

FSA's New Training and Competence Regime to Take Effect on 1 November 2007

1 November 2007 marks the beginning of the FSA's new training and competence regime. Fund managers and advisers are thus faced with the challenge of responding to the changes implemented by the new regime.

What is the new training and competence regime?

FSA's new training and competence regime consists of two elements:

1) a "competent employees rule", which requires firms to employ personnel with skills, knowledge and expertise necessary to fulfill their professional responsibilities. Although this is a requirement of the Markets in Financial Instruments Directive (MiFID) and thus could have been confined to MiFID business only, the FSA has decided to apply the requirement to all firms in respect of all types of business, and to amend the Senior Management, Systems and Controls sourcebook ("SYSC") accordingly; and

2) a new Training and Competence sourcebook ("TC") that is shorter and, in the words of the FSA, more "outcome-focused" and "user friendly" than its predecessor.

What are the differences from the previous regime?

The main difference is that firms with no retail clients will not be subject to TC regulations. Instead, they will need only to satisfy the competent employees rule contained in SYSC.

Firms with retail clients will be subject to both SYSC and TC. However, those requirements taken together are not greatly different from the training and competence regime that preceded them. In particular, the existing appropriate examination requirements for those employees conducting various types of activity with private customers will remain, along with the "safe harbour" provided by selecting an appropriate examination from the list of examinations maintained by the Financial Services Skills Council ("FSSC").

What do fund managers and advisers need to do in order to comply?

Those firms whose only clients are the funds themselves will be subject to the competent employees rule only. It will be up to the senior management of the firm to decide how that rule should be satisfied. In keeping with its new focus on more principles-based regulation, FSA has deliberately given firms the flexibility to design policies and procedures that suit their business models, rather than seeking to impose a particular method of compliance.

Such firms will therefore need to have in place a process that results in the employment of suitably experienced and knowledgeable persons. No requirement exists for these persons to have passed any examination, provided that the firm concerned can demonstrate to the FSA, if required, that by employing such a person the firm meets the required SYSC standard. Therefore, firms should have appropriately documented procedures in place to justify the course that they have followed, both in relation to the initial employment and to the steps taken to ensure that the employee attains and retains the necessary standards.

For the less adventurous firms in this category, the FSA has indicated that firms may wish to take TC into account (even though it does not strictly apply to them) in complying with the training and competence requirements in SYSC; and that the FSA, in assessing compliance with the knowledge component of the competent employee rule, will "take into

account” any requirement a firm has for its employees to pass a relevant examination on the FSSC list. In practice, that would seem to indicate that fund managers and advisers without retail clients will have a “safe harbour” in respect of compliance with this component if they require such examinations to be passed.

In the future, firms may also wish to take advantage of the further “quasi safe harbour” that the FSSC is planning to provide. The FSSC intends to develop Industry Guidance on training and competence good practice, to seek FSA confirmation of that guidance, and to put in place a process whereby the FSSC will endorse a firm’s training and competence arrangements if the firm meets the standards contained in the guidance. The FSA has indicated that such endorsement would provide it with “added confidence” that firms have in fact put the endorsed guidance into practice. The FSSC plans a pilot scheme before the end of 2007, suggesting that the endorsement process may be implemented in the course of 2008.

Fund managers and advisers who have retail clients will be subject to both the competent employees rule and TC. The FSA regards TC as supplementing the competent employees rule for retail activities. Since the contents of TC are essentially the same as their counterparts in the old TC2, such firms will need to make little if any change to their current arrangements. They may, however, find it useful to satisfy themselves (and to document this decision once made) that their actions taken in accordance with TC are sufficient to meet the requirements of the competent employees rule.

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