FINANCIAL REGULATOR
Rialtóir Airgeadais

SECOND CONSULTATION ON FIT AND PROPER TEST

February 2006

CONSULTATION PAPER CP15

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1 Background

The Financial Regulator issued a consultation paper on proposals for a common fit & proper test for directors and managers (Approved Persons) of all financial services firms in February 2005. The closing date for submissions was extended to 30 June 2005. The submissions received are available at our website, www.financialregulator.ie.

Most of the responses come from the larger firms and from representative bodies of the industry's sectors. While there were negative public responses to aspects of the consultation, the overwhelming majority of the written responses welcomed the review and the opportunity to comment on the proposals. Larger firms were in the main supportive of the proposals, while smaller firms were more concerned about resource and cost implications.

Having analysed the responses, the following are our main proposals on amending our present fitness and probity regime. This short consultation on these amended proposals will be completed by end April 2006 before the final regime is implemented in June 2006.

2 General Points about process

The fitness and probity regime primarily fulfils a gatekeeper role in ensuring that entrants to the key approved positions at board and senior management level are taken up by people of competence and integrity. Once persons have been approved by the Financial Regulator, they, along with the firms they represent are subject of course to the laws, codes and general rules of the regulatory regime. Thus, there will be no requirement for regular formal updates of the information provided in the Individual Questionnaire (IQ). However, if there is any material change at any time to the information provided to the regulator at the time of entry, such change should be provided to the Financial Regulator immediately.

In the same spirit, existing Approved Persons will not be asked to complete the new IQ.

The purpose for completion of the questionnaire is to provide information to the Financial Regulator in deciding whether a person is to be approved or not. The actual process of approval follows.

Approval or refusal depends on the information provided along with any other information gathered by the Financial Regulator. In this context, verification by the firm of the information provided would assist in speeding the regulator's decision-making process. Moreover, it assists the firm in ensuring that there are no issues arising from the material that would cause the firm to reconsider its proposal to appoint the person. In many cases, the person is well known to the firm, either as an employee or former employee or as a person of standing in the financial services community. In such cases, the firm is already in a position to verify the completed IQ to the Financial Regulator, without needing to carry out checks. Where checks are needed, areas such as references from former employers, validity of professional qualifications or membership of professional associations would seem to be the most appropriate checks.

Before any decision is made by the Financial Regulator to refuse an application, there would of course be a full due process, including a right of reply to a "minded to refuse" response. Moreover, individuals that are unhappy with the final decision have rights of recourse to other appeals mechanisms, including the Appeals Tribunal and up to and including the Courts. This gatekeeper role of the fitness and probity test is paramount to protecting the industry's reputation from the beginning.

3 Proposed Amendments

The main concerns emerging from the consultation process were:

1. Scope
2. Uniformity of the test, in particular
    a. The need for the questionnaire to be filled in by individuals already subject to such a test abroad
    b. The extent to which the fitness and probity test could be applied uniformly
    c. The length of the questionnaire already completed by applicants
3. Tax compliance
4. The degree of bureaucracy which could ensue and the length of the list of agencies that the Financial Regulator might contact
5. Length of personal history
6. Unscheduled departure

3.1 Scope

A number of respondents asked for greater clarity as to who should be in the class of Approved Persons and therefore should be subject to the fit and proper test. As a principles-based regulator, our emphasis is on vetting those who will direct the company and who will be responsible for ensuring that the company is run in compliance with relevant law. Accordingly, the intended scope of this test covers:

- The Board of Directors, including the executive members of the Board and senior managers of the larger institutions;
- In the case of small sole trader firms or unincorporated firms, those who direct the affairs of the firm (usually the owner / manager).

All of those to be covered by the test will be referred to as "Approved Persons".

It is the responsibility of the Board of Directors, in the case of companies, and owner/managers, in the case of other firms, to ensure that all those to be appointed to positions within the firm are fit and proper before appointment.

A further question arises as to what happens once a person is approved and more widely the Financial Regulator's expectations in relation to the employees of financial services firms. As a principles-based regulator we expect the Board of an incorporated financial institution to require its own members, the directors, and the employees to be in full compliance with their contract, which should include an internal code of ethical behaviour. This code should cover behaviour in relation to the conduct of tax affairs (see section 3.3). We would expect that any serious breaches would be maintained on record in the firm as a matter of course along with the record of any disciplinary action taken.

There are particular positions in a financial institution (e.g., internal auditors, compliance officers) where, by virtue of their role in ensuring that the company is being run in compliance with all its legal and regulatory obligations, it is vital that the persons occupying them are fit and proper. In the case of large incorporated firms, it is a matter for the Board, the audit committee of the Board and particularly for the non-executive Directors of the Board, to satisfy themselves that such persons are indeed fit and proper. The appointment to such posts will be further and more explicitly

addressed in a paper on corporate governance that will issue for consultation during 2006.

3.2 Uniformity of test

3.2.1 Treatment of Foreign Approved Persons

The Financial Services Industry in Ireland varies greatly in the range and area of its activities. Thus, we have small intermediary firms providing access to a range of financial services products to Irish customers, often in particular geographic areas of Ireland. On the other hand, we have indigenous financial institutions and subsidiaries of international financial institutions that provide cutting edge financial services to professional clients internationally. Legitimate concerns have been raised by the industry that, in the case of the latter, there would be a duplication of effort in respect of individuals who are already subject to regulatory scrutiny by virtue of being directors or managers in similar or related firms in other jurisdictions.

The Financial Regulator recognises that other EU/EEA regulators apply comparable standards of fitness and probity in accordance with the Directives relevant to the various sectors. While all third country fit and proper tests might not be comparable, many (the US, Canada, Australia, Switzerland) are. Accordingly, the Financial Regulator is prepared to accept as meeting our fit and proper test clearance by EU/EEA regulators. In respect of third country regulators, we are prepared to accept clearance by regulators with comparable standards. The decision in these latter cases will be made on a case-by-case basis.

3.2.2 Sectorial Differences

It was felt by some respondents that some of the questions asked in the IQ were unnecessarily intrusive, particularly those seeking bank account details. It is important to emphasise that there was no intention to be intrusive. These questions reflected the differences between various sectors in the industry. So, for example, references from banks can be useful in determining if an investment firm or intermediary who is conducting business for customers and holding client money is solvent and is able to conduct their own financial affairs.

The Financial Regulator accepts that it is unwieldy to impose a single test that is designed to capture all of the issues that arise in all sectors.

3.2.3 Length of IQ

The Individual Questionnaire has been considerably shortened. It has been customised so that parts of the form need only be filled by particular sectors or industry types (e.g. wholesale and retail).

3.3 Tax Compliance

The Financial Regulator has already stated that proven serious misbehaviour including deliberate tax evasion is taken extremely seriously. The Financial Regulator is of the view, in making decisions about proposed entrants to the industry, that their record in the tax area should be taken into account.

In the consultation the majority of respondents questioned the actual value of tax compliance certificates as the Revenue certification related solely to declared liabilities. Others pointed to the potential difficulties in obtaining certificates in some cases.

The legal requirement in the private sector to provide tax compliance certification relates to the provision of grants or procurement contracts. The certification is a snapshot in time and is essential for the above purposes. The objective in the case of regulation is to assure past and continuing appropriate conduct of tax affairs. It is therefore proposed, as emphasised in section 3.1, that a condition of acceptance as an Approved Person would be a full commitment to a code of behaviour in the conduct of tax affairs on their own behalf and on behalf of customers.

The emphasis in public policy on personal tax compliance is on voluntary disclosure to the Revenue Commissioners and, where evasion is detected, on bringing the taxpayer into compliance, the appropriate penalties having been paid. This raises the question of whether the Financial Regulator could preclude persons with publicly declared tax penalties from the financial services industry where the Revenue, as the competent tax authority, has not initiated criminal proceedings. It is not an indicator that distinguishes between more or less serious misbehaviour.

However, as intimated in the earlier consultation, conviction on indictment of a tax offence will be regarded by the Financial Regulator as an indication that a person is not proper and will bar a person from holding a position as an Approved Person.

The Financial Regulator has also made it clear that there is no tolerance for serious and systematic tax evasion. The 2005 Finance Act gives greater powers to the Revenue Commissioners to prosecute institutions or persons who aid tax evasion by others.

It is proposed therefore to amend the IQ to include a specific question in relation to tax as follows:
Have you been convicted, on indictment, of tax offences or of aiding and abetting tax evasion?

Summary convictions of a serious nature would be viewed as information needed by the Regulator in order to adjudicate on the application. Hence the question in the IQ, question no 3.3 – Have you been convicted of any offences (excluding minor offences) other than those declared above?

3.4 Degree of Bureaucracy

Many respondents were concerned with the length of the list of agencies that the Financial Regulator might contact. Many felt that this was unduly intrusive and impinged on an individual's right to privacy. Some also thought that the fact that the list was illustrative rather than exhaustive was perhaps unconstitutional. Others felt that the grant of blanket consent (to contact any or all of the agencies) was inappropriate and that consent should be obtained for approaching each individual agency or, alternatively, that the firm or individual should be made aware when an approach was being made.

It is proposed to limit the scope of the permission given to the Financial Regulator to pursue enquiries with specified bodies as listed in the revised IQ. It should be understood that it is not intended that the Financial Regulator would contact all of the organisations listed or that this would happen in all cases. It is further proposed that nominees would be contacted in advance to advise them that the Financial Regulator proposed to approach any of the organisations listed (other than in the cases of checks with the Garda or with the ODCE).

3.5 Length of History

It is proposed that, for the purposes of supplying a CV, only the details of the last 10 years of a person's history need to be supplied. However, material information falling outside that period should be disclosed.

3.6 Unscheduled Departure

The unscheduled resignation of an Approved Person may be for personal reasons. On the other hand, it may be for reasons that would be of interest to the Financial Regulator in assessing the financial strength or general standards of governance in the company. Accordingly, all approved persons should be made aware by the firm that in the event of an unscheduled departure, they may avail of the opportunity to make contact with the Financial Regulator through the completion of the form attached as Appendix 3 to the IQ.

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All submissions should be made on or before 31 March 2006