches of the statements of principle:

Statement 5:

Statement of Principle 5 requires an approved person performing a significant influence function to take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function is organised so that it can be controlled effectively.

This includes:

- Reporting lines
- Authorisation levels and job descriptions
- Suitability of individuals

Statement 6:

Statement of Principle 6 requires an approved person performing a significant influence function to exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his controlled function, e.g.

1. An approved person failing to take reasonable steps adequately to inform himself about the affairs of the business for which he is responsible.
2. An approved person delegating the authority for dealing with an issue or a part of the business to an individual or individuals (whether in-house or outside contractors) without reasonable grounds for believing that the delegate had the necessary capacity, competence, knowledge, seniority or skill to deal with the issue or to take authority for dealing with that part of the business.



9. Code of Ethics and Professional Standards

The CFA® Code of Ethics

- Act with integrity, competence, diligence, respect, and in an ethical manner
- Place the integrity of the investment profession and the interests of clients above their own personal interests
- Use reasonable care and exercise independent professional judgment
- Practice and encourage others to practice in a professional and ethical manner
- Promote the integrity of, and uphold the rules governing, capital markets
- Maintain and improve the professional competence of themselves and others

9. Code of Ethics and Professional Standards

Standards of Professional Conduct

- Professionalism
 - Knowledge of the law
 - Independence and objectivity
 - Misrepresentation
 - Misconduct
- Integrity of capital markets
 - Material non-public information
 - Market manipulation
- Duties to clients:
 - Loyalty, prudence and care
 - Fair dealing
 - Suitability
 - Performance presentation
 - Preservation of confidentiality

9. Code of Ethics and Professional Standards

Standards of Professional Conduct (cont.)

- Duties to employers:
 - Loyalty
 - Additional compensation arrangements
 - Responsibilities of supervisors
- Investment analysis, recommendations and action
 - Diligence and reasonable basis
 - Communication with clients
 - Record retention
- Conflicts of interest
 - Disclosure of conflicts
 - Priority of transactions
 - Referral fees
- Responsibilities as a CFA Institute member
 - Conduct as members and candidates of CFA program
 - Reference to CFA Institute, the CFA designation and the CFA program

Keeping on target

Claire works as an independent financial advisor but sometimes her work is outside the scope of her expertise and she refers to a larger investment advisory firm who subsequently pays her referral commissions. According to the CFA Code of Ethics what should she do?

- A: It is acceptable that referral fees are paid to an IFA
- B: It is perfectly acceptable to have received these fees if there has been proper prior disclosure
- C: Ensure that the benefits of these referral fees are used to purchase equipment to aid her in bridging the gap in her knowledge
- D: It is not in the best interests of the client to accept these fees and she should refer the client on to the larger firm



9. Code of Ethics and Professional Standards

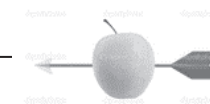
Ethics in the investment industry

Ethics	Compliance
Prevention	Detection
Principles-based	Laws/rules-based
Values-driven	Fear-driven
Implicit	Explicit
Spirit of the law	Letter of the law
Discretionary	Mandatory

Keeping on Target

A CFA Institute member lives in Strictitania (a country with strict securities laws) and has an office in Laxitania (a country with lax securities laws). If the laws of Strictitania say that professional conduct is governed by the country in which the investment business is conducted, which rules apply to the member when conducting business through the Laxitanian office?

- A: The laws of Strictlandia
- B: The Code and Standards of the CFA Institute
- C: The member can choose which laws to follow
- D: The laws of Laxitania



Answer to the question on the previous slide:

B: It is perfectly acceptable to have received these fees if there has been proper prior disclosure

Answer to the question on the previous slide

B: The member must apply the stricter of the applicable law and the Code and Standards.