

Statement of Policy

Conditions, time limits and variations of approval

July 2015



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PRUDENTIAL REGULATION
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12 May 2017 - this document has been updated, see
<http://www.bankofengland.co.uk/pr/Pages/publications/sop/2017/conditionsupdate.aspx>

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1 Introduction

1. This statement of policy is issued by the Prudential Regulation Authority (PRA) in accordance with section 63ZD of the Financial Services and Markets Act 2000 (FSMA) as amended by the Financial Services (Banking Reform) Act 2013,⁽¹⁾ which requires the PRA and the Financial Conduct Authority (FCA) to issue a statement of their respective policies on:

- approving individuals under section 59 of FSMA subject to conditions and time limits; and
- varying approvals under section 59 of FSMA.⁽²⁾

2. The statement applies to all Relevant Authorised Persons (Relevant Firms) as defined in section 71A of FSMA namely:

- banks;
- building societies;
- credit unions; and
- PRA designated investment firms.

3. In discharging its general functions, the PRA must, so far as is reasonably possible, act in a way that advances its statutory objectives.⁽³⁾ The PRA is also required to have regard to certain regulatory principles.⁽⁴⁾ The PRA may alter or replace this statement of policy at any time subject to consultation.

2 Statutory framework

4. Section 61 of FSMA allows the PRA to approve applications to perform a Senior Management Function (SMF) under section 59 of FSMA:

- subject to any conditions that the PRA considers appropriate; and/or
- for a limited time period; and in either case, only
- where it appears to the PRA that it is desirable to do so in order to advance any of its objectives.

5. Similarly, sections 63ZA and 63ZB of FSMA allow the PRA to vary approvals to perform SMFs granted under section 59 of FSMA either at the request of a Relevant Firm or at the PRA's own initiative, where:

- the PRA gave the approval; or
- the FCA gave the approval and the Relevant Firm is PRA-authorised; and

- the PRA considers that it is desirable to do so in order to advance any of its objectives. Variations of approval may include the imposition, modification or removal of conditions and/or time limits.

6. Before exercising its powers under section 63ZB of FSMA, the PRA is required to consult with the FCA. Moreover, where the PRA wants a variation of approval made at its own initiative to take place immediately, it must comply with section 63ZC of FSMA, which gives the firm and Senior Manager concerned the right to make representations.

3 General approach

7. Sections 61, 63ZA and 63ZB of FSMA give the PRA flexibility to address issues which can arise when considering applications to perform an SMF or assessing the fitness and propriety of existing Senior Managers on an ongoing basis. However, these powers can only be used if they appear to advance the PRA objectives. This will be assessed on a case-by-case basis taking into account the circumstances of the firm and the relevant Senior Manager.

8. Moreover, these FSMA powers complement, but do not replace the PRA's ability to:

- discuss candidates for SMF roles informally with firms (without detracting from firms' obligation to vet those candidates under Section 60A of FSMA);
- approve applications unconditionally but make non-binding recommendations on issues such as learning and development plans, either at the time of approval or subsequently; or
- reject applications or withdraw the approval of individuals deemed not to be fit and proper.

9. In line with the PRA approach documents, the PRA may discuss the potential imposition of conditions and time limits on the approvals of individual Senior Managers with the boards and senior management of the firms concerned.⁽⁵⁾ However, firms should not view the availability of such conditions and time limits as a way of facilitating the approval of individuals who otherwise fail to meet minimum standards of fitness and propriety.

(1) www.legislation.gov.uk/ukpga/2013/33/contents/enacted.

(2) The PRA's and FCA's power to vary approvals are set out in Sections in sections 63ZA or 63ZB of FSMA.

(3) Sections 2B and 2C of FSMA.

(4) Sections 2G and 3B of FSMA.

(5) *The PRAs approach to banking supervision*, June 2014, paragraphs 43 and 195; www.bankofengland.co.uk/publications/Documents/prapproach/bankingappr1406.pdf.

10. Similarly, while the PRA relies on supervisory dialogue in seeking to ensure that Senior Managers address risks to a firm's safety and soundness on an *ex-ante* basis, it reserves the right to use its power to vary approvals on its own initiative to impose conditions requiring individual Senior Managers to take certain action where justified.

11. The rest of this statement of policy sets out, for illustrative purposes, a series of non-binding, non-exhaustive examples of situations where the PRA may use its FSMA powers to impose time limits, conditions and variations on the approvals of Senior Managers. However, each case will be assessed individually and firms should not rely on these examples to predict or develop expectations about the likely outcome of a given application.

4 Time-limited approvals

12. If a firm appoints an individual to perform a function which, in all other circumstances, would be an SMF subject to pre-approval by the PRA (PRA SMF); the appointment is solely to provide cover for an PRA SMF whose absence is temporary or reasonably unforeseen and the appointment will be for less than twelve weeks in a consecutive twelve-month period, that individual will not require pre-approval.⁽¹⁾

13. However, as soon as it becomes apparent that the individual will be performing a PRA SMF for more than twelve weeks in a consecutive twelve-month period, the firm will be required to apply for pre-approval.

14. Therefore, the use of time-limited approvals will only be applied to applications to perform an SMF on an interim, provisional or temporary basis for a period exceeding or likely to exceed twelve weeks in a consecutive twelve-month period.

15. An example of where the PRA may approve an individual subject to a time-limit is where:

- an SMF leaves a firm suddenly or unexpectedly;
- the firm needs to fill the SMF vacancy immediately;
- it is likely to take longer than twelve weeks to recruit a permanent replacement; and
- there is an individual at the firm not currently approved to perform the relevant SMF, such as a deputy, who the firm and the PRA deem capable of fulfilling the role in an interim capacity but not necessarily on a permanent basis.

16. There is no formal upper limit on the duration of time-limited approvals, which will be set on a case-by-case basis.

5 Probationary time limits

17. There may be circumstances where a firm wants to appoint a candidate to perform an SMF who may, in their proposed role, be responsible for dealing with unusual or severe challenges in the foreseeable future. In this situation, although the candidate is deemed fit and proper, it might be appropriate to approve him or her subject to a time limit, with a view to reassessing him or her for a permanent position in due course.

18. In this situation, a time-limited approval may be accompanied by a condition requiring the individual to:

- complete a certain action on or before the end of the time limit, for example a requirement on an acting Head of Internal Audit (SMF5) to produce a revised Audit Plan for the firm within the next six months; or
- refrain from taking specific actions or decisions associated with the role until a permanent approval is granted, for example a requirement on an interim Chief Risk function (SMF4) not to review the firm's risk appetite until approved on a permanent basis.

19. A further example could be where:

- the Chief Executive (SMF1) of a large bank resigns unexpectedly;
- the firm wants to appoint the head of retail banking, which is the bank's largest and most significant business line, as interim Chief Executive;
- PRA supervisors consider that the head of retail banking would be capable of running the firm on a day-to-day basis but note that he or she has no experience developing a long-term strategy for the firm as a whole; and
- the firm's Chairman and Head of HR estimate that it could take up to a year to recruit a permanent Chief Executive and believe that the Head of Retail Banking could be the ideal candidate if he or she can deliver a viable five-year strategic plan.

20. In this situation, it may be appropriate to approve the head of retail banking as Chief Executive (SMF1) subject to a twelve-month time limit, during which he or she would be expected to produce a five-year plan for the firm. The plan would be taken into account when considering whether to approve him or her on a permanent basis.

(1) Senior Management Functions 2.3.

21. Once a time limit is imposed, FSMA does not allow the PRA to remove or reduce it before it lapses. Consequently, where a time limit is imposed in conjunction with a condition, fulfilment of the condition does not automatically cause the time limit to lapse. In this situation, when the time limit lapses, the PRA will re-examine the individual's circumstances (including fulfilment of any conditions) and if it deems it appropriate will grant a fresh approval which may or may not be subject to a time limit.

6 Role-scale limited approvals

22. Where a firm is expanding, transforming its business model or its risk profile and there are identifiable upcoming milestones, the PRA may wish to link the duration of one or more Senior Managers' approvals to these milestones.

23. An example might be an unlisted bank which currently operates only in the United Kingdom but is planning an initial public offering and a number of overseas acquisitions which are projected to treble the size of its balance sheet and give it a global footprint over the next three years.

24. The incumbent Chief Finance function (SMF2) holder has never managed the financial resources of an institution as large or complex as this bank intends to become. In this situation, it may be appropriate to either:

- limit his or her approval to three years (the projected time for completing the expansion); or
- link it to certain expected milestones (ie the point at which the firm's balance sheet exceeds a predetermined size) at which point his fitness and propriety would be reassessed in light of the new circumstances.

25. The imposition of a role-scale-linked time limit on a Senior Manager's approval would apply without prejudice to other obligations which may arise on a firm in those circumstances, such as the duty to provide the PRA and FCA with a revised Statement of Responsibilities if the relevant Senior Manager's responsibilities undergo a 'significant change' (section 62A of FSMA) and to meet any information or verification requirements imposed by the PRA under that section and under Applications and Notifications 5.3 and 6.3.

7 Performing an SMF after a time limit lapses

26. Should an individual continue to perform an SMF following expiry of a time-limited approval, he or she will be deemed to be performing an SMF without approval and may be liable to penalties under section 63A of FSMA.⁽¹⁾

27. The firm may also be liable under section 59(1) of FSMA for failing to take reasonable care to ensure that the individual does not perform an SMF without approval.

28. Moreover, the Senior Manager responsible for managing or overseeing the firm's performance of its obligations under the Senior Managers Regime (under Allocation of Responsibilities 4.1(1)) may be guilty of misconduct under section 66B(5) of FSMA if he or she cannot satisfy the PRA that he or she took reasonable steps to avoid the contravention of section 59(1) of FSMA occurring or continuing.⁽²⁾

29. Firms must remain aware of the expiry of all time-limited approvals and promptly inform the regulator of any steps they intend, or may be required, to take ahead of their expiry.

8 Conditional approvals

30. Conditional approvals may be granted in cases where a candidate has been deemed fit and proper overall but, typically, where the assessment has unveiled an action or development point whose completion would advance the PRA's objectives.

31. Before imposing conditions, the PRA may undertake an interview to assess the candidate's competency and capability for the SMF he or she is seeking to perform. However, it may also impose conditions without a prior interview.

32. The PRA may ask a candidate to undertake training to enhance their competency and capability in a specific area where this is desirable to advance the PRA's objectives. Fulfilment of conditions may be subject to a deadline, which would differ from any potential accompanying statutory time limits on the individual's approval.

33. An example might be the case of a bank which is looking to appoint its current head of credit risk as Chief Risk Officer and is seeking approval for him or her to perform the Chief Risk function (SMF4). The candidate has substantial experience in credit and operational risk but their knowledge of market risk, which accounts for a significant part of the firm's risk profile, is out of date. In this situation, it might be appropriate to attach a condition to the individual's approval requiring him or her to undertake training to update his or her knowledge of market risk by a specified date.

(1) The PRA's approach to enforcement: statutory statements of policy and procedure sets out the PRA's policy on the imposition and amount of penalties under *inter alia* sections 63A of FSMA; www.bankofengland.co.uk/publications/Documents/other/pr/approachenforcement.pdf.

(2) In addition, under section 66B (3) of FSMA, any Senior Manager or Certified employee who was knowingly concerned in the firm's breach of section 59(1) of FSMA would also be guilty of misconduct.

34. In some circumstances conditions may require a candidate to refrain from or cease undertaking certain actions. They may also require the candidate to go beyond regulatory requirements in a given area. An example might be a systemically important bank which is seeking approval for a new Chairman (SMF9) who sits on the board of two major non-financial firms. While these two additional directorships are within the limits imposed under CRD IV, supervisors are concerned about their potential impact on the candidate's ability to devote sufficient time to his or her proposed Chairman role which, for a firm of this size and complexity, would typically require a near full-time commitment. In this situation, it might be appropriate to attach a condition to the individual's approval requiring them to resign from one or both of the other non-executive directorships.

35. There may be circumstances where conditions imposed on a Senior Manager's approval can also be imposed on the firm as a whole using the PRA's powers under section 55M of FSMA. An example could be a condition to produce a remediation plan within a specified timeframe setting out the process by which a specific business unit intends to rectify deficiencies in its prudential systems and controls. This could potentially be imposed on the firm, its Chief Executive (SMF1) or, if applicable, the relevant Head of Key Business Area (SMF6).

36. In considering whether to impose a condition on a Senior Manager's approval under section 63ZB of FSMA instead of or in addition to imposing a requirement on the firm under section 55M, the PRA may take into account a number of factors including but not limited to:

- whether it would be more appropriate to impose the requirement on the firm, for instance because it relates to a matter reserved to the board as a whole;
- the extent to which the subject matter of the condition already forms part of the Senior Manager's responsibilities, as evidenced by documents including his or her Statement of Responsibilities; and
- whether the regulatory outcome which the condition is seeking is within the control of the relevant Senior Manager, including through any direct reports for which he or she is responsible.

9 Failure to observe a condition

37. Failure to observe a condition by the set deadline does not, in itself, invalidate an approval granted under section 59 of FSMA but, depending on the circumstances, may amount to a breach by the firm and/or the relevant Senior Manager of a number of regulatory requirements including but not limited to:

- Section 63A(2)(b) of FSMA;
- Fundamental Rules 1, 2, 6 and 7.(1);
- Individual Conduct Rule 1 and Senior Management Conduct Rule 4; and
- General Organisational Requirements 5.1(5), 5.2 and 5.3.

38. Moreover, non-fulfilment or late fulfilment of a condition may be deemed to constitute a failure by the relevant Senior Manager to observe minimum standards of fitness and propriety and could trigger disciplinary action, including withdrawal of approval.

10 Variations of approval

39. The circumstances which may lead to a time limit or condition being imposed on a prospective Senior Manager may also lead to an incumbent Senior Managers' approval being varied, either at the firm's request or the PRA's own initiative.

40. In addition, the PRA may vary an individual's approval to give explicit responsibility for managing or overseeing delivery of a specific and potentially *ad hoc* and time-limited regulatory requirement or remedial action.

41. For example, a UK-regulated firm has just entered into a three-year deferred prosecution agreement with overseas authorities after being accused of local market misconduct. Breach of the deferred prosecution agreement could seriously imperil the firm's safety and soundness, eg through fines and/or loss of key local authorisations. The PRA may vary the approvals of one or more Senior Managers so as to make them explicitly responsible for ensuring and overseeing compliance with the terms of the agreement in order to further the firm's safety and soundness.