Regulatory reference rules now in force under senior managers regimes

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As of 7 March 2017, many executives working in banking and insurance now come within the scope of the new regulatory rules relating to references. Although the full regime has only now come into force, this regulatory development has

already had a palpable effect on the employer-to-employee relationship in those sectors.

Background

For context, the rules form part of the senior managers regimes, introduced by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) in March 2016 in response to the global financial crisis and a desire to more closely regulate the conduct of individuals.

The senior managers regimes are known in banking as the Senior Managers and Certification Regime (SM&CR) and in insurance as the Senior Insurance Managers Regime (SIMR). They are underpinned by the recommendations of the Parliamentary Commission on Banking Standards, which consulted and reported on professional standards and culture in the UK banking sector, and by the subsequent Financial Services (Banking Reform) Act 2013.

In 2013, in the wake of the Libor and FX-rigging scandals that have featured regularly in the news, the Bank of England's 'Fair and Effective Markets Review' made further recommendations aimed at raising individuals' conduct standards, including that the FCA and PRA should consult on a compulsory form of regulatory reference.

The new rules are the culmination of this, and have among their aims the identification and prevention of the 'rolling bad apple' – the individual who moves from employer to employer to avoid their conduct history from catching up with them.

What do the new rules require?

The full rules are intended by regulators to be a key tool in enabling firms to share relevant information to support their assessment of candidates' fitness and propriety. These are those who are candidates for senior management functions,

significant harm functions, senior insurance management functions, controlled functions, key function holders and notified non-executive directors.

- The new rules contain a mandatory form of standard reference, which specifies information that must be included. In addition to identifying the individual, it must include:
- whether they performed a significant harm function or had been an approved person at the firm;
- whether they were in a specified role, such as a key function holder or notified non-executive director;
- whether any disciplinary action was taken against them that amounted to a breach of an individual conduct requirement, such as the Conduct Rules, or breaches under the Statements of Principle and Code of Practice for Approved Persons, or that is relevant to the individual's lack of fitness and propriety to perform a function. 'Disciplinary action' means the issuing of a formal written warning, suspension or dismissal of a person, or reduction or recovery ('clawback') of their remuneration;
- a factual description of the breach including dates, the basis for disciplinary action and its outcome. Firms are not obliged to include information that has not been properly verified;
- any information that may be relevant to the assessment of whether the individual is fit and proper.

The hiring firm must take reasonable steps to obtain regulatory references from past employers going back six years from the date of the reference request. There is no time limit for misconduct that is serious, and so a firm giving a reference must check whether there was any serious misconduct at any point and, if so, disclose it in the reference.

A firm also has a duty to update a regulatory reference it sent previously to an individual's employer where misconduct

comes to light after the employee's departure. It must do so for a period of six years from the date the individual left the firm where it becomes aware of matters which, if it were drafting the reference now, would cause it to write it differently.

The practical effects

Along with other features of the senior managers regimes, such as certification, these new rules are part of the shifting of responsibility for verifying individuals' fitness and propriety from the regulator to the firms.

Although implementation of the new rules was delayed for a year to March 2017, preparation for their entry into force, combined with the changes already brought about by those parts of the senior managers regime introduced a year ago, has already had an important and tangible bearing on the employment relationship for those working at affected firms.

Individuals' behaviour and conduct histories are now being scrutinised like never before. Recently detected conduct issues that may have otherwise passed unadmonished and past conduct that did, are being picked up and used to form the basis for disciplinary processes and investigations of fitness and propriety.

There has been an emphatic hardening of employers' attitudes to the pursuit of such matters and away from resolving them. In great part this must be attributed to firms wanting to ensure their regulatory compliance, but in some cases there is also a notable zeal on the part of those conducting the processes and making the decisions. It is not always the case that firms take a fair and impartial approach to investigating and disciplining individuals and, if anything, some firms are adopting a more obviously adversarial approach than before.

Furthermore, the rules are clear that a firm must not enter into an arrangement or agreement that limits its ability to

make regulatory reference disclosures. In other words, a firm is precluded from agreeing or limiting what it will say about an individual in a regulatory reference by terms agreed in a settlement agreement or a COT3. The FCA's guidance to the rules states: 'A firm should not give any undertakings to supress or omit relevant information in order to secure a negotiated release.' Any such agreement or arrangement will be void.

Where an employee's future career is at risk, not only at that firm but also within their chosen area of financial services, the stakes for the individual could not be higher.

The unsurprising consequence of this hardening in positions is that disputes between employers and employees over alleged misconduct are being fought harder and for longer. An employee who faces a disciplinary sanction that threatens to end their career has little option but to challenge it forcefully, if only to influence what lies on the firm's record when regulatory references are compiled in future.

It remains the case that employers have common law duties when providing a reference, including that a reference provided must be true, accurate and fair, and not give misleading information. Satellite litigation is bound to be created where regulatory references are not so compiled.

What does the future hold?

The senior managers regimes currently apply to deposit takers and investment firms, that is to say banks, and Solvency II firms and large non-directive insurers, that is to say insurers. For the present, this does not include insurance brokers.

However, the Government is proposing that, from 2018, the regime will be extended to the wider financial services industry, replacing the Approved Persons Regime. It is understood that this would bring approximately 60,000 more

firms within its scope, meaning that it would apply to asset managers, private equity firms, inter-dealer brokers and other types of broker. As with banks and insurers, the impact for those firms and their employees is difficult to over-estimate.

Nick Wilcox, Senior Associate

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