Consultation response - Joint response to FCA Consultation Paper CP15/22: Strengthening accountability in banking: consultation in extending the Certification Regime to wholesale market activities

7 September 2015

The British Bankers' Association (BBA) and The Association for Financial Markets in Europe (AFME) welcome the opportunity to comment on FCA's consultation paper CP 15/22.

The BBA is the leading association for banks active in the UK. It represents over 170 banking members, which are headquartered in 50 countries and have operations in 180 countries worldwide. As well as banks headquartered in the UK, BBA members include third country banks which operate in the UK either as branches or subsidiaries, or often as a combination of both. The BBA is registered on the EU Transparency Register, registration number 5897733662-75.

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is registered on the EU Transparency Register, registration number 65110063986-76.

Both BBA and AFME members and their employees will be impacted by the FCA's proposals, so we are pleased to be able to respond jointly to the consultation paper.

Both organisations would like to place on record their appreciation of the considerable amount of time and efforts that has been and continues to be devoted by both regulators to assisting the industry to understand and implement this complex new regime. However we would note that there is still a great deal of work to be done in a short timeframe.

Our response is structured in line with the questions posed in CP 15/22.

Question 1: proposed significant harm category for individuals dealing with clients

Our members have no fundamental issue with the FCA extending the scope of the Certification Regime to address customer dealing activities by employees who are not material risk takers or retail investment advisers. There is, however, a concern that, as drafted, the extension may unintentionally (a) capture a broad number of overseas individuals who may have very little contact with UK clients; and (b) as a result of the removal of the "30 day" concession, lead to firms having to "pre-certify" a large number of personnel based overseas on the basis that they may occasionally come to the UK.

Key questions in relation to the scope of the proposed customer-dealing function

Assuming the relevant individual is not already identified as a Senior Manager, our understanding is that, in order to determine whether an individual will fall within the proposed "client-dealing function", it is necessary to ask the following questions:

- Is the individual an "employee" of the relevant authorised person (SYSC 5.2.21G)?
- Is the individual performing one of the activities listed (draft SYSC 5.2.44R)?

- Is the individual dealing with clients of the relevant authorised person in a manner substantially connected with the carrying on of regulated activities (per draft 5.2.45R and SYSC 5.2.18R (2))?
- Is the individual performing the function from an establishment of the relevant authorised firm in the UK, or dealing with a client of the firm in the UK from an establishment of the relevant authorised firm (or its appointed representative) overseas (per draft 5.2.19R(1)?

Our understanding is that an individual will only need to be certified as performing the new function if the answer to each of these questions is yes. It would be useful if the FCA could confirm this is the right approach, but in any event in answering those questions a number of interpretational issues arise. In summary:

- "Employee" is defined as an individual who personally provides, or is under an obligation personally to provide, services to the firm in question under an arrangement made between the firm and the person providing the services or another person **and** is subject to (or to the right of) supervision, direction or control by the firm as to the manner in which those services are provided. The FCA has indicated in recent meetings that this definition is intended to capture a broader scope of arrangements than an "employee" under employment law, but exactly how broad the types of "arrangements" are that may be captured is unclear. We believe that the definition is designed to capture employee service company and related secondment arrangements or situations where someone is clearly appointed to provide services and act on behalf of an entity, for example as an officer of an entity but does not necessarily have a service contract, rather than wider policy/booking model arrangements within a group of companies, but it would be helpful if this could be clarified.
- It is unclear how the requirement that the employee must be performing a function "in a manner substantially connected" to the carrying on by the firm of regulated activities should be interpreted. "Dealing with" clients is defined broadly to include having "contact with clients". The informal guidance that we have received from FCA staff is that there is no *de minimis* on the level of contact required for these purposes, such that any contact, no matter how minor, will be considered "dealing with" clients. This does not seem to align with the "substantially connected" requirement which, we would argue, is the correct test.
- "Clients" is also defined very broadly to include: (a) any person with whom a firm conducts, or intends to conduct, regulated activities or other activities; (b) a corporate finance contact; or (c) a venture capital contact. Whilst the extension to cover corporate finance and venture capital contacts is understandable, draft 5.2.47R(1) the inclusion of the words "or other activities" seems to be a significant extension that could capture dealings with counterparties to commercial transactions, rather than the traditional, existing, definition which focuses on persons with whom a firm is conducting regulated activities. This expansion receives no discussion in the FCA's consultation, and we would suggest that it be deleted.

Overseas implications of the extension being consulted upon

Our member firms with a global footprint are having difficulty determining how the proposed extension (and the Certification Regime more generally) should apply to individuals based overseas.

By way of example, it seems to us that an individual formally employed by a Hong Kong firm, which forms part of the same global group as the UK relevant authorised person, who can book trades to the UK relevant authorised person, should not be treated as falling within the scope of the Certification Regime simply because on occasion these trades will have been entered into with the London office of a client of the UK authorised entity. This is because firms would generally not view the individual in Hong Kong as being an employee of the UK authorised entity under an "arrangement", or even if he were an employee he is not performing the function from an overseas establishment of the UK authorised firm and his overall role and activities are not substantially connected with the regulated activities of the UK firm. (Consistent with current PRA and FCA expectations, UK senior management oversight would in any event be maintained over remotely booked business of this nature.)

Individuals visiting the UK

Under the current Approved Persons Regime, there is no need to obtain CF30 approval for persons based overseas provided that: (a) they spend no more than 30 days in any 12 month period in the UK; and (b) they are appropriately supervised by a person approved to perform the CF30 function (SUP 10A.10.8R). We understand that no equivalent exception is presently proposed as part of the FCA's proposed extension to the Certification Regime. We further understand that this is either because the FCA considered that there was no need for such an exemption in circumstances where the need for regulatory pre-approval was being removed for certified persons, or that the FCA is concerned that the legislation as drafted does not permit for an exemption to be granted.

Our members' UK teams running the certification process will need to devote substantial resources to gather much of the equivalent information that would be needed for a CF30 approval process in order to complete the initial fitness and propriety assessment. Without a 30 day grace period, firms would need to pre-certify any individuals who may visit the UK to perform a "significant harm" function simply because of the possibility of them working from the UK for a few days. This appears disproportionate.

As mentioned at a recent industry meeting therefore, we would therefore strongly encourage the FCA to reintroduce an equivalent to the current 30 day grace period as part of the extension of the Certification Regime. We consider that any risks associated with such individuals visiting the UK and performing a "significant harm" function are appropriately mitigated by ensuring that (as with the current SUP regime) such individuals are supervised by someone who is either a Senior Manager or a certified person.

We are not aware of any legislative reason why this grace period should not be permitted under the new regime and believe the regulators have the ability to specify (and suggest that they do specify) that an individual will not be performing a "significant harm function" from an establishment of the firm in the United Kingdom to the extent he/she is not physically present in the United Kingdom for more than 30 days per year provided that he/she is appropriately supervised by a senior manager or a certified person when in the United Kingdom.

Question 2: Proposed category of significant harm function for algorithmic trading

Generally, we do not object to the FCA's proposed extension of the Certification Regime to those involved in approving the deployment of trading algorithms and subsequent monitoring activity relating to their performance. However, we understand that the FCA's intention is only to capture those individuals in the front office (first line of defence) who are responsible for approving the deployment and monitoring of trading algorithms and not to capture individuals in second/third line of defence control functions, nor those who are, for example, simply writing/coding the algorithms from an IT perspective. It would be helpful if this could be clarified in guidance included in the final handbook text, particularly given the references to "monitoring……compliance" in draft SYSC 5.2.49R. It should be noted that member firms have differing approval requirements for the deployment of algorithms and approval may include sign-off from second line of defence control functions as one element of that process, so clarification that draft SYSC 5.2.54G would not apply to individuals within those functions would be helpful.

Similarly, it would be helpful if the FCA could confirm our understanding that this function will not apply to persons based overseas who are not "employees" of a relevant authorised person or do not otherwise contact UK based clients as part of their activities as regards deployment or monitoring of algorithms.

Questions 3 and 4: Proposal to align the scope of the FCA's Certification Regime/Conduct Rules for Material Risk Takers with the PRA regime

Scope of Material Risk Takers definition

Broadly speaking, members agree with the FCA's proposal to align the FCA's Certification Regime for Material Risk Takers with the PRA regime.

However, clarity on the interpretational issues outlined in our response to Q1 will also assist member firms in understanding the scope of application of the material risk taker category of certified persons.

Material Risk Takers in EEA branches

Separately, we wish to flag that the extent to which MRTs of EEA firms will fall within the scope of Certification Regime is unclear under the current draft rules. The ambiguity arises from SYSC 5.2.42R, which defines Material Risk Takers by reference to the dual regulated firms Remuneration Code (SYSC 19D), and SYSC 5.2.43G, which states that the MRT category does not apply to firms which are not subject to SYSC 19D.

The FCA has confirmed separately that SYSC 19D does not apply to EEA branches; the identification of MRTs under CRD IV is a matter dealt with through home state implementation of CRD IV. This would appear to mean that a Material Risk Taker does not need to be certified by an EEA branch, even if (a) the role they are performing relates to the conduct of regulated activities by the branch in the UK and (b) the Material Risk Taker is based in the UK / performing the role from the EEA branch in the UK. This does not appear to be consistent, however, with some of the statements made in FS15/3 (see paragraph 3.7 in particular), which seem to envisage at least some MRTs being certified even by EEA firms. We should be grateful if the FCA could clarify its position.

Question 5: Cost-benefit analysis

We do not intend to comment in detail on the FCA's cost-benefit analysis. However, given the current level of uncertainty amongst member firms regarding the scope and application of the new categories of certified person, there is a risk that the cost-benefit analysis significantly under-estimates the costs for firms (both one-off and ongoing), particularly those with a global footprint. This reinforces the need for clarity and proportionality in relation to those captured under the certification regime.

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