

# One step closer: (almost) final FCA and PRA rules for new Senior Managers' and Certification Regime published

In the run up to the deadline of 7 March 2016, the publication of the FCA and PRA's almost final rules on its new senior managers and certification regime (SM&CR) on 7 July 2015 is welcome progress for firms.

The FCA consultation is '[CP15/22 Strengthening accountability in banking: final rules \(including feedback on CP14/31 and CP15/5\) and consultation on extending the Certification Regime to wholesale market activities](#)'. The PRA, on the other hand, has issued three papers: (i) '[PS16/15 strengthening individual accountability in banking: responses to CP14/14, CP28/14 and CP7/15](#)'; (ii) '[SS28/15 strengthening individual accountability in banking](#)'; and (iii) '[Statement of policy, conditions, time limits and variations of approval](#)'.

The key points amongst these publications include:

- the proposals to amend the Certification Regime to include individuals involved in wholesale activities, such as trading, who could pose significant harm to the firm or its customers;
- the inclusion of persons involved in algorithmic trading in the FCA Certification Regime; and
- the removal of the territorial limitation for material risk takers (MRTs) in the Certification Regime and Conduct Rules which means that overseas MRTs who deal with UK clients will be subject to the Certification Regime and Conduct Rules; and
- the FCA's clarification that there is no territorial limitation on senior managers.

These rules apply only to the banking industry, not the insurance industry (whose rules on governance are also being overhauled in a concurrent process). It is slightly surprising that the FCA has not used this paper to set out proposals for the extension of the SM&CR to

other firms, such as inter-dealer brokers and asset managers as suggested by the recommendations of the Fair and Effective Markets Review (FEMR) (which we covered in our Ashurst briefing [here](#)). However there are some clues (e.g. the extension of the Certification Regime to algorithmic traders) that such an extension is on the way.

This briefing summarises the main changes announced in the FCA and PRA papers as well as giving a recap on some of the key elements of the SM&CR.

## 1. SENIOR MANAGERS' REGIME (SMR)

### Senior management functions (SMFs) and Prescribed Responsibilities

As a reminder, between the PRA and FCA there are 17 specified SMFs. These must be clearly allocated amongst senior managers in a firm. Not all SMFs will be relevant in all firms.

Firms must also identify individuals who have overall responsibility for activities, functions or areas. If he/she is not otherwise identified as undertaking a SMF, they will need pre-approval for SMF18 (Other Overall Responsibility Function).

The FCA and PRA set out 30 Prescribed Responsibilities. These are responsibilities that should be assigned to individuals who hold SMFs. Senior Managers must have statements of responsibility and the firm must set out this out in a Responsibilities Map which is kept up to date. The FCA's paper sets out an example Responsibilities Map for a small credit union that will be a good indication for firms of what the FCA expects more generally.

### Sharing responsibilities

The FCA has previously said that it would not expect firms to split a Prescribed Responsibility between several Senior Managers with each having responsibility for only some or part of the Prescribed

Responsibility. Sharing of a Prescribed Responsibility is possible in limited circumstances such as job-sharing or during handover periods. The FCA has therefore said that, where more than one Senior Manager is responsible for a Prescribed Responsibility, each of those Senior Managers will be held wholly responsible for it. The FCA has admitted in this CP that there may be some circumstances where splitting a Prescribed Responsibility may be justified for example where a particular area of a firm is co-headed by two individuals. Where a Prescribed Responsibility is shared the FCA would expect to see:

- identical sections of Statements of Responsibilities for each Senior Manager;
- Senior Managers to be jointly responsible;
- if there is a difference in geographical coverage, an explanation of this clearly set out in the Statements of Responsibility; and
- an explanation of the shared Prescribed Responsibility in a firm's Responsibilities Map.

Statements of Responsibility must be limited to 300 words to describe each responsibility and signed by the Senior Manager.

There is express provision for those who provide temporary cover for up to twelve weeks (for a Senior Manager) or four weeks (for a certified person) who would not need approval or certification.

### **Territoriality**

The FCA has clarified that the SMR has no territorial limitation. Therefore firms must allocate responsibility to a Senior Manager for all activities, business areas, and management functions overseas, including from a branch overseas. This includes all transactions which take place, either in part or in full, overseas.

This aligns with the rules for incoming branches which require the branch to allocate responsibility for all transactions, including where there is remote booking into the UK branch from overseas.

Being physically located overseas does not preclude a person from performing a SMF.

### **Legal entities**

The SMR applies to legal entities individually rather than banking groups as a whole. This means firms must identify individuals who are accountable for the entity in question – regardless of whether he/she is an employee of that entity (although the FCA expects some arrangement to exist between the person/entity if he/she is neither an employee or director).

### **Consultants/outsourced roles**

Where an individual performs a SMF in relation to a firm but is not an employee or director of that firm, they will still require FCA/PRA approval to perform a SMF, most likely SMF7 Group Entity Senior Manager.

### **NEDs**

The FCA and PRA previously confirmed (in CP15/5) that 'ordinary' NEDs (referred to now as 'notified NEDs') would not need approval as a Senior Manager. NEDs who are the Chairman, Senior Independent Director, or Chair of the Audit, Remuneration, and Nomination Committees would need approval. In practice, almost all NEDs will therefore be caught.

Despite this, the PRA emphasises the principle of collective decision-making of boards and highlights its paper on board responsibilities (which we summarised in our Ashurst newsflash [here](#)).

For NEDs, the PRA does not require advance notification but must be notified when the appointment is confirmed. The PRA subtly suggests that firms may wish to discuss any plans for board appointments with the PRA in advance of securing any candidates.

The PRA has also clarified that notified NEDs must observe Conduct Rules 1-3 and Senior Management Conduct Rule 4 (described below). The PRA says that this should be a contractual requirement either written into the staff handbook or in a contract of employment or appointment (the PRA notes that most employment contracts allow amendments for regulatory requirements so this should not be too onerous).

## PROCESS OF ALLOCATION OF RESPONSIBILITIES

### 1 Identify all entities in the group that are caught

Relevant authorised person means:

- UK incorporated entity; and
- Not insurance company; and
- Is either:
  - a deposit taker; or
  - a PRA investment firm who deals as principal

### 2 Consider what activities, business areas or functions are performed by each entity and which Prescribed Responsibilities are relevant to them

- e.g. does it hold client assets?
- e.g. is it a ring-fenced body?
- e.g. does it have gross total assets of £10bn and accounts for 20% of group's gross revenue?

### 3 For each entity, identify individuals holding core SMFs (1-17)

- SMF1 Chief executive function
- SMF2 Chief finance function
- SMF3 Executive director function
- SMF4 Chief risk function
- SMF5 Head of internal audit function
- SMF6 Head of key business area function
- SMF7 Group entity senior management function
- SMF8 Credit Union SMF
- *SMF9 Chairman function*
- *SMF10 Chair of risk committee function*
- *SMF11 Chair of the Audit Committee function*
- *SMF12 Chair of the Remuneration Committee function*
- *SMF13 Chair of the Nominations Committee function*
- *SMF14 Senior Independent Director function*
- SMF16 Compliance oversight function
- SMF17 Money Laundering Reporting function

### 4 Allocate Prescribed Responsibilities to individuals holding SMFs

- (See table of Prescribed Responsibilities in annex)
- To at least one SMF
- Consider which Prescribed Responsibilities must go to an executive

### 5 Identify overall responsibilities of senior individuals for any other activity

- If not already SMF1-17, will need approval for SMF18
- SMF18 Other Overall Responsibility function

### 6 Record the allocation of responsibilities

- In individual Statements of Responsibilities and include these in the firm's Responsibilities Map

*\*italics represent roles to be held by NEDs.*

## 2. CERTIFICATION REGIME

Firms are responsible for assessing the fitness and propriety of certified staff. A number of issues have been clarified by both the FCA and PRA in relation to the Certification Regime in these papers.

### Regulatory References

The FCA is postponing its rules on regulatory references due to the recommendations of FEMR. The FCA rules require firms who are seeking to appoint a person to a certification function to request a reference from all previous employers of the candidate from the past five years. In response to a request, a regulated firm would need to disclose any facts that led them to conclude that a candidate breached a Conduct Rule, including the disciplinary action taken and the outcome. The FEMR review received several responses suggesting additions to the content of regulatory references and suggestions on how the format should work. The FCA is considering these responses and will publish their conclusion prior to the implementation of the new SM&CR in March next year.

### Benchmarks

Persons who are current CF40 approved persons (benchmark submitters) or CF50 (benchmark administrators) will fall within the Certification Regime (unless they require approval for a SMF for another reason).

### Temporary cover

The FCA confirms that the length of time a certified position can be covered by someone who is not certified is four weeks.

### Criminal record checks

The FCA does not require firms to conduct criminal record checks on certified staff - only those subject to the SMR.

### Scope of the Certification Regime

The FCA has clarified that a function performed by a NED will not be a Certification Function.

The Certification Regime applies to staff who are employed in positions where they could pose a risk of significant harm to the firm or any of its customers ("significant harm functions"). The new FCA rule in SYSC 5.2.26R sets out the list of what these functions will be and the FCA has made it clear that it does not expect firms to make any further assessments to

determine whether any other roles within a firm would constitute a significant harm function. If it is not on the list, it will not be a significant harm function.

Significant harm functions are:

- CASS oversight
- Benchmark submission and administration
- Proprietary trader
- Significant management
- Functions requiring qualifications
- Managers of certification employees
- Material risk takers (as defined under the dual regulated firms Remuneration Code)

The PRA Certification Regime applies to those who are "significant risk takers" which in essence is material risk takers as defined in the PRA remuneration rules. This means that the PRA Certification Regime is narrower than the FCA Certification Regime. However, the PRA intends to consult on an amendment to the definition of material risk taker in the Certification Regime to include any employee whose professional activities have a material impact on the firm's risk profile (taking into account quantitative and qualitative criteria used for the remuneration rules).

## 3. EXTENSION OF CERTIFICATION REGIME

A key element of this FCA paper is the proposal to extend the Certification Regime to individuals involved in wholesale market activities. The definition of significant harm functions (set out above) will capture individuals in customer facing roles that are subject to qualification requirements but not more junior wholesale staff or individuals currently approved under CF30 and who would not be subject to a qualification requirement.

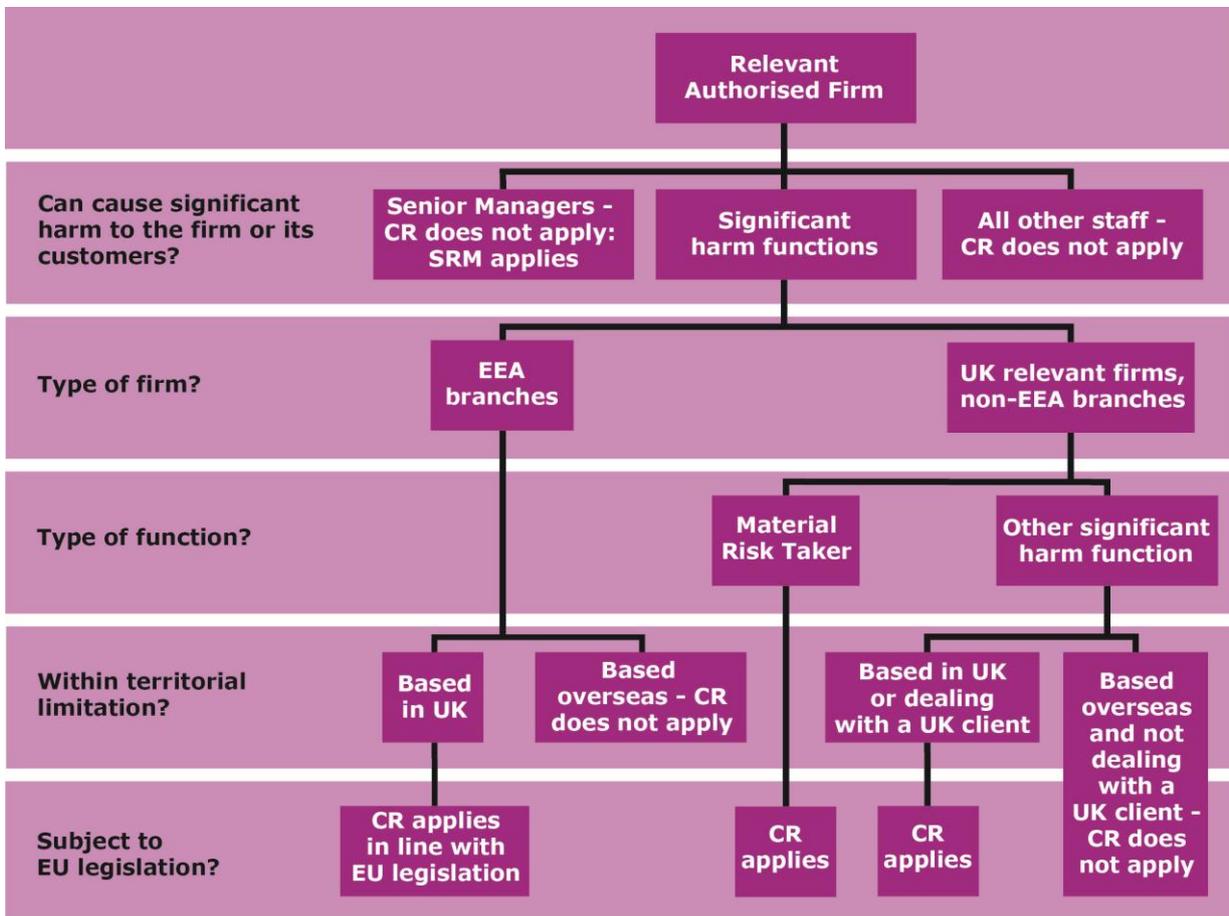
The FCA is proposing the addition of two new categories to the significant harm function definition. These are:

- Individuals dealing with clients – which will include retail clients, professional clients and eligible counterparties and broadly means having contact with these clients. This is intended to have a wider scope than the current CF30 approved persons and will cover:
  - advising on investments other than a non-investment insurance contract and performing

- other functions related to this (such as dealing and arranging);
- dealing, as principal or agent, and arranging deals in investments;
- acting in the capacity of an investment manager and functions connected with this; or
- acting as a bidder's representative.
- Algorithmic trading – which will capture individuals who are responsible for:
  - approving the deployment of a trading algo or material part of it;
  - approving the deployment of a material amendment to a trading algo or a material part of one or the combination of algos; or
  - monitoring or deciding whether or not the use or deployment of a trading algo is or remains compliant with the firm's obligations.
- Material Risk Takers (MRTs) – the FCA acknowledges that there is a potential inconsistency between the FCA's and PRA's Certification Regimes in relation to MRTs. The PRA regime only applies to MRTs, which is narrower

than the FCA's (because those who can cause significant harm to a firm is narrower than those who can cause significant harm to a firm's customers). In addition, the FCA regime is limited to those in the UK (the territorial limitation) whereas there may be MRTs overseas who will be captured by the PRA regime. Unlike the SMR, the FCA's Certification Regime will not capture overseas individuals who remote book transactions into a UK firm unless there is a UK client. The FCA is removing the territorial limitation in its Certification and Conduct Rules for MRTs. This will align the PRA and FCA regimes.

*The FCA's proposal to extend the Certification Regime to algorithmic traders will lead to a situation where those who work in banks and PRA authorised investment firms are subject to these rules but those in independent, smaller investment firms are not. This is only sensible if there will be a blanket roll out of the SM&CR to all FCA regulated firms in the future. FEMR suggested that the SM&CR should be extended to cover inter dealer brokers and asset managers so future extensions are a certainty.*



## 4. CONDUCT RULES

The FCA continues to emphasise that it believes that the wide application of the Conduct Rules will improve accountability and awareness of conduct issues throughout firms. In this paper, it has however changed its approach on the proportional application of the Conduct Rules and reporting suspected or known breaches.

Clarification has also been given that notified NEDs will not be subject to Conduct Rules (although the PRA expects adherence to some, as mentioned above).

The FCA's final rules allow firms to report suspected and actual breaches on an annual basis, rather than quarterly, in many cases. This means that actual or suspected breaches must be reported by the firm as follows:

<b>Conduct rule breaches by Senior Managers</b>	Seven business days of the firm becoming aware
<b>Conduct rule breaches by other staff</b>	Annually (to cover the annual period to 1 October to be submitted by end of October) – only suspicions that are proven or are ongoing at the time of reporting need to be included
<b>General obligation</b>	Ongoing requirement to notify the regulators of matters of which it would reasonably expect notice and specifically of a significant breach of a rule. Separate to SMR but will include significant breaches of Conduct Rules by any staff.

The PRA however is sticking with its requirement for any suspected breach of the Conduct Rules by PRA certified staff to be notified within seven days. The PRA also notes that breaches are limited to a person's conduct in relation to the activities which that person performs in their capacity as an employee or Senior Manager and therefore behaviour outside of work is in

many cases unlikely to involve a breach of the Conduct Rules.

### Conduct Rules

<b>Rule 1</b>	You must act with integrity
<b>Rule 2</b>	You must act with due skill, care and diligence
<b>Rule 3</b>	You must be open and cooperative with the FCA and PRA and other regulators
<b>Rule 4</b>	You must pay due regard to the interests of customers and treat them fairly
<b>Rule 5</b>	You must observe proper standards of market conduct
Senior manager conduct rules	
<b>SC1</b>	You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively
<b>SC2</b>	You must take reasonable steps to ensure that the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system
<b>SC3</b>	You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively
<b>SC4</b>	You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice

## 5. TRANSITIONAL PROVISIONS AND NEXT STEPS

The FCA has noted that firms must:

- by 8 February 2016 – submit a notification (plus a Statement of Responsibilities and a Responsibilities Map) for an individual who has been approved under the current Approved Persons Regime and is moving to an equivalent function (as set out in the FCA paper) under the SMR - this is only where an individual performs a SMF in the same entity that they are currently an approved person in;
- on 7 March 2016 – identify individuals who perform significant harm functions, and are therefore caught by the Certification Regime, but firms will have until 7 March 2017 to issue certificates of fitness and propriety for these people; and
- on 7 March 2017 – apply Conduct Rules.

The PRA has clarified that individuals working in a parent entity who will be performing a SMF in relation to a subsidiary but are not currently approved for the subsidiary will not be able to grandfather across. However the PRA has said that applications can be made in advance from 1 January 2016 (and such application will be treated as if they were made on 7 March 2016 but will be considered earlier).

There is general acknowledgement from both the FCA and PRA that firms will need to continue to recruit new individuals in the run up to commencement. Applications forms for individuals who will not begin performing their role until after 7 March 2016 will be available from 1 January but if a person is to begin the role before this date they will need to apply for controlled function approval. If an application is made for a controlled function before 7 March but has not been determined by 7 March it will be treated as if it has been made under the new regime for an equivalent SMF.

### Final rules still awaited

Finalised rules have not been published by the FCA on the following:

Consequential amendments to other parts of the handbook (CP14/31)	Expected Summer 2015
Feedback and near final rules for incoming branches of overseas firms	Expected Summer 2015
Guidance on the presumption of responsibility (CP15/9) and other guidance relating to enforcement matters (CP14/13)	Expected Autumn 2015
Senior management responsibility regarding whistleblowing (CP15/4)	Expected late in 2015
Regulatory references (final rules postponed due to recommendations made by the FEMR) (CP14/13)	Expected in time for the commencement of the regime in March 2016
Reporting breaches of conduct rules (CP14/13)	Unknown

### Key dates for firms

Electronic grandfathering forms available for submission	Autumn 2015
PRA SMR applications can be made in advance	1 January 2016
Submission deadline for grandfathering notifications	8 February 2016
Commencement date of SM&CR	7 March 2016
Application of Conduct Rules to staff who are not within the SM&CR	7 March 2017
First annual submission notifying breaches of the Conduct Rules (including staff who are not within the SM&CR)	End October 2017

**ANNEX: TABLE OF COMBINED LIST OF FCA AND PRA PRESCRIBED RESPONSIBILITIES**

<b>Description of prescribed senior management responsibility (as set out in SYSC, where prescribed by the FCA)</b>		<b>FCA- prescribed?</b>	<b>PRA- prescribed?</b>
<b>Applying to all firms</b>			
<b>a.</b>	Responsibility for the firm’s performance of its obligations under the senior management regime	SYSC 4.7.7R(1)	4.1(1)
<b>b.</b>	Responsibility for the firm’s performance of its obligations under the employee Certification Regime	SYSC 4.7.7R(2)	4.1(2)
<b>c.</b>	Responsibility for compliance with the requirements of the regulatory system about the management responsibilities map	SYSC 4.7.7R(3)	4.1(3)
<b>d.</b>	Overall responsibility for the firm’s policies and procedures for countering the risk that the firm might be used to further financial crime	SYSC 4.7.7R(4)	-
<b>e.</b>	Responsibility for the allocation of all prescribed responsibilities in accordance with diagram on page 3.	-	4.1(20)
<b>Applying to larger firms</b>			
<b>f.</b>	Responsibility for: (a) leading the development of; and (b) monitoring the effective implementation of; policies and procedures for the induction, training and professional development of all members of the firm’s governing body.	SYSC 4.7.7R(5)	4.1(13)
<b>g.</b>	Responsibility for monitoring the effective implementation of policies and procedures for the induction, training and professional development of all persons performing designated senior management functions on behalf of the firm other than members of the governing body.	SYSC 4.7.7R(6)	4.1(5)
<b>h.</b>	Responsibility for overseeing the adoption of the firm’s culture in the day-to-day management of the firm.	-	4.1(6)
<b>i.</b>	Responsibility for leading the development of the firm’s culture by the governing body as a whole.	-	4.1(14)
<b>j.</b>	Responsibility for: (a) safeguarding the independence of; and (b) oversight of the performance of; the internal audit function, in accordance with SYSC 6.2 (Internal Audit)	SYSC 4.7.7R(7)	4.1(15)
<b>k.</b>	Responsibility for: (a) safeguarding the independence of; and (b) oversight of the performance of; the compliance function in accordance with SYSC 6.1(Compliance).	SYSC 4.7.7R(8)	4.1(16)
<b>l.</b>	Responsibility for: (a) safeguarding the independence of; and (b) oversight of the performance of; the risk function, in accordance with SYSC 7.1.21R and SYSC 7.1.22R (Risk control).	SYSC 4.7.7R(9)	4.1(17)
<b>m.</b>	Responsibility for overseeing the development of, and implementation of, the firm’s remuneration policies and practices in accordance with SYSC 19D (Remuneration Code)	SYSC 4.7.7R(10)	4.1(18)
<b>n.</b>	Responsibility for the independence, autonomy and effectiveness of the firm’s policies and procedures on whistleblowing, including the procedures for protection of staff who raise concerns from detrimental treatment	-	4.1(19)
<b>o.</b>	Management of the allocation and maintenance of capital, funding and liquidity	-	4.1(7)
<b>p.</b>	The firm’s treasury management functions	-	4.1(8)
<b>q.</b>	The production and integrity of the firm’s financial information and its regulatory reporting in respect of its regulated activities	-	4.1(9)
<b>r.</b>	The firm’s recovery plan and resolution pack and overseeing the internal processes regarding their governance	-	4.1(10)
<b>s.</b>	Responsibility for managing the firm’s internal stress-tests and ensuring the accuracy and timeliness of information provided to the PRA and other regulatory bodies for the purposes of stress-testing;	-	4.1(11)

<b>t.</b>	Responsibility for the development and maintenance of the firm's business model by the governing body;	-	4.1(12)
<b>u.</b>	Responsibility for the firm's performance of its obligations under Fitness and Propriety in respect of its notified non-executive directors	-	4.1(4)
<b>Applying in specified circumstances</b>			
<b>v.</b>	If the firm carries out proprietary trading, responsibility for the firm's proprietary trading activities;	-	4.2(1)
<b>w.</b>	If the firm does not have an individual performing the Chief Risk function, overseeing and demonstrating that the risk management policies and procedures which the firm has adopted in accordance with SYSC 7.1.2 R to SYSC 7.1.5 R satisfy the requirements of those rules and are consistently effective in accordance with SYSC 4.1.1R.		4.2(2)
<b>x.</b>	If the firm outsources its internal audit function taking reasonable steps to ensure that every person involved in the performance of the service is independent from the persons who perform external audit, including (a) Supervision and management of the work of outsourced internal auditors and (b) Management of potential conflicts of interest between the provision of external audit and internal audit services		4.2(3)
<b>y.</b>	If the firm is a ring-fenced body, responsibility for ensuring that those aspects of the firm's affairs for which a person is responsible for managing are in compliance with the ring-fencing requirements.		4.2(4)
<b>z.</b>	Overall responsibility for the firm's compliance with CASS	SYSC 4.7.7R(11)	-
<b>Applying to small firms<sup>1</sup> only</b>			
<b>aa.</b>	Responsibility for implementing and management of the firm's risk management policies and procedures		5.2(3)
<b>bb.</b>	Responsibility for managing the systems and controls of the firm	-	5.2(4)
<b>cc.</b>	Responsibility for managing the firm's financial resources.	-	5.2(5)
<b>dd.</b>	Responsibility for ensuring the governing body is informed of its legal and regulatory obligations	-	5.2(6)

<sup>1</sup> Small firms are firms with gross total assets of £250 million or less (determined on the basis of the annual average amount calculated across a rolling period of 5 years (calculated by reference to the firm's annual accounting date)).

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