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Preparing an Application for Authorisation

A series of guides addressing common issues in relation to preparing an application for authorisation.

Guide 7: Governance arrangements

Background

Electronic Money Institutions ("EMI") and Payment Institutions ("PI") are required to maintain robust governance arrangements including *"a clear organisational structure with well-defined, transparent and consistent lines of responsibility"*. A firms' governance arrangements are the procedures used in the decision-making and control of the business that provide its structure, direction and accountability. The governance arrangements that firms should put in place are therefore very much focussed on the organisation of the business and the reporting of information within the business.

The application for authorisation will need to include a description of the governance arrangements which demonstrates that they are proportionate, appropriate, sound and adequate given the context of the business. The descriptions provided in the application should be reasonably detailed and consider the three lines of defence approach.

This guide should help you develop governance arrangements that are appropriate for description in your application and to be operated on an ongoing basis once authorised.

Scope of the governance arrangements

The scope of the governance arrangements, which will need to be designed considering the specific context of the business, should include:

- Decision-making procedures, especially with regard to strategic decision making
- Reporting lines between business functions and key roles (inc. the Board)
- Internal reporting and communication processes (inc. the type and frequency of information reported)
- Arrangements for regular monitoring of internal controls and procedures (e.g. the use of internal audit, the Compliance Monitoring Programme and Risk Register); and
- Measures that would be taken to address any deficiencies.

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The FCA will assess whether the firms' governance arrangements are appropriate, sound and adequate by taking account of a number of factors, such as the:

- Services being provided by the firm (i.e. the scope of the regulated services and any unregulated activities)
- Nature, scale and complexity of the business (inc. the use of outsourcing arrangements)
- Diversity of operations (e.g. geographical diversity, the use of branches, agents and distributors)
- Volume and size of transactions; and
- Degree of risk associated with each area of its operation.

The descriptions of the internal and external audit arrangements should also be within the scope of the governance arrangements described in the application.

Governance arrangements should be established throughout the business and operate across all three-lines of defence, particularly within the second and third lines of defence:

- First line of defence – operational information should be gathered and reported to the second line of defence.

- Second line of defence - typically involving the activities of senior managers, such as the Compliance Manager, who would be responsible for collating management information for provision to the third-line of defence (and any group audiences). In doing so, the second line would work with the first line to gather and prepare appropriate management information.

- Third line of defence would comprise the activities of the Board and any Internal Audit activities. The decision-making and control of the business should be exercised by the Board having considered appropriate management information.

Information will need to be reported between these three lines to facilitate a coherent enterprise-wide governance approach.

Responsibility for governance arrangements

Overall responsibility for the operation of appropriate governance arrangements would rest with the Board. From a day-to-day perspective, the CEO (or similar lead role) should take responsibility for ensuring that the governance arrangements support the provision of management information to the Board that is sufficient to enable to Board to exercise their oversight of the business.

Responsibilities should be set out in role specific job descriptions and appropriate training provided.

The application for authorisation should detail the respective responsibilities of the Board, CEO and other senior managers (at the second line of defence) in relation to the governance arrangements. These would all be roles performed by EMD or PSD Individuals – see, *Compliance Arrangements: Guide 6 - EMD PSD Individuals*.

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Monitoring governance arrangements

The Board should ensure that it regularly reviews its systems and controls, including its governance arrangements; this could be achieved through the activities of internal audit (if the function is maintained), external review / audit services or through the request of information from the second line of defense.

The Board will need to ensure that the governance arrangements appropriately reflect the firms' business model, its projected development and growth, as well as relevant risks. Monitoring activities should be included in the firms' Compliance Monitoring Programme - see, ***Compliance Arrangements: Guide 3 - Building a Compliance Monitoring Programme***.

The processes operated to ensure that governance arrangements are monitored will need to be described in the application for authorisation.

Management reporting information

Management reporting information will need to be reported to the Board (and any Board-level Committees that are maintained) on a regular basis in order to facilitate their oversight of the business. The format of the reporting information and level of detail should be specified by the Board. Standard reporting information should be provided ahead of each Board meeting and ad-hoc information requested by the Board whenever required.

Within the context of a larger group, management reporting information may also be provided to group audiences, e.g. a Group level Board and relevant committees.

Management information would typically be provided to the Board as part of a 'Board Pack', ensuring that information on certain topics is reported on a regular basis. The structure of a Board Pack could include sections covering:

- Operations
- Business development
- Financial and capital
- Regulatory compliance
- Risk management; and
- Financial crime.

The Board Pack, agenda and minutes should be retained as a matter of good practice (and evidence of the functioning governance arrangements).

What do we need to describe in an application for authorisation?

As referenced in the current FCA application form, an application for authorisation requires a description of the following areas, which are pertinent to the firms' governance arrangements:

- Different procedures to carry out periodical and permanent controls, i.e. Risk Register, Compliance Monitoring Programme, Internal Audit, etc.
- Identity and responsibilities of individuals responsible for internal control functions (these will mostly function at the second line of defence)

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- Composition of the management body and any oversight committees; and
- Description of the group governance (if applicable).

The description of the governance arrangements should focus on the operation of the Board, the responsibilities of the Board members, and the reporting of information to enable the Board's oversight of the business.

The descriptions should incorporate a three lines of defence approach and bind together the descriptions that are provided in relation to risk management, financial control, compliance arrangements, internal controls and financial crime. This content should be provided in sufficient detail to enable the FCA to assess whether the applicant firm is operating governance arrangements that are proportionate, appropriate, sound and adequate given the context of the business.

Importantly, following submission of the application, the governance arrangements described in the application should start to be operated (if not already) to assist the firm respond to the FCA's questions (that will inevitably be raised during their assessment of the application).