Joint response to the FCA CP15/31 and PRA CP 36/15

Strengthening accountability in banking and insurance: regulatory references

December 2015

Introduction

The British Bankers' Association (BBA) and The Association for Financial Markets in Europe (AFME) welcome the opportunity to comment on FCA and PRA's joint consultation paper on regulatory references[1].

The BBA is the leading association for banks active in the UK. It represents over 170 banking members, which are headquartered in 50 countries and have operations in 180 countries worldwide. As well as banks headquartered in the UK, BBA members include third country banks which operate in the UK either as branches or subsidiaries, or often as a combination of both. Eighty per cent of the world's global systemically important banks are members of the BBA.

The BBA is registered on the EU Transparency Register, registration number 5897733662-75.

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME advocates stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is registered on the EU Transparency Register, registration number 65110063986-76.

Both BBA and AFME members and their employees will be impacted by the FCA's proposals, so we are pleased to be able to respond jointly to the consultation paper.

Key messages

The BBA and AFME support regulatory reference reforms….

We support the FCA and PRA's objectives in requiring firms to obtain a reference in a prescribed format when they are recruiting a Senior Manager or Certified person, in order to help prevent the 'recycling' between firms of individuals with a poor conduct record.

[1] *http://www.fca.org.uk/static/documents/consultation-papers/cp15-31.pdf*

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Although these requirements are broadly reflective of the current regulatory regime firms will face significant increases in relation to their responsibilities in giving references. These might include:

- tracking and recording of disciplinary action with respect to any conduct rule breaches and other relevant information;
- tracking and recording of past references provided;
- potentially broadening the scope of regulatory investigations to include those who have left an impacted firm who might otherwise not be the focus of an investigation[2];
- providing updated references or references in relation to older conduct breaches taking place outside the six year reference period.

These are likely to present some transitional issues as our members update their systems where necessary to ensure sufficiently comprehensive records are kept and procedures are in place to facilitate compliance with the new requirements.

….but timing is a concern

The establishment of an extensive regulatory references rule-set, which we support, will create significant new systems and process implementation requirements for our members, This concern is particularly significant as we do not expect the finalised rules, which may be amended in light of industry feedback, and recently proposed legislative changes (notably the proposed removal of s. 64B (5) of FSMA), to be published until shortly before commencement.

Given these concerns, *we request that a 12 month transition period be granted* to March 2017 delaying the requirement for firms to have in place and to update the full range of regulatory references, focusing instead on only on references connected with the hiring of Senior Managers, Notified NEDs and Material Risk Takers. Although a slight delay will mean that firms would not have access to information that may help them assess whether every potential employee is fit and proper, it is necessary that they be allowed to focus on a narrower population during this time so that they might properly implement the changes necessary to support the new regulatory references rule-set.

Such a narrowed population would allow firms to focus on:

- assuring themselves that their systems, policies and procedures are fit for purpose;
- training where necessary third party vendors so that they are able to give the full range of required references;
- developing procedures to ensure a fair and consistent approach to issuing revised references (assuming this requirement remains in the final rules);
- addressing data protection issues.

[2] Whilst we believe this scope broadening is not envisaged it would be helpful to have FCA/PRA confirmation that this is not intended.

The impact of such a delay would be mitigated as the existing APER requirements that a firm should provide 'all relevant information' would remain in place for the wider population during the transition period.

It is reasonable to require updating of regulatory references …

The updating of regulatory references is an important component in ensuring that a potential employer has a full understanding of an individual's regulatory history. As the consultation paper acknowledges, there will be impediments that may make this difficult to achieve, for instance where an individual has had a period employed in a non-relevant authorised person (RAP).

So we support the provision of updated references but only in the twelve months after an individual has left a firm and where an investigation was undertaken but only definitively concluded subsequent to the end of employment. We take the view that a six year look-back will result in significant additional operational effort and will deliver little extra information.

We therefore request that the obligation to revise regulatory references be limited to only the first 12 months after an employee's departure.

Other questions arise in relation to:

- the passing on of a revised reference along a chain of employers;
- the materiality of information contained therein;
- the detail and accuracy of information relating to older breaches;
- the period of time that it is reasonably practicable for a firm to take in responding to a regulatory reference.

These could be best answered via guidelines confirming the type of information that the regulators anticipate an updated reference will include with a clear statement that the updating obligation only arises in relation to concluded breaches and resulting disciplinary action and that an employer provides any further information at their own risk. *We believe that the FICC Markets Standards Board is ideally placed to compile guidelines and recommend that it does so*.

But we have concerns about fairness…..

Employers giving references have a duty to provide information that is true, fair and accurate[3] and based on documented fact, as the FCA acknowledges. The firm compiling the reference must take reasonable care, as not doing so could mean it incurs liability in negligence, defamation or discrimination to the worker, and/or the third party to which the reference is provided, for any economic loss they suffer and injury to feelings. In extremis the referee could incur liability for libel or slander.

Where a firm, despite reasonable steps being taken, has been unable to make contact with the employee, and subsequently is of the opinion that to provide a reference in such

[3] Bartholomew v. London Borough of Hackney [1999] IRLR 460

circumstances would be contrary to the general legal requirement to provide information that is true, fair and accurate, it should not be compelled to provide a reference.

…and data protection issues

The proposed rules contemplate the giving and receiving of regulatory references across international borders, reflecting the global nature of the London's financial markets. In a case where both the giver and receiver of a reference are RAPs and required to request and give a reference, issues of data protection may arise if the reference relates to employment in a RAP's overseas office where local data protection rules act as an impediment to the provision of the information included in a reference. For instance France and Germany have data protection and employment requirements that may significantly restrict this.

This can place the reference provider in the impossible situation of having to choose between meeting FCA requirements yet contravening data protection laws. We would therefore ask the regulators to confirm that;

- impacted firms will only be expected to take reasonable steps to obtain or provide a reference;
- impacted firms are not expected to provide a reference in circumstances where, to do so, would conflict with any data privacy or employment law obligations in a jurisdiction in which an employee is or was located;
- the understand that any such reference covering a period of overseas employment may not completely satisfy the prescribed requirements that a firm would be expected to satisfy in relation to a period of employment in the UK.

In this regard, we take comfort from the pragmatic approach adopted in para 2.5 of the CP:

> *In some instances firms will be hiring from firms that are either not regulated in the UK, or from outside the regulated financial sector entirely. In these instances hiring firms should still make reasonable efforts to secure a reference as part of their assessment of the fitness and propriety of prospective candidates*

…as well as employment law issues

For employers receiving an updated reference, employment laws may not be aligned with the FCA and PRA's expectations as to the type of action the new employer should take in relation to the employee for whom an updated reference has been received. Guidance would be helpful on regulators' expectations in these circumstances.

Responses to questions

Q1: Do you agree with the proposal to require RAPs to request a reference from previous employers in the past six years for candidates of an SMF and certification functions, or notified NED, credit union NED, credit union NED roles and to require insurers to request references for candidates for a SIMF, or for becoming a key function holder?

We agree, but have the following concerns.

Unambiguous limitation of the look back requirement

We read the requirements at proposed SYSC 22.3.9 as suggesting that some events taking place more than six years before the reference request should be disclosed, at least in some instances. This creates a 'tail' which potentially allows for an open ended disclosure obligation. It is unclear in what circumstances the regulators envisage the reference extending beyond six years, and therefore this requirement is likely to be implemented inconsistently throughout the industry, creating the risk of arbitrary and unfair outcomes for individuals. We believe that this look back period should be clearly and unambiguously restricted to the period of six years before the reference request.

Alternatively it would be helpful if the FCA came up with some worked examples to shed further light on its expectations based on its own experience of reviewing Approved Persons applications. But, as we note above we firmly believe a limitation of the look back period to six years is most appropriate.

Application to contractors and secondees

Clarification is required in relation to an employer's contingent workforce who may be undertaking certification functions. They may be employed by their own limited company or seconded from a professional services firm and not subject to the disciplinary procedures of the entity to which they are providing services. As non-RAPs there would be no compulsion on such firms to provide a reference. Any reference generated by an individual's own limited company would create obvious conflict problems.

Furthermore, it is very unlikely that a RAP firm would be in a position to conclude that a breach had occurred or to take any disciplinary action. The most likely outcome would be that the arrangement under which the contingent worker was working would be wound up. Therefore, even if a RAP firm was to obtain a reference, it would nearly always be 'empty'. We would be grateful if the regulators could give further thought to the position of these individuals.

Intragroup references

We think it is disproportionate and inappropriate to require regulatory references to be obtained in a group context. A group should be able to decide for itself how it addresses matters arising from individuals changing roles within the group, including how it assesses the fitness and propriety of any individual who is selected to take on a role falling within the scope of the reference requirements. The 'rolling bad apple' concern, in our view, is intended to address movement of employees between distinct and separate industry organisations. It should be left to a firm to determine whether it is appropriate to seek a reference in relation to any intragroup employee transfers. We do not consider that this should be a mandatory requirement.

Q2: Do you agree with mandating the proposed specific disclosure requirements for RAPs and Insurers?

We agree that there should be improved disclosure between regulated firms and that the proposals helpfully provide a strong base of mandated minimum disclosure.

We would welcome further guidance on what information it is envisaged that firms should provide where an individual resigns or otherwise leaves the firm's employment whilst under investigation for a suspected but as yet unproven breach and the circumstances under which the information should be provided. Our assumption is that, in the interests of fairness to the individual, such information should not be disclosed until an internal investigation had been completed and findings discussed with the individual, to ensure fairness, before the firm is required to disclose such information in line with its obligations to provide a true, fair and accurate reference based on documented fact. However our members have not reached consensus on this issue with some suggesting that investigations, whether concluded or not, should be disclosed.

Q3: Do you agree with the proposal to require RAPs and insurers to provide a reference in a standard template (as appended in Appendix 4 of this consultation)?

We agree and support the proposal that the consistency of regulatory references should be improved via a standard template. But we are mindful of confidentiality obligations to other employees, clients and third parties as well as the need to protect proprietary information. There is a risk that disclosure could compromise these obligations.

We would welcome guidance on:

- whether A (1) of the template should more properly read as follows:

  …is performing or has at any time performed a specified senior management function or certification function.

- the extent of information required in respect of an individual's role and responsibilities as stated at point (C)(3) and (D) of the draft regulatory reference template. We believe a job title rather than an extended role description should suffice, bearing in mind that an employing firm will have conducted its own enquiries before deciding to make a job offer to a person that is the subject of a reference. The requirement to summarise previous roles/responsibilities is onerous and disproportionate. Firms would not have the supporting records during the 6 year transition period and are likely to have significant data privacy concerns with fulfilling this request.

- the type and extent of information required in setting out the facts which led a firm to conclude that an individual was in breach of any individual conduct requirements as stated at point (E) of the draft regulatory reference template. We assume the reference should include internal disciplinary outcomes and would welcome clear text in the rules specifying that this is the case in order to minimise the risk that employees challenge/sue former employers for including such information.

- whether the inclusion of information at point (H) of the reference is voluntary or mandatory. As currently drafted the suggestion is it is mandatory i.e. 'please provide…' but this is open ended and potentially undermines the consistency the rest of the reference is seeking to achieve. If an issue requires more detail regarding the context then we agree (H) can be used for this purpose, but as a mandatory

requirement it encourages the provision of potentially irrelevant or unnecessary information for the sake of completing a mandatory box on the form.

- Why the regulators consider it appropriate to require the firm giving the reference to disclose information about changes to variable remuneration including malus or clawback in the description of its response to the finding of a regulatory breach or a determination that an individual was not fit and proper. The information on disciplinary sanctions should be sufficient to meet the FCA/PRA's stated aims in this context. If however the FCA and PRA decide to retain the requirement to disclose changes to variable remuneration (which we do not support) then this should be explicitly restricted to malus and clawback as a result of a disciplinary sanction.

Q4: Do you agree with the proposal to require RAPs and insurers to, where appropriate, issue an updated reference to RAPs and insurers to whom it has sent a reference in the past six years?

Whilst agreeing with the intent of this proposal we believe that requiring the issuance of an updated reference for up to six years is too long. Instead we propose a twelve month period by which time a firm will have conducted one fitness and propriety check cycle. We take the view that a six year revision period will result in additional operational effort, representing a significant burden for firms with insufficient counter-balancing benefit.

As we note above, we believe that the receiving employing firm would have a legal obligation to notify the individual of the update and give them a reasonable opportunity to respond before being able to draw any conclusion from the update that had been received which may, or may not, lead to further action by the employer.

Such a lengthy revision period may lead to an increased risk of error as the passage of time makes facts more difficult to safely determine, which in turn increases risk of litigation. Additionally, at least in the early years the required granularity of information may not be available. It is also disproportionate as it does not allow for any rehabilitation of the individual. Additionally, we would expect that upon notifying the individual, they would in turn meet their personal obligation to notify their current employer of the matters in question (as part of the annual certification process), which would thus achieve the same objective.

We agree with the FCA that once an employee has left the firm retrospective judgements about fitness and propriety will be almost impossible to substantiate and recommend that the regulators clarify that fitness and propriety findings should only be the subject of an updated reference where they relate to concluded conduct rule breaches. But, as we note above, some of our members believe that investigations, whether concluded or not, should be disclosed.

The requirements in relation to the passing on of a revised reference along a chain of employers are unclear. According to Rule 22.2.6, B must give A details of any differences which are significant for an assessment by A of P's fitness and propriety as soon as reasonably practicable, regardless of whether P is still employed by A. There is no clear guidance as to what A is meant to do with that information if A is no longer P's employer, or indeed never was. We would welcome clarification although our working assumption is that

there is no requirement to pass the new information further up the chain of employers. Doing so would, in our view, create data protection and employment law issues. As the information will relate to P's conduct when working at B, rather than at A, it is not clear that it would be appropriate for A to include it in any reference that A issues – especially since A cannot verify the information B has provided.

Furthermore there are clear data protection concerns if the prospective employee decided not to accept A's job offer or where this offer was withdrawn by A. Where this is the case there should be no requirement on B to provide updated references to A.

We foresee a further increased risk of, possibly mendacious, litigation throughout the employment chain. For instance where a firm received an updated reference and subsequently discovered issues in their own firm it may try to recover damages from the original firm for providing an inaccurate reference at the time. Given this risk as much clarity as possible from the FCA and PRA would be welcome.

Q5: Do you agree with the proposal to modify prescribed responsibilities to include compliance with regulatory reference requirements?

Yes, we see this as a reasonable extension of the pre-existing requirements in respect of prescribed responsibilities.

Q6: Do you agree with the proposals to introduce a requirement on the retention of records, and the requirement to have adequate policies and procedures in place to comply with regulatory reference requirements?

We question the necessity of formally requiring a firm to ensure that adequate policies and procedures are in place. If firms are to provide regulatory references and to exercise due skill and care in doing so, in addition to the proposal to mandate specific disclosure requirements, firms will inherently need to take policy and procedural steps to fulfil these obligations. We would prefer that there should be no formal requirement on the retention of records – this will happen anyway - but without the further layer of governance-checking that a formal requirement would involve. If there is to be a formal requirement, we would emphasise the practical difficulty of becoming compliant with these requirements by 7th March 2016, given that the final rules are not expected to be published by the regulators until the end of February 2016.

Q7: Do you agree that it would be helpful to clarify in a rule that firms should not enter into arrangements that conflict with their obligations to disclose all relevant information?

We agree that it would be inappropriate for arrangements to be entered into, perhaps as an individual exits a firm, which would prevent the firm from complying with the regulatory references requirements.

Q8: Do you agree with our analysis of compliance costs for RAPs, insurers and other firms?

We disagree with the "minimal costs" that the regulators have estimated, because of the following factors:

- firms will require IT systems enhancement and additional resources (whether electronic or physical) to maintain historic and real time data at all times;

- the process of seeking and providing a reference will in all probability make the hiring process longer;

- firms also risk employment law issues if they provide a reference which an employee subsequently disputes, so will probably need to take legal advice in advance of some less straightforward references being issued;

- the regulatory reference regime will be very administratively burdensome which will result in additional costs for firms, including additional cost/resources for compliance and legal oversight and additional audit reviews;

- requiring employers to seek references within their own group companies would potentially increase costs;

- as the sourcing of references is typically obtained via a third party vendor, there is likely to be an increase in the cost of these services as a much greater population of individuals may be impacted by the regime than is currently the case;

As we assume the original CBA was carried out against the baseline of a statutory requirement to record and report all conduct rule breaches (i.e. the requirement in s. 64B (5) of FSMA) the PRA and FCA should reconsider the CBA in light of the legislative changes to the individual accountability proposed in the Bank of England Bill which propose the removal of the requirement to record and report all conduct rule breaches. If the government's proposals are ratified firms would be required to keep details of conduct rule breaches which do not result in disciplinary action solely for the purposes of providing references. This could significantly alter the CBA.

Other issues

Suspension

We have concerns about the question at (C) (2) of the template relating to suspension.

Suspension in an employment context is a neutral act that precedes a disciplinary decision; it is not a disciplinary sanction. The wording of the form should make it clear that suspension of the controlled function relates only to suspension as a result of a direct supervisory authority decision, not an internal decision taken by the firm to suspend the individual whilst its own investigations take place.

Response time

It would be helpful for the PRA / FCA to include a rule specifying how long an in-scope firm has to respond to a request for regulatory reference. We suggest a period of six to eight weeks unless it is not reasonably practicable to do so.

Definition of employee

The broad definition of "employee" proposed to be adopted for the purposes of SYSC 22 is wider than the definition adopted for the purposes of the Conduct Rules and Certification Regime. In particular, the provisions of subsection (5) of the proposed amended definition of employee (which, amongst other things, extends the cohort of "employees" to those performing a function (undefined) of the firm under an arrangement entered into by a contractor of the firm – e.g. the staff of sub-contractors) is not qualified by any requirement that the individuals caught be subject to the supervision, direction or control of the relevant RAP firm.

As we note above it appears that, as drafted, a RAP firm would have an obligation to provide a reference in respect of an individual with whom it has no contractual relationship and no right of supervision, direction or control (and, hence, no entitlement to take any disciplinary action in respect of the individual); who does not participate in any of the firm's regulated activities and who is not subject to either the certification or conduct rules regimes. In these circumstances, the current proposals requiring the RAP firm to obtain and record data regarding the individuals are unduly onerous given the very limited potential content of that data and the limited use that any such information could be to a hiring RAP firm in its assessment of fitness and propriety of an individual.

Privacy Impact Assessment

Given the potential for the regulatory reference requirements to create a risk of breaches of data protection law we suggest that it may be helpful for a full Privacy Impact Assessment to be conducted around the implementation of these rules. We would also suggest that the FCA may wish to consult the Information Commissioner's Office to seek their input into the final requirements for this process.

Responsible executives

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