



28 April 2010

Mr Nigel Fray
Operational and Reporting Policy Team
Permissions, Decisions and Reporting Division
Financial Services Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

Dear Mr Fray

Re: CP 10/3 Effective Corporate Governance

We are writing to you on behalf of the members of the Association for Financial Markets in Europe (AFME). A description of AFME is attached for your reference.

Firstly, we thank you and Ms Janet Brown for taking the time to meet with our working group to discuss a number of matters which are raised in the CP or which arise from the CP. We found the meeting to be very helpful and productive.

We fully support the FSA's intention to establish a more intensive approved persons process in the interest of more effective corporate governance by regulated firms. This amounts to a more fulsome approach by the FSA to its statutory duty to operate an approved persons process. We welcome the opportunity to respond to this CP and to offer some comments on matters not covered by the specific questions posed in the CP.

We are mindful of the necessity to provide further guidance around corporate governance. However, the scale of the envisioned approach goes well beyond both the existing FSA practice and the Walker recommendations. The CP states that the responsibility to appoint appropriate people for key roles rests with each firms' nominations committee of the board and executive management. Under the new structure proposed in the CP there is a risk that the FSA will be seen as an integral part of each company's hiring process i.e. reviewing and approving the robustness of the interview process and the substance of each application. In addition many candidates will be interviewed by the FSA. Given the new FSA focus on competence as well as probity, it may well be perceived that the FSA shares responsibility for each appointment of a SIF unless there has been intentional withholding of material information. The fact that the supervision of SIFs may be

done by separate FSA personnel from those who may technically be approving their appointment will diminish but not eliminate the inter-relatedness of the processes.

It is clear that the FSA intends to take upon itself a substantial workload closely tied to the regulated firms' ability to manage themselves. Thus, it is very important that the FSA establish clear service standards to allow firms to progress appropriately and in a timely manner with their hiring decisions. While we understand and appreciate that the FSA will need to take its time to do its own due diligence, failure to establish clear standards and timeframes could be a predicate for frustration unless practical provisions are in place to permit interim appointments allowing an appointee to function with full authority during the interim. This underscores the FSA's need to adequately resource this function. In addition, greater continuity could be achieved for firms if acting or potential SIFs were allowed to continue to function at firms until the relevant application is approved/disapproved, rather than be limited to 12 weeks as is currently the case.

With respect to the CF00 classification, we understand that this is primarily a reclassification/renumbering of existing overseas registrations except where existing approved persons in regulated parent entities will require an additional approval to reflect their significant influence on a subsidiary. It would be helpful to have more detailed guidance to clarify the application of and boundaries of the CF00 approved persons responsibilities particularly in the overseas context. In addition, we are uncertain, as to how the measures will be enforced with respect to international firms operating in London. It would be helpful if the guidance incorporated flexibility to reflect the different natures of CF00 responsibilities and gave indications of behaviour likely to be considered unacceptable, perhaps through the mechanism of evidential provisions (as in APER 4).

With respect the CP's treatment of the role and responsibilities of non-executive directors (NEDS), we do not agree that existing guidance setting out boundaries on the responsibilities of NEDs should be removed. This would be a very serious disincentive to those holding or considering a NED position. Rather the existing guidance should be clarified including clarity on avoiding overlapping NEDs' responsibilities with those of executive directors. The guidance should clarify the applicable enforcement policies vis a vis NEDS. It also should be clear that the further distinguishing of NED responsibilities (e.g. audit, remuneration, risk, etc.) should only be expected where appropriate.

Finally, we would like greater clarification regarding the interview process as described in the CP, particularly:

1. Issues concerning equal pay and non-discrimination are beyond the scope of the FSA's intervention into a firm's hiring and promoting process. They are not directly related to governance or risk management. These are matters which are covered by other government agencies.

2. FSA should provide firms with adequate information regarding interviews, including details of the questions asked, the level of detail required for sufficient answers, any pertinent comments and a list of attendees. Such minutes should be available to the candidate and the proposing firm.

Also, we recommend that all candidates be allowed to attend interview meetings accompanied by a representative of the hiring firm who may take notes during the process. Members are interested in ensuring that an adequate level of transparency exists within this process. In addition, access to this type of information benefits both the FSA and member firms since, over time, certain themes will emerge such that firms will be able to anticipate FSA requirements and therefore, put forth better, more qualified candidates in the first instance.

3. It is not clear how an individual candidate may be expected to perform due diligence on a firm which is already regulated by the FSA apart from publicly available information sources. There is not likely to be sufficient time or resources available to a candidate to perform a comprehensive analysis to a professional standard. The FSA is in a better position to inform the candidate of its views of the firm and apparently intends to do so. Of course, each individual's understanding of his/her intended role and responsibilities and related matters would be appropriate topics for the interview. It is clear that NEDs and others need time after their engagement to develop their approach to their roles.
4. We think the FSA should state its duty of fairness to all candidates and the firms involved, including its duty to avoid arbitrary decisions. A detailed explanation of any decision to deny approval should be provided to the concerned firm, followed by an opportunity for the individual and the firm to respond before finalization of the FSA decision.
5. The standards to be observed in the process of deciding whether to publish disapprovals should be stated. Such decisions should take account of fairness to the individual and the firm involved, and should not be used by the FSA to pressure participants in the process. We suggest that an anonymised report of disapprovals/drop-outs could inform regulated firms on a regular basis (perhaps quarterly) regarding the key themes which can be taken from individual cases.

We have attached our answers to the questions proposed in the CP for your review. If it would be useful to you, we would be pleased to discuss the issues raised in CP with you and your team.

Yours sincerely

A handwritten signature in black ink, appearing to read 'W. Ferrari', with a stylized flourish at the end.

William J Ferrari
Managing Director

AFME (Association for Financial Markets in Europe) was formed on November 1st 2009 following the merger of LIBA (the London Investment Banking Association) and the European operation of SIFMA (the Securities Industry and Financial Markets Association). AFME represents a broad array of European and global participants in the wholesale financial markets, and its 179 members comprise all pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with SIFMA in the US, and the Asian Securities Industry and Financial Markets Association through the GFMA (Global Financial Markets Association), and provides members with an effective and influential voice through which to communicate the industry standpoint on issues affecting the international, European, and UK capital markets. For more information please visit the AFME website, www.AFME.eu.

FSA Consultation Paper 10/3 – Effective Corporate Governance

List of consultation questions

Q1. Do you agree with our proposal to separately identify certain key roles that are performed within the CF1 (director) CF2 (NED) or CF28 (systems and controls) controlled functions?

We do agree with the FSA proposal to separately identify certain key roles that are performed within the CF1 and CF2 controlled functions, but we believe that the clarifications should not preclude executive directors from performing the roles of chairperson of the risk/audit/remuneration board committees where that is deemed appropriate in all the circumstances by the firm. We also believe that these roles and committees may not be appropriate for unlisted subsidiaries or groups having a strong, centralized governance structure outside the UK. With respect to the proposal to identify/authorize separate functions to replace CF28, we understand that regulated firms have generally had competent individuals in the finance, risk, and internal audit functions. The fact that some boards failed to oversee/direct the activities of these professionals led to many of the problems, which have since been identified. FSA proposals concerning a CRO and the relevant board committees (risk, remuneration, audit) will address the failures of boards to properly deal with these areas where the most significant failures have occurred. Since the challenge of dealing with the differentiated functions under CF1 and CF2 will constitute a substantial undertaking by the FSA, it may be more efficient to focus resources on CF1 and CF2 controlled functions at this time and to find practical ways to expedite what are now CF28 appointments similar to current practices.

Q2. Are there any other key roles we should be identifying?

We do not have any recommendations at this time. In our view, attention should be focused on CF1 and CF2 positions.

Q3. Do you agree that we should separately approve all candidates for a systems and controls function, even if they have, or are seeking, approval to perform a governing function?

We agree with respect to the approval of all appointments for a systems and control function even where the same applicant has, or is applying for, approval for any of the governing control functions.

Q4. Do you agree that we should automatically grant the new controlled functions to individuals already performing the relevant role within their existing approvals?

Yes, we strongly agree that the FSA should automatically approve new controlled functions for individuals already performing the relevant role within the existing approvals.

Q5. Do you agree that a phased approach of between 3 and 12 months is sufficient for the notification process, and that the Remuneration Code provides an appropriate basis for this phasing?

In our view, a minimum of 9 months should be allowed for the notification process for all firms. There will likely be a large volume of new candidates for the CF13, 14, 15 categories currently held by those approved for a governing function, especially where the due diligence process and background checks must be re-started e.g. credit history and criminal record checks.

Q6. Do you agree that we should extend the proposed CF00 (parent entity SIF) to apply irrespective of the corporate status of the UK subsidiary?

We agree.

Q7. Do you agree that we should extend the proposed CF00 (parent entity SIF) regime to apply to regulated firms whose parent entity is also FSA-authorized?

We agree that it would be appropriate to extend the CF00 regime to parties in an FSA-authorized parent, provided that the extension is pragmatic and sensible within the parent. It usually makes sense to appoint CF00s at the next level up from the subsidiary's executive leadership. We consider that it should not be necessary for a person holding a parent entity SIF who performs a similar role for an FSA regulated subsidiary to be subject to additional scrutiny in order to obtain a CF00 status approval. Notification should be sufficient for existing professionals. Additional scrutiny should be required only when the activities of the subsidiary to be monitored are completely unrelated to the activities of the parent being monitored by the party in question e.g. an unrelated economic/financial sector.

Q8. Do you agree that these transitional periods are sufficient?

We urge a minimum transitional period of 9 months. There will be the need to undertake a due diligence process including background checks, credit histories, etc.

Q9. Do you agree that it is appropriate for us to extend CF29 to UK branches of incoming EEA banks accepting retail deposits?

We have no objection to the application of CF29 to UK branches of EEA banks accepting retail deposits.

Q10. Do you agree that our proposed guidance on compromise agreements is useful in clarifying the current position?

We agree with the proposed guidance concerning compromise agreements whereby conduct relevant to the approved person status of an employee would be subject to disclosure to the FSA, provided that the guidance would not require the disclosure of other matters which are not directly related to the conduct at issue.

Q11. Do you agree with our proposed guidance on the time commitment required for chairmen and NEDs?

We agree that time commitment by a NED is an important factor in his ability to meet his responsibilities. The initial time commitment should be determined by the board as necessary in their judgement. The candidate's acceptance of the conditions should be accepted in good faith by the FSA and subject to review by all parties on an ongoing basis. New board members will necessarily have an initial view of the time required based on others' perceptions and will need some time to define a modus operandi. We note that flexibility should be permitted with respect to subsidiaries which are owned by a regulated entity and unlisted subsidiaries which are part of a regulated group having a strong, centralized governance model.

Q12. Do you agree that we should delete the guidance in SYSC 2 and 4 on NEDs' responsibilities?

No, we must strongly disagree. We consider that a withdrawal of the guidance in SYSC 2 and 4 on NEDs' responsibilities would be interpreted as a widening of NEDs' potential liabilities. The statement that a NED's responsibilities are broad without further clarification adds to this perception. It would be preferable to add to the existing guidance making it clear that NEDs are responsible for intervening with and challenging the executive directors of the board when it is appropriate to do so. It is not practical to expect a NED to oversee the conduct of executives below board level, and it is outside the accepted role of NEDs. It is the board executive's role to oversee the conduct of their subordinates. The FSA's stated intention to look closely at NEDs' failure to challenge or intervene in a timely and efficient way should include some objective standards of assessment which would preclude an ex post facto or hindsight approach. If an NED registers a concern with the board about a policy and votes against it, there would seem to be little room for criticism of the NED. If a NED registers a concern but, after investigating, accepts a proposal, likewise there would be little room for criticism, provided that his analysis is the product of his due care and skill. If the representations of a proposer which are not unreasonable are later found to be faulty, it would not be fair to criticise a NED as a matter of hindsight. There can be no guarantee that all decisions will be correct or that all projections will be accurate especially in hindsight.

The CP's language which refers to "broad responsibilities" of NEDs should be qualified and the guidance should clearly indicate that "intervention" by a NED means making representations to the executive directors of the board, and where appropriate to the full board or chairman of the board.

There is an apparent need for further official guidance to be established after public consultation by the FSA as envisioned by FSMA. The responsibilities of NEDs are distinguishable from the responsibilities of the chairperson of a risk/audit/remuneration committee of the board which may or may not be chaired by a NED. The duties of NEDs should not usurp the role of executive directors or the specific roles of the chairman and senior independent director. The proposed official guidance would give appropriate meaning to the CP's stated intent not to expect NEDs to be responsible for matters outside their responsibilities.

Q13. Do you agree that we should amend our rules to reflect the introduction of the new Corporate Governance Code?

We agree

Q14. Do you agree with the content of our proposed guidance on board risk committees?

We agree with the proposed guidance that firms, particularly FTSE 100 listed banks and insurance companies, should consider the value of establishing a risk committee at board level to advise the board on the firm's overall risk appetite, current risk exposures, and future risk strategy. However, firms should have full discretion as to whether to create such a board committee based on their own reasonable analysis of their business model, structure, and risk tolerance/appetite. Global firms that are doing business in the UK and are subject to comparable risk management policies in their home jurisdictions should be afforded reasonable flexibility with respect to their UK subsidiaries. It makes no sense to impose a risk/audit/remuneration committee on a legal entity basis when the group is managed centrally for those purposes on a global basis. Smaller firms that otherwise meet the necessary risk management requirements are less likely to require a board risk committee.

Q15. Do you agree with the content of our proposed guidance on CROs?

We do agree with the content of the FSA proposed guidance on CRO's. However, a flexible approach by the FSA is needed because it may not be sensible or efficient for some firms to appoint a CRO, depending on the firm's size, as well as the nature and complexity of its existing risk management structure.