

Chapter 2

FSA Principles and High-Level Requirements

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2.1 Introduction

This Chapter deals with:

- (a) the Financial Services Authority (“FSA”) Principles for Business;
- (b) the FSA’s Statements of Principle for Approved Persons;
- (c) certain high-level requirements set out in Chapters 1 and 9 of the Lloyd’s Sourcebook; and
- (d) the Conduct of Business Sourcebook as it applies in the Lloyd’s context.

It addresses the regulatory background to and underlying reasons for the Principles for Business and the Statements of Principle for Approved Persons, what they are, who they apply to and the scope of their application, and considers briefly the consequences of breaching them. Also dealt with are the principal high-level requirements concerning the regulatory functions of the Society of Lloyd’s and general prudential requirements contained in Chapters 1 and 9 of the Lloyd’s Sourcebook. The Chapter ends with an overview of the extent to which the rules and guidance in the Conduct of Business Sourcebook (“COBs”) apply to activities carried on by underwriting agents, members’ advisers and the Society of Lloyd’s itself.

The Principles for Business and the Statements of Principle for Approved Persons are contained in Block 1 (High Level Standards) of the FSA Handbook. COBs forms part of Block 2 (Business Standards) and the Lloyd’s Sourcebook is one of the specialist sourcebooks in Block 5.

2.2 The Principles for Business

2.2.1 What are they?

In its October 1999 policy statement¹ the FSA described its aim in proposing a set of principles to apply to FSA-authorized businesses as being:

“to formulate succinct high-level precepts stating the fundamental obligations of regulated businesses which would provide a basic yardstick for firms to order their behaviour by and provide a basis for supervisory and enforcement activity by the FSA itself.”

The main considerations taken into account by the FSA in formulating the Principles for Business included the following:

- (a) fitness and propriety – they are intended to express the main dimensions of what is required for an underwriting agent or the Society of Lloyd's to be fit and proper (*see* Chapter 1). Being ready, willing and organised to abide by them is therefore a critical factor in applications for permission to carry on regulated activities as an underwriting agent under Part IV Financial Services and Markets Act 2000 (“FSMA 2000”), and breaching them may call into question whether a regulated firm continues to be fit and proper;
- (b) durability and flexibility – they are formulated at a level of generality which is intended to ensure that they will be durable without amendment (in the absence of major changes in the legislative environment) and that the regulatory system will never be completely silent on an issue.

They are therefore essential FSA tools to which underwriting agents, members' advisers and the Society of Lloyd's itself must have regard and with which they must comply at all times.

The Principles for Business are set out in Table 2.1 below.

Each Principle is considered below. (In the first edition of this work, each of the Principles was compared with the corresponding Lloyd's “core principle” for underwriting agents. As the Lloyd's core principles were revoked by the Underwriting Byelaw (No. 2 of 2003) this comparison is no longer relevant.)

¹ The FSA Principles for Business: response on Consultation Paper 13.

Table 2.1: Principles for businesses

1 Integrity	A firm must conduct its business with integrity.
2 Skill, care and diligence	A firm must conduct its business with due skill, care and diligence.
3 Management and control	A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
4 Financial prudence	A firm must maintain adequate financial resources.
5 Market conduct	A firm must observe proper standards of market conduct.
6 Customers' interests	A firm must pay due regard to the interests of its customers and treat them fairly.
7 Communications with clients	A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.
8 Conflicts of interest	A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.
9 Customers: relationships of control	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 judgement.
10 Clients' assets	A firm must arrange adequate protection for clients' assets when it is responsible for them.
11 Relations with regulators	A firm must deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice.

2.2.1.1 Principle 1 – Integrity

This is perhaps the most fundamental of all the Principles for Business and is a key concept in relation to the fit and proper test. In the first consultation paper on the Principles for Business, integrity was described as “a moral concept stating the fundamental obligation on firms to act honestly and straightforwardly”. Breaches of Principle 1 are likely to be regarded as among the gravest breaches of all the Principles.

2.2.1.2 Principle 2 – Skill, care and diligence

Principle 2 imposes obligations on underwriting agents in their dealings with policyholders and members of Lloyd's, as well as in respect of their internal arrangements. The organisation and control of an agent's affairs and business processes (which are the subject of Principle 3) are key factors contributing to the conduct of its business with due skill, care and diligence as Principle 2 requires.

2.2.1.3 Principle 3 – Management and control

Principle 3 requires a firm to keep an effective grip on its own affairs. The required level of sophistication of an underwriting agent's systems of organisation, risk management and control will depend on the size and complexity of the organisation. The FSA expects "adequate risk management systems" to cover all risks material to the firm's activities (examples given include legal and operational risk), not just those which relate to financial soundness.

The standard required by Principle 3 is not absolute but one of reasonable care.

The rules and guidance within the Senior Management Arrangements, Systems and Controls ("SYSC") section in Block 1 of the Handbook, which amplify the obligations under Principle 3, are considered in Chapter 3.

2.2.1.4 Principle 4 – Financial prudence

The Lloyd's Sourcebook contains detailed provisions concerning the adequacy of the financial resources of Lloyd's and its members. Chapter 6 of this book deals in detail with this aspect of the financial prudence Principle in the Lloyd's context.

At present, Lloyds is required by the FSA to impose and monitor financial resource requirements for underwriting agents. So for the time being there are no detailed FSA rules in this area with direct application to underwriting agents, the FSA relying on Lloyd's to impose these on the market. This may change in the future, although financial resource requirements for underwriting agents in respect of their own agency business are outside the scope of the forthcoming changes to bring Lloyd's insurance business within the scope of the Integrated Prudential Sourcebook ("PRU") consulted on in FSA consultation (papers CP 178 "Review of Prudential Regulation of the Lloyd's Market" and 04/7 "Lloyd's: integrated prudential requirements, and changes to auditing and actuarial requirements").

2.2.1.5 Principle 5 – Market conduct

In the first consultation paper on the Principles for Business, the FSA commented that:

“This Principle requires firms to achieve proper standards as participants in organised and over-the-counter markets. In many cases the requisite standards will be set out in the FSA’s Code of Market Conduct and evidenced in market codes, such as the Takeover Code, or exchange rules.”

The Code of Market Conduct has no practical application to Lloyd’s underwriting agents. It is conceivable that the FSA might, in certain circumstances, take into account an underwriting agent’s failure to comply with standards of conduct specified in the various codes which now derive their authority from the Underwriting Byelaw (No. 2 of 2003), in assessing whether an underwriting agent had complied with Principle 5.

2.2.1.6 Principle 6 – Customers’ interests

This Principle is the foundation of (amongst other things) firms’ complaints-handling obligations (*see* Chapter 7).

2.2.1.7 Principle 7 – Communications with clients

Principle 7 contains an obligation to communicate information “in a way which is clear, fair and not misleading”. This reflects the FSA’s statutory objective of promoting public understanding of the financial markets and is meant to emphasise, in the case of underwriting agents, the importance of providing information to their policyholders and to the members of Lloyd’s for whom they act which is clear and understandable.

2.2.1.8 Principle 8 – Conflicts of interest

Principle 8 refers specifically to conflicts of interest between one customer (being policyholders or members) and another as well as conflicts between the authorised firm itself and its customers, and imposes an obligation on underwriting agents to manage such conflicts fairly. The Lloyd’s Sourcebook imposes specific requirements upon the Society of Lloyd’s in respect of conflicts of interest (*see* 2.4.2 below).

2.2.1.9 Principle 9 – Customers: relationships of trust

Principle 9 is not limited to situations where a firm has a fiduciary relationship with its customer, although for an underwriting agent it does apply in respect of the agent’s conduct towards the Lloyd’s members to whom the agent owes fiduciary duties. For members’ agents and members’ advisers, Principle 9 applies in respect of the advice they

give to the members for whom they act concerning membership of Lloyd's and participation on individual syndicates.

2.2.1.10 Principle 10 – Clients' assets

The Client Assets Sourcebook ("CASS") contains substantive materials on customer asset protection applicable to Lloyd's itself and to members' agents in respect of the management of members' funds (*see* 2.5 below).

2.2.1.11 Principle 11 – Relations with regulators

Chapter 15 of the Supervision Manual contains guidance (in SUP 15.3.8) as to particular events or actions of which the FSA must be notified by an underwriting agent in order for it to comply with Principle 11. These include (but are not limited to) the following:

- (a) any proposed restructuring, reorganisation or business expansion which could have a significant impact on the firm's risk profile or resources (examples given include: setting up a new undertaking within a firm's group, or a new branch; providing cross-border services into a new territory; providing a new type of product or service; entering into or significantly changing a material outsourcing arrangement);
- (b) any significant failure in the firm's systems or controls, including those reported to the firm by its auditor;
- (c) any action which a firm proposes to take which would result in a material change in its capital adequacy or solvency (examples given include: any action which would result in a material change in the firm's financial resources; a material change resulting from the payment of a special or unusual dividend or the repayment of share capital or a subordinated loan; for firms which are subject to the rules on consolidated financial supervision, any proposal under which another group company may be considering any such action; significant trading or non-trading losses, whether recognised or unrecognised).

The agreement between the FSA and Lloyd's entitled "Supervision Arrangements for Underwriting Agents" (which was designed to promote efficient and effective supervision of underwriting agents and to prevent unnecessary duplication in their supervision by the FSA and Lloyd's (*see* Chapter 3, 3.4)) provides that notifications under Principle 11 should be given to the agent's supervisor in Lloyd's Regulatory Division instead of to the FSA. (Since the Regulatory Division was disbanded in 2003, such notifications are made to the Risk Management section of Lloyd's Corporation.)

In certain circumstances Principle 11 imposes an obligation upon Lloyd's and on underwriting agents to cooperate with overseas regulators (to the extent that they have jurisdiction and the cooperation required relates to regulated activities). Principle 11 does not create a new, separate duty for authorised persons to cooperate beyond what is required by their pre-existing relationships with other regulators.

2.2.2 To whom do the Principles for Business apply?

The Principles for Business apply (subject to the rules concerning the scope of their application) to all authorised persons. In the Lloyd's context they apply to the Society of Lloyd's and to managing agents, members' agents and members' advisers.

2.2.3 Scope of application

The Principles for Business apply with respect to regulated activities (*see* Chapter 1, 1.4.1.1), but in applying them with respect to general insurance business and pure protection long-term insurance business the FSA will proceed only in a prudential context. This means that it does not expect to exercise its powers where there is a contravention of the Principles unless the contravention amounts to a serious or persistent violation which:

- (a) has implications for confidence in the UK financial system; or
- (b) brings into question the fitness and propriety of Lloyd's or of the underwriting agent concerned; or
- (c) has implications for the adequacy of Lloyd's financial resources or those of the underwriting agent concerned.

The Principles apply also with respect to the communication (and approval) of financial promotions (*see* 2.5 below). Principles 3, 4 and (insofar as it relates to disclosing to the FSA) 11 apply with respect to the carrying on of any non-regulated as well as regulated activities and taking into account the activities of other members of a group of companies of which an underwriting agent is a part. This means, for example, that the potential impact of the activities of another member of the group or common risk management systems operating across a group will be relevant in determining the adequacy of a firm's risk management systems or financial resources. But it does not mean that the inadequacy of the risk management systems or financial resources of another group company will automatically result in a firm contravening Principle 3 or 4.

Principles 1, 2 and 3 apply to activities carried on anywhere in the world (in a prudential context). Principle 5 also applies to worldwide activities, but only to the extent to which they might have a negative effect on confidence in the UK financial system. In considering whether to take regulatory action under Principle 1, 2, 3 or 5 in relation to activities carried on outside the UK, the FSA will take into account the standards expected in the market in which the firm is operating. Business Principles 4 and 11 also apply to worldwide activities.

Principles 6, 7, 8, 9 and 10 impose requirements expressly in relation to an authorised person's "clients" or "customers". These requirements depend, in part, on the characteristics (i.e. in simple terms, the size and sophistication) of the client or customer concerned. The FSA gives as an example the fact that the information needs of a general insurance broker will be different from those of a retail general insurance policyholder.

How are these characteristics to be assessed? COB 4 contains detailed provisions on so-called "client classification". The application of the provisions of COBs to a firm in respect of a particular client (be it a policyholder or a broker) depends upon the classification of that client. For this purpose there are three categories of client:

- (a) market counterparties;
- (b) intermediate customers; and
- (c) private customers.

The expression "client" refers to all three categories; "customer" refers only to intermediate and private customers.

Principles 6, 8 and 9 (and the first part of Principle 7) apply only in relation to customers (i.e. clients which are not market counterparties). Generally, a firm is required to classify a client before conducting "designated investment business" with or for the client. COB 12 (Lloyd's) extends the usual meaning of the term "designated investment business", in the context of a firm carrying on activities to which COB 12 applies, to include the activities of advising on syndicate participation at Lloyd's and acting as a managing agent at Lloyd's. However COB 12.1.13 provides that, in the context of these activities, COBs applies only in respect of members or potential members of Lloyd's, except the information and cancellation/withdrawal requirements in COB 6.7 and COB 6.8 relating to insurance contracts (which in the Lloyd's context are relevant only to managing agents) which apply in respect of policyholders and potential policyholders. In practice, this means that in the

Lloyd's context the client classification rules in COB 4 apply to their full extent only in respect of members and prospective members of Lloyd's.

In contrast, insurers are not required to classify their general insurance clients and may therefore choose to comply with Principles 6, 7, 8 and 9 as if all their policyholders were customers. Logically (although the point is not entirely clear because of the way in which COB 12 is drafted) this would appear to extend to managing agents. Insurers (logically including managing agents) may, however, choose to classify their clients – in which case Business Principles 6, 7, 8 and 9 will not apply to clients classified as “market counterparties”. These would include other authorised persons, and could also include, if an agent chose to treat them as market counterparties, local and public authorities, large partnerships and unincorporated associations and trustees of large trusts and certain pension schemes (subject in each case to obtaining their consent to being so classified) and large companies, for example companies with (or with a holding company or subsidiary which has) called-up share capital of at least £10 million, or with any two of:

- (a) a balance sheet total of at least €12.5 million;
- (b) net turnover of at least €25 million; and/or
- (c) an average of 250 or more employees during the year concerned.

Managing agents are however required to classify the members of their managed syndicates (who are also their clients, in addition to policyholders), so members who are market counterparties (e.g. other authorised firms, or companies within the same group as an authorised firm) – and, if the agent chooses to “upgrade” them to market counterparty status, large companies (as defined above) – will be treated as clients for the purposes of Principles 6–9.

For a members' agent, the market counterparty concept will only apply if the agent chooses to treat large corporate members as market counterparties, as above. All other members or prospective members will be customers, and Principles 6, 7, 8 and 9 will therefore apply in full with respect to them.

2.2.4 Consequences of breach: brief overview

A firm will be liable to disciplinary sanctions if it commits a breach of the Principles for Business (*see* Chapter 5). The Principles are also relevant to the FSA's powers to:

- (a) gather information;
- (b) investigate and intervene;
- (c) vary a firm's permission to carry on regulated activities under Part IV FSMA 2000,

and provide a basis on which the FSA may apply to a court for an injunction or restitution order or require a firm to make restitution. However, contravention will not give rise to an action for damages by a private person under Section 150 FSMA 2000 (*see* Chapter 5).

Some of the rules and guidance in the Handbook deal with the bearing of the Principles upon particular circumstances. However, the FSA is careful to point out that since the Principles are designed as a general statement of regulatory requirements applicable in new or unforeseen situations, and in situations in which there is no need for guidance, the specific rules and guidance in the Handbook which deal with the bearing of the Principles upon particular circumstances must not be viewed as exhaustive.

2.3 The Statements of Principle

2.3.1 *What are they?*

As explained in Chapter 1 (1.8), Section 59 FSMA 2000 is the foundation of the regime for approval of individuals who perform "controlled functions", both within Lloyd's and underwriting agents.

Under Section 64(1) FSMA 2000 the FSA has the power to issue statements of principle with respect to the conduct expected of approved persons. When the FSA issues statements of principle it is obliged by Section 64(2) also to issue a code of practice for the purpose of helping to determine whether or not a person's conduct complies with them. It can include in any code of practice one or more of the following:

- (a) descriptions of conduct which, in its opinion, complies with a statement of principle;
- (b) descriptions of conduct which, in its opinion, does not comply with a statement of principle;
- (c) factors which, in its opinion, are to be taken into account in determining whether or not a person's conduct complies with a statement of principle.

Section 64(7) FSMA 2000 provides that any such code which is in force at the time when the conduct in question takes place may be relied upon so far as it “tends to establish” whether or not that conduct complies with a statement of principle. Failure to comply with a statement of principle does not of itself give rise to any right of action by persons affected, or affect the validity of any transaction. It can, however, lead to personal disciplinary action by the FSA (*see* Chapter 5).

The FSA’s rationale for issuing a separate set of statements of principle for approved persons and associated codes of practice was described in a policy statement issued in June 2000² as being, fundamentally, the desire to influence the behaviour of individuals and therefore firms (because firms can only act through individuals) in order to help achieve the FSA’s statutory objectives of maintaining confidence in the financial system, promoting public understanding of the financial system, protecting consumers and reducing financial crime.

The FSA regards the regulation of individuals as a tool through which the interests and aims of the individuals within a firm can be aligned with those of the firm itself. In the absence of such regulation the FSA believes that the interests and aims of the firm and its managers would not necessarily be aligned, partly because the sanctions which individual firms could levy on their managers in circumstances of regulatory failure would be limited. Accordingly the FSA has issued the Statements of Principle and Code of Practice for Approved Persons which are designed to achieve this alignment of interests and aims.

The Statements of Principle are as follows.

Table 2.2: Statements of Principle for Approved Persons

Statement of Principle 1	An approved person must act with integrity in carrying out his controlled function.
Statement of Principle 2	An approved person must act with due skill, care and diligence in carrying out his controlled function.
Statement of Principle 3	An approved person must observe proper standards of market conduct in carrying out his controlled function.

² High-level standards for firms and individuals: Issues arising out of CP 35 and CP 26.

Table 2.2: continued

Statement of Principle 4	An approved person must deal with the FSA and with other regulators in an open and cooperative way and must disclose appropriately any information of which the FSA would reasonably expect notice.
Statement of Principle 5	An approved person performing a significant influence function must 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.
Statement of Principle 6	An approved person performing a significant influence function must exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his controlled function.
Statement of Principle 7	An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function complies with the relevant requirements and standards of the regulatory system.

The provisions of the Code in respect of each of the Statements of Principle are summarised below. In drawing up the Code the FSA has opted (with one or two exceptions) to set out descriptions of conduct which, in its opinion, do not comply with the relevant Statements of Principle. The Code has the status of an evidential provision (*see* Section 149 FSMA 2000). Non-compliance with the Code in respect of a particular Statement of Principle will therefore “tend to establish” non-compliance with the Statement of Principle concerned. However, not all provisions of the Code have evidential status; some are in the form of “guidance” (*see* Section 157 FSMA 2000), which is neither binding nor has evidential effect but indicates what the FSA regards as desirable, and some serve merely as background information. All provisions mentioned below are evidential unless specifically identified as guidance or background information.

2.3.1.1 Statement of Principle 1 – Integrity

In the FSA’s opinion, conduct of the following kinds does not comply with Statement of Principle 1:

- (a) deliberately misleading (or attempting to mislead) by act or omission a client, the approved person's firm (or its auditors or appointed actuary) or the FSA. Examples of deliberately misleading behaviour include falsifying documents; providing false or inaccurate information (including details of training, qualifications, past employment record or experience) to the firm or its auditors or to the FSA and destroying or causing the destruction of documents or tapes or their contents;
- (b) deliberately recommending an investment to a customer, or carrying out a discretionary transaction for a customer, where the approved person knows that he is unable to justify its suitability for that customer;
- (c) deliberately failing to inform, without reasonable cause, a customer, the approved person's firm (or its auditors) or the FSA of the fact that their understanding of a material issue is incorrect, despite being aware of their misunderstanding;
- (d) deliberately preparing inaccurate or inappropriate records or returns in connection with a controlled function;
- (e) deliberately misusing the assets or confidential information of a client or of the approved person's firm;
- (f) deliberately designing transactions so as to disguise breaches of regulatory requirements and standards;
- (g) deliberately failing to disclose the existence of a conflict of interest in connection with dealings with the client.

2.3.1.2 Statement of Principle 2 – Due skill, care and diligence

In the FSA's opinion, conduct of the following kinds does not comply with Statement of Principle 2:

- (a) failing to inform a customer (being, in the Lloyd's context, a member or policyholder) or the approved person's firm (or its auditors) of material information in circumstances where the approved person was aware, or ought to have been aware, of such information, and of the fact that he should provide it;
- (b) recommending an investment to a customer or carrying out a discretionary transaction for a customer where the approved person does not have reasonable grounds to believe that it is suitable for that customer;
- (c) undertaking, recommending or providing advice on transactions without a reasonable understanding of the risk exposure of the transaction to a customer;
- (d) undertaking transactions without a reasonable understanding of the risk exposure of the transaction to the firm;

- (e) failing without good reason to disclose the existence of a conflict of interest in connection with dealings with a client;
- (f) failing to provide adequate control over a client's assets;
- (g) continuing to undertake a controlled function despite having failed to meet the standards of knowledge and skill set out in the Training and Competence Sourcebook for that controlled function.

2.3.1.3 Statement of Principle 3 – Proper standards of market conduct

The FSA has issued guidance in respect of Statement of Principle 3 to the effect that it expects all approved persons to observe proper standards when participating in organised and over-the-counter markets. The Code of Practice as it relates to Statement of Principle 3 is unusual in that it contains a description of conduct – compliance with the Inter-Professional Code and the Code of Market Conduct – which in the FSA's opinion does comply with the Statement of Principle (in almost all other instances, the Code contains descriptions of behaviour which the FSA regards as failing to comply). As mentioned in 2.2.1.5 above, the Code of Market Conduct has no practical application to Lloyd's underwriting agents, and although it is conceivable that the FSA could introduce a code of conduct for the Lloyd's market, there are no known plans for it to do so. As with Principle 3 of the Principles for Business it is conceivable that the FSA might in certain circumstances take into account the failure of an approved person employed by an underwriting agent to comply with standards of conduct specified in the various codes which derive their authority from the Underwriting Byelaw in assessing whether that person has complied with Statement of Principle 3.

2.3.1.4 Statement of Principle 4 – Dealing with the FSA and other regulators

For the purpose of Statement of Principle 4, other regulators are those which have recognised jurisdiction in relation to regulated activities and a power to call for information from the approved person in connection with his controlled function or (in the case of an individual performing a significant influence function) in connection with the business for which he is responsible. This will include Lloyd's and may include a relevant stock exchange or an overseas regulator.

In the FSA's opinion, conduct of the following kinds does not comply with Statement of Principle 4:

- (a) failing to report promptly in accordance with the approved person's firm's internal procedures (or if none exist, direct to the FSA), information which it would be reasonable to assume would

be of material significance to the FSA, whether in response to questions or otherwise. The Code of Practice makes two points in relation to conduct of this kind. The first (by way of background information) is that there is no duty on an approved person to report such information directly to the FSA unless he is one of the approved persons responsible within the underwriting agent for reporting matters to the FSA (i.e. the person or one of the persons who performs controlled function 10, the compliance oversight function (*see* Chapter 1, 1.8.4.2)). But if an approved person takes steps to influence the decision where information is not reported to the FSA or acts in a way that is intended to obstruct the reporting of the information, then the FSA will view him, in respect of the information concerned, as being one of those within the firm who has responsibility for deciding whether to report the matter concerned. Second, there are various factors (having evidential status) which may be taken into account by the FSA in determining whether there has been a breach of Statement of Principle 4. These include:

- (i) the likely significance to the FSA of the information which it was reasonable for the individual to assume;
 - (ii) whether the information related to the individual or to his firm;
 - (iii) whether any decision not to report the matter internally was taken after reasonable enquiry and analysis of the situation;
- (b) where the approved person is solely or jointly responsible within the firm for reporting matters to the FSA (or to Lloyd's on the FSA's behalf) failing promptly to inform the FSA (or Lloyd's) of information of which he is aware and which it would be reasonable to assume would be of material significance to the FSA, whether in response to questions or otherwise. The FSA, in determining whether or not there has been compliance with Statement of Principle 4 where information has not been passed on to it, may again take into account the likely significance to the FSA of the information which it was reasonable for the person concerned to assume and whether any decision not to inform the FSA was taken after reasonable enquiry and analysis of the situation;
- (c) failing without good reason to:
- (i) inform a regulator of information of which the approved person was aware in response to questions from that regulator;
 - (ii) attend an interview or answer questions put by a regulator, despite a request or demand having been made;

- (iii) supply a regulator with appropriate documents or information when requested or required to do so and within the time limits attaching to such a request or requirement.

“Regulator” in this context would include Lloyd’s or any relevant overseas regulator, as well as the FSA.

2.3.1.5 Statement of Principle 5 – Significant influence functions: organisation

In the FSA’s opinion, conduct of the following kinds does not comply with Statement of Principle 5:

- (a) failing to take reasonable steps to apportion responsibilities for all areas of the business under the approved person’s control;
- (b) failing to take reasonable steps to apportion responsibilities clearly amongst those to whom responsibilities have been delegated. Examples include:
 - (i) implementing confusing or uncertain reporting lines;
 - (ii) implementing confusing or uncertain authorisation levels;
 - (iii) implementing confusing or uncertain job descriptions and responsibilities;
- (c) in the case of an approved person tasked with the “apportionment and oversight” function under SYSC 2.1.3 (*see* Chapter 1, 1.8.4.1), failing to take reasonable care to maintain a clear and appropriate apportionment of significant responsibilities among the firm’s directors and senior managers. This will be the case if, for example, there is a failure to review regularly the significant responsibilities concerned and a failure to act where that review shows that those significant responsibilities have not been clearly apportioned;
- (d) in the case of an individual performing a significant influence function, failing to take reasonable steps to ensure that suitable individuals are responsible for those aspects of the business under the control of that individual. Behaviour constituting a failure to take such reasonable steps includes:
 - (i) failing to review the competence, knowledge and skills and performance of staff to assess their suitability to fulfil their duties, despite evidence that their performance is unacceptable;
 - (ii) giving undue weight to financial performance when considering the suitability or continuing suitability of an individual for a particular role;
 - (iii) allowing managerial vacancies which put at risk compliance with the underwriting agent’s regulatory obligations to remain, without arranging suitable cover for the responsibilities.

The Code contains further detailed guidance³ designed, first, to assist approved persons performing significant influence functions in assessing what “reasonable steps” may be required with a view to ensuring that suitable individuals are responsible for those aspects of the business under the approved person’s control (the key point being that if the strategy of the business concerned is to enter high-risk areas, then the degree of control and strength of monitoring reasonably required within the business will be high), and secondly concerning apportionment of responsibilities, reporting lines, authorisation levels and job descriptions, suitability of individuals and temporary vacancies.

2.3.1.6 Statement of Principle 6 – Significant influence functions: management and delegation

In the FSA’s opinion, conduct of the following kinds does not comply with Statement of Principle 6:

- (a) failing to take reasonable steps to be adequately informed about the affairs of the business for which the approved person is responsible. Examples given of offending behaviour include:
 - (i) permitting transactions without sufficient understanding of the risks involved;
 - (ii) permitting expansion of the business without reasonably assessing the potential risks of such expansion;
 - (iii) inadequately monitoring highly profitable or unusual transactions or business practices;
 - (iv) accepting implausible or unsatisfactory explanations from subordinates without testing the veracity of those explanations;
 - (v) failing to obtain independent expert opinion where appropriate;
- (b) delegating the authority for dealing with an issue or a part of the business to an individual or individuals (whether in-house or to outside contractors, e.g. under an outsourcing arrangement) without reasonable grounds for believing that the delegate has the necessary capacity, competence, knowledge, seniority or skill to deal with the issue or to take authority for dealing with part of the business;
- (c) failing to take reasonable steps to maintain an appropriate level of understanding about an issue or part of the business that the approved person has delegated to an individual or individuals (whether in-house or to outside contractors). Examples here include:

³ APER 4.5.10–4.5.15.

- (i) disregarding an issue or part of the business once it has been delegated;
- (ii) failing to require adequate reporting once the resolution of an issue or management of part of the business has been delegated;
- (iii) accepting implausible or unsatisfactory explanations from delegates without testing their veracity;
- (d) failing to supervise and monitor adequately the individual or individuals (whether within the firm or outside contractors) to whom responsibility for dealing with an issue or authority for dealing with a part of the business has been delegated. Examples of this type of offending behaviour include:
 - (i) failing to take personal action where progress is unreasonably slow, or where implausible or unsatisfactory explanations are provided;
 - (ii) failing to review the performance of an outside contractor in connection with the delegated issue or business.

In determining whether or not conduct under (b), (c) and (d) above complies with Statement of Principle 6, the FSA expects the competence, knowledge and/or seniority of the individual or individuals to whom responsibility or authority has been delegated and his or their past performance and record to be taken into account.

Again, the Code contains a number of items of guidance in respect of Statement of Principle 6.⁴ This guidance recognises that an approved person performing a significant influence function will not always personally manage on a day-to-day basis the business for which he is responsible in his controlled function, and that the extent to which he does so will depend on a number of factors including the nature, scale and complexity of the business and his position within it. The guidance emphasises that the larger and more complex the business, the greater the need for clear and effective delegation and reporting lines, and that the FSA will look to the approved person to take reasonable steps to ensure that systems are in place which result in issues being addressed at the appropriate level (and that when issues come to the approved person's attention, he should deal with them in an appropriate way).

The Code also contains additional guidance with regard to Statement of Principle 6 in respect of the approved person's knowledge about the

⁴ APER 4.6.11.

business, delegation and continuing responsibilities where an issue has been delegated:

Knowledge about the business

- (a) The approved person is required to understand and inform himself about the business of the firm sufficiently to understand the risks of its trading, credit and other business activities so that he understands that part of the business for which he is responsible in his controlled function.
- (b) Before approving any expansion of the any of the firm's business into new areas the approved person must investigate and satisfy himself, on reasonable grounds, about the risks, if any, to the business relating to the expansion.
- (c) Where unusually profitable business is undertaken, or where the profits are particularly volatile or the business involves funding requirements on the firm beyond those reasonably anticipated, the approved person should require appropriate explanations to be provided by those who report to him. Where those explanations are implausible or unsatisfactory, he should take steps to test their veracity.
- (d) Where the approved person is not an expert in a particular business area, he should consider whether he or those with whom he works have the necessary expertise to provide him with an adequate explanation of the issues within that business area. If not he should seek an independent view and advice from elsewhere within or outside the firm.

Delegation

- (a) An approved person performing a significant influence function (see Table 1.1) may delegate the investigation, resolution or management of an issue or authority for dealing with a part of the business to individuals who report to him or to others. Where this occurs the approved person must have reasonable grounds for believing that the delegate has the confidence, knowledge, skill and time to deal with the issue. (For example, if the compliance department only has sufficient resources to deal with day-to-day issues, the guidance states that it would be unreasonable to delegate to it the resolution of a complex or unusual issue without ensuring it had sufficient capacity to deal with the matter adequately.)
- (b) If an issue raises questions of law or interpretation, the approved person may need to take legal advice. If appropriate legal expertise is not available in-house, consideration may need to be given to the appointment of an appropriate external adviser.

- (c) The FSA recognises that an approved person performing a significant influence function will have to exercise his own judgement in deciding how issues relating to delegation are dealt with, and that in some cases that judgement will, with the benefit of hindsight, be shown to have been wrong. An approved person will not be in breach of Statement of Principle 6 unless he fails to exercise due and reasonable consideration before delegating the matter in question. If in doubt about how to deal with an issue or the seriousness of a particular compliance problem an approved person performing a significant influence function should consider speaking to the FSA to discuss the approach proposed to be taken (although responsibility for dealing with the problem or issue cannot be delegated to the FSA).

Continuing responsibilities where an issue has been delegated

The Code emphasises that whilst the resolution of an issue or authority for dealing with part of the business can be delegated, the responsibility which an approved person performing a significant influence function has for the issue or part of the business concerned in his controlled function cannot be delegated. It is his responsibility to ensure he receives progress reports and to question them where appropriate. He may need to challenge explanations which he receives and take action himself to resolve a problem (which may include increasing the resource applied to it, reassigning the resolution internally or obtaining external advice or assistance). Where an issue raises significant concerns, he should act clearly and decisively (if appropriate, by suspending members of staff or relieving them of all or part of their responsibilities).

2.3.1.7 Statement of Principle 7 – Significant influence functions: compliance
In the FSA's opinion, the following types of conduct do not comply with Statement of Principle 7:

- (a) failing to take reasonable steps to implement (either personally or through a compliance department or other departments) adequate and appropriate systems of control to comply with the relevant requirements and standards of the FSA in respect of the regulated activities of the firm concerned. One example of behaviour within this category is the failure by an approved person who is responsible for controlled function 8 to take reasonable care to oversee the establishment by the underwriting agent of systems and controls appropriate to its business;

- (b) failing to take reasonable steps to monitor (either personally or through a compliance department or other departments) compliance with the relevant requirements and standards of the FSA in respect of the regulated activities of the firm concerned;
- (c) failing to take reasonable steps adequately to inform himself about the reason why significant breaches (whether suspected or actual) of the relevant requirements and standards of the FSA in respect of the authorised firm's regulated activities may have arisen (taking account of the systems and procedures in place) – for example by failing to investigate (through obtaining an expert opinion where appropriate) what systems or procedures may have failed;
- (d) failing to take reasonable steps to ensure that procedures and systems of control are reviewed and, if appropriate, improved following the identification of significant breaches (suspected or actual) of the relevant requirements and standards of the FSA in respect of the authorised firm's regulated activities;
- (e) in the case of a member's agent or members' adviser, failure by the firm's money laundering reporting officer to discharge the responsibilities imposed on him in accordance with Chapter 7 of the Money Laundering Sourcebook;
- (f) failure by an approved person performing the compliance oversight function (controlled function 10) to take reasonable steps to ensure that appropriate compliance systems and procedures are in place.

The Code contains guidance in respect of Statement of Principle 7 under the headings "Systems of control", "Possible breaches of regulatory requirements" and "Review and improvement of systems and procedures".⁵ The main points are as follows.

Systems of control

An approved person performing a significant influence function is required to take reasonable steps to ensure that the business for which he is responsible has operating systems and procedures which include well-defined steps for complying with the detail of relevant FSA requirements and standards and for ensuring that the business is run prudently. The nature and extent of the systems of control required will depend upon the relevant requirements and standards and the nature, scale and complexity of the business of the authorised firm.

⁵ APER 4.7.12–4.7.14.

Possible breaches of regulatory requirements

Reasonable steps should be taken to ensure that actual or suspected problems involving possible breaches of relevant FSA requirements and standards are dealt with in a timely and appropriate manner. This may involve carrying out an investigation to find out what systems or procedures may have failed and why, and it may be necessary to obtain expert opinion on the adequacy and efficacy of the systems and procedures.

Review and improvement of systems and procedures

Where independent reviews of systems and procedures have been undertaken and result in recommendations for improvement, the approved person performing a significant influence function should ensure that (unless there are good reasons not to) any reasonable recommendations are implemented in a timely manner. What is reasonable in any given circumstances will depend on the nature of the inadequacy and the cost of the improvement. It is reasonable for a cost benefit analysis to be undertaken when assessing whether the recommendations are reasonable.

2.3.2 *To whom do the Statements of Principle apply?*

Statements of Principle 1, 2, 3 and 4 apply to all approved persons. Statements of Principle 5, 6 and 7 apply only to approved persons who perform significant influence functions in the performance of such functions (*see* Table 1.1).

All of the Statements of Principle apply only to the extent that an approved person is performing a controlled function for which approval has been sought and granted. The fact that a person may be approved for one purpose does not have the effect of bringing all his functions or activities within the scope of the Statements of Principle.

2.3.3 *Consequences of breach: brief overview*

In general terms, approved persons will be liable to disciplinary sanctions if they commit a breach of the Statement of Principle. Failure to comply with a Statement of Principle does not of itself give rise to any right of action by persons affected or affect the validity of any transaction (Section 64(8) FSMA 2000).

It is important to note that an approved person will only be in breach of the Statements of Principle where he is "personally culpable". Personal

culpability will arise only where the conduct of the approved person concerned is deliberate or where the standard of such conduct is below that which would be reasonable in all the circumstances. Further details on disciplinary sanctions and personal culpability are set out in Chapter 5.

It was clearly stated in the FSA's June 2000 policy statement "High-level standards for firms and individuals: Issues arising out of CP 35 and CP 26" that, if the action of an approved person was reasonable at the time, taking account of all the circumstances, he will not be in breach of the relevant Statement of Principle. In respect of Statements of Principle 5, 6 and 7 this is reflected in the Code, which provides that in determining whether or not the conduct of an approved person performing a significant influence function complies with Statements of Principle 5 to 7, the FSA will take into account (amongst other things) (1) whether he exercised reasonable care when considering the information available to him, and (2) whether he reached a reasonable conclusion which he acted on.

In addition, guidance set out in the Code⁶ provides that the significance of conduct identified in the Code as tending to establish a breach of a Statement of Principle will be assessed only after all the circumstances of the particular case have been considered. Account will be taken of the context in which the course of conduct concerned was undertaken (including the precise circumstances of the individual case), the characteristics of the controlled function in question and the behaviour to be expected in that function.

2.4 Lloyd's Sourcebook: high-level requirements

This Section contains an overview of the high-level elements of the Lloyd's Sourcebook ("LLD") which apply in a Lloyd's context, in addition to the Principles for Business and the Statements of Principle.

LLD 1 (entitled "Society's regulatory functions") takes the form of guidance, which is intended to:

- (a) promote confidence in the market at Lloyd's by ensuring that it is appropriately and effectively regulated by the Society of Lloyd's and the Council and those to whom the Council delegates the Society's regulatory functions;

⁶ APER 3.1.3.

- (b) protect policyholders and Lloyd's members; and
- (c) enable the FSA to use its resources in an efficient and effective way when regulating underwriting agents and approved persons acting for or on behalf of those agents, by making it possible for the FSA to rely on the Society and the Council to carry out certain functions on behalf of the FSA or otherwise.

2.4.1 Delegation of functions

LLD 1.2 provides that the Society is to establish and maintain a clear, appropriate and effective delegation of responsibilities for the carrying out of its regulatory functions so that the Council can adequately monitor and control them. This delegation is required to be approved and recorded by the Council and reviewed at least once a year. The terms and limits of any such delegation must be made clear to those to whom the authority has been delegated and any committee, individual or other person to which the Society delegates authority should have formal terms of reference, make and retain proper records (including minutes of its meetings) and be composed of an appropriate number of individuals who are collectively and individually fit and proper.

The Society is also required to ensure that the FSA is able to interview or otherwise obtain information directly from the committees, individuals or other persons to whom the Society delegates responsibility for carrying out its regulatory functions (including by affording the FSA access to the records of such committees, individuals or other persons).

2.4.2 Conflicts of interest

LLD 1.3 additionally requires Lloyd's to establish and maintain appropriate and effective arrangements to ensure that the carrying out of its regulatory functions is not subject to any improper influence or appearance of improper influence. Such arrangements are required to extend to conflicts and perceived conflicts of interest that arise for employees of Lloyd's, members of the Council (who may participate in or undertake business in the Lloyd's market) and others who may be involved in carrying out Lloyd's regulatory functions. Lloyd's is required to structure itself and to delegate authority so that it can continue properly to carry out its regulatory functions despite any conflicts or perceived conflicts of interest. In addressing these issues, it has to consider (amongst other things):

- (a) the size and composition of any committees to which authority to carry out its regulatory functions has been or will be delegated; and
- (b) the necessity to transfer authority to take decisions or responsibilities to alternatives should a conflict or perceived conflict of interest arise.

In particular, on the issue of conflicts, Lloyd's is required to issue guidelines setting out how conflicts of interest are to be handled and to impose requirements to ensure that the guidelines are followed. These must include:

- (a) guidelines for determining whether a conflict of interest exists;
- (b) the need for prompt disclosure of any conflict of interest to enable others who are not affected by the conflict to decide how it should be managed;
- (c) guidelines for declaring any conflict of interest at proceedings of the Council and any committees to which the Council delegates responsibility for carrying out Lloyd's regulatory functions;
- (d) the circumstances in which a general advance disclosure of any conflicts of interest will usually be sufficient;
- (e) the circumstances in which a general advance disclosure may not be sufficient;
- (f) the circumstances in which it may be appropriate for a conflicted individual to withdraw from involvement in the matter concerned without disclosing the interest;
- (g) the circumstances in which individuals should withdraw from the decision-making process, from access to relevant information, or from proceedings of the Council or of any committees to which authority to carry out Lloyd's regulatory functions has been delegated by the Council; and
- (h) the penalty or other sanction that will apply if guidelines are not followed or requirements are not complied with.

Lloyd's is further required to establish and maintain appropriate and effective arrangements to monitor compliance with such guidelines and requirements on the part of its staff and other persons involved in carrying out its regulatory functions. It is also required to make and retain a register of interests, and make and retain records of conflicts of interest that have been disclosed and the steps taken to handle them.

2.4.3 Use of confidential information

LLD 1.4 requires Lloyd's to establish and maintain appropriate and effective arrangements to ensure that confidential regulatory information received or created by it is used only for carrying out its regulatory functions and is subject to appropriate and effective restrictions limiting disclosure and use.

2.4.4 Prudential requirements

LLD 9 applies substantially the same high-level prudential requirements to Lloyd's as are currently applied to insurance companies by the Interim Prudential Sourcebook for non-Lloyd's insurers. Much of this material will be withdrawn in line with the introduction of the proposed new chapter specifically relating to Lloyd's in PRU, consulted on in CP 04/7 "Lloyd's: integrated prudential requirements, and changes to auditing and actuarial requirements". The FSA will undertake a consultation exercise later in 2004 on the withdrawal of material from LLD, consistent with its withdrawal of the Interim Prudential Sourcebook for Insurers ("IPRU(INS)"). The remainder of this section summarises the existing high-level LLD material on prudential requirements.

Certain high-level prudential requirements relating to insurance business carried on at Lloyd's are set out at LLD 9.1. The purpose of these requirements is to:

- (a) protect policyholders against the risk that Lloyd's and its members may not have adequate financial resources to meet claims as they fall due;
- (b) promote confidence in the Lloyd's market by requiring Lloyd's, and through Lloyd's its members, to maintain resources which are adequate to meet their liabilities;
- (c) promote confidence in the Lloyd's market and enhance public awareness by improving the transparency of financial reporting by Lloyd's; and
- (d) protect the interests of consumers of insurance business at Lloyd's.

The rules in respect of general prudential requirements for the Society of Lloyd's are as follows:

- (a) it must manage its affairs, including the exercise of its byelaw-making powers, with due regard to the interests of policyholders and potential policyholders;

- (b) it must ensure that its affairs are soundly and prudently managed and take reasonable steps to ensure that the Lloyd's market is soundly and prudently managed;
- (c) it must adopt the standards of due care and diligence set out in the custody rules in Chapter 2 of the Client Assets Sourcebook ("CASS") in relation to the custody of assets that constitute members' funds;
- (d) it may not permit any syndicate to carry on both long-term insurance business and general insurance business;
- (e) it must, having regard to the availability and value of its central funds, ensure that its assets and its members' assets are adequate to meet the liabilities which its members assume in their insurance business at Lloyd's; and
- (f) it must:
 - (i) ensure that its admissible assets:
 - that are investments are diversified and adequately spread; and
 - taking into account the risks imposed to the Society by its activities and by the insurance business carried on by its members, are of appropriate safety, yield, maturity and marketability; and
 - (ii) take reasonable steps to ensure that the admissible assets of members:
 - which are investments are diversified and adequately spread; and
 - taking into account the type of insurance business carried on by those members, are of appropriate safety, yield, maturity and marketability.

The provisions of the Lloyd's Sourcebook which contain general guidance on financial resources and rules and guidance concerning accounting principles and records are dealt with in Chapter 6.

2.5 Conduct of Business Sourcebook (COBs)

The final part of this Chapter provides a brief overview of the extent to which the conduct of business rules in COBs apply to activities carried on by Lloyd's underwriting agents, members' advisers and the Society of Lloyd's itself.

The COBs provisions are a harmonisation of the rules of the old self-regulatory organisations ("SROs") made under the Financial Services Act

1986 regime. The primary purpose of COBs is to set business standards for various aspects of the relationships which authorised persons have with their customers. In applying certain parts of COBs to Lloyd's, and to underwriting agents and members' advisers, the intention is to provide protection for Lloyd's members in respect of the advisory and asset custody services they receive. With one or two exceptions in the areas of financial promotion and product disclosure/cancellation and withdrawal, the provisions of COBs do not apply to the conduct of insurance business at Lloyd's.

2.5.1 COBs: Summary of contents

Set out below is a broad summary of the contents of COBs:

- (a) COB 1: Application and general provisions.
- (b) COB 2: Rules which apply to all firms conducting designated investment business (which expression, in the Lloyd's context, includes advising on syndicate participation and managing the underwriting capacity of a Lloyd's syndicate).
- (c) COB 3: Financial promotion.
- (d) COB 4: Accepting customers (covering client classification – *see* 2.2.3 above – and terms of business and client agreements).
- (e) COB 5: Advising and selling (including “know your customer” and suitability requirements and requirements concerning customers' understanding of risk, disclosure of charges and excessive charging).
- (f) COB 6: Product disclosure and the customer's right to cancel or withdraw.
- (g) COB 7: Dealing and managing (which includes provisions concerning conflicts of interest).
- (h) COB 8: Reporting to customers.
- (i) COB 9: Client assets (the COB 9 provisions were moved to CASS with effect from 1 January 2004).
- (j) COB 10: Operators of collective investment schemes.
- (k) COB 11: Trustee and depository activities.
- (l) COB 12: Lloyd's.

2.5.2 COBs: Application in the Lloyd's context

Chapter 12 (Lloyd's) of COBs deals specifically with the application of various COBs provisions in the Lloyd's context. This is done by reference to types of business activity, namely:

- (a) advising on syndicate participation at Lloyd's;
- (b) acting as a managing agent;
- (c) managing members' Funds at Lloyd's; and
- (d) communicating or approving financial promotions (the "Lloyd's Financial Promotion Activity") in relation to:
 - (i) syndicate capacity;
 - (ii) syndicate membership;
 - (iii) effecting or carrying out contracts of insurance written at Lloyd's;
 - (iv) advising on syndicate participation at Lloyd's; or
 - (v) the management of members' Funds at Lloyd's; together, the "COBs Lloyd's Activities".

COBs applies in full as far as members' agents, members' advisers and Lloyd's itself are concerned, except to the extent specifically disapplied. COB 12 contains tables to help Lloyd's businesses locate those COBs rules which are particularly relevant to their activities, but these are qualified by the statement that:

"Firms should be aware that these tables may not include all rules which apply to an individual firm as these will vary depending upon the firm's particular circumstances and that there may be other COB rules that apply."⁷

As far as members' and managing agents are concerned, Lloyd's own regulatory requirements remain applicable to them even if these requirements cover similar matters to the applicable COBs provisions.

2.5.3 Members' agents, members' advisers and Lloyd's

For members' agents, members' advisers and Lloyd's itself, COBs is applied in full except to the extent that provisions are specifically disapplied in COB 12.1.14 in respect of the COBs Lloyd's Activities of advising on syndicate participation and managing members' Funds at Lloyd's.

The disapplied provisions can be summarised as follows:

- (a) the customer terms of business contents requirements set out in COB 4.2.15 (general requirements) and COB 4.2.16 (managing investments on a discretionary basis), as referred to in COB 4.2.11;

⁷ COBs 12.1.16.

- (b) the rule in COB 4.2.12 allowing customer terms of business to be contained in more than one document;
- (c) COB 6 (Product disclosure and the customer's right to cancel or withdraw);
- (d) the provisions of COB 8.2 (Periodic statements) in respect of the COBs Lloyd's Activity of advising on syndicate participations (i.e. these provisions do apply in respect of the activity of managing members' Funds at Lloyd's);
- (e) COB 11 (Trustee and depository activities).

Apart from the specifically disapplied provisions listed above, the rest of COBs potentially applies to members' agents, members' advisers and Lloyd's itself. It is clear, however, that certain provisions in practice do not apply in respect of the COBs Lloyd's Activities, for example those concerning Polarisation and Status Disclosure (COB 5.1) and Clearing Firms (COB 5.8). Rules of particular relevance to the COBs Lloyd's Activity of advising on syndicate participation at Lloyd's are set out in COB 12.1.18. These are:

- (a) the provisions of COB 4.2 concerning Terms of business and customer agreements (except those disapplied by COB 12.1.14 as mentioned above);
- (b) COB 5 (Advising and selling); and
- (c) COB 7.1 (Conflict of interest and material interest).

COB 12.1.19 specifies rules of particular relevance to the carrying on of the COBs Lloyd's Activity of managing members' Funds at Lloyd's, being:

- (a) the provisions of COB 4.2 concerning Terms of business and customer agreements (except those which are disapplied by COB 12.1.14 in the context of the COBs Lloyd's Activity of advising on syndicate participation at Lloyd's);
- (b) COB 7 (Dealing and managing);
- (c) COB 8.1 (Confirmation of transactions); and
- (d) COB 8.2.1–8.2.6 and 8.2.9 (Periodic statements).

It should be noted that COBs 12.1.11 requires a members' agent or members' adviser, when advising a potential member of Lloyd's who is a private customer to become a member of a syndicate, to take reasonable steps to ensure that Lloyd's membership is suitable for that customer (having regard to the facts disclosed by him and other relevant facts about the customer of which the members' adviser is or reasonably should be aware).

2.5.4 Managing agents

The position concerning the application of COBs to managing agents is much clearer than it is for members' agents because for managing agents the opposite approach is taken: COBs does not apply to them (to the extent that they carry on the activity of managing the capacity of a Lloyd's syndicate) except as follows:

- (a) COB 1: Application and general provisions.
- (b) COB 2: Rules which apply to all firms conducting designated investment business.
- (c) COB 4.1: Client classification.
- (d) COB 6.7: Cancellation and withdrawal (in practice applicable only to agents which manage life syndicates).
- (e) COB 6.8: Insurance contracts – life and general (provision of information and record-keeping requirements).

In addition the rules and guidance concerning financial promotion contained in COB 3 apply to managing agents (as they do to members' agents, members' advisers and Lloyd's itself) when carrying on the Lloyd's Financial Promotion Activity (as defined in 2.5.2 above). Guidance in COB 12.1.8 points out that syndicate business plans may be used in ways that bring them within the definition of a financial promotion and that in such cases the financial promotion rules will apply – in particular COB 3.6 (Confirmation of compliance and approval), COB 3.7 (Records) and COB 3.8 (Form and content of financial promotions).

