

Governance, Accounting and Auditing Policy Division  
Policy and Risk Directorate  
Central Bank of Ireland  
PO Box 559  
College Green  
Dublin 2

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### **Consultation Paper CP51 -The Fit and Proper Regime in part 3 of the Central Bank Reform Act 2010**

We welcome the opportunity to respond to Consultation Paper 51 in which the Central Bank has requested comments on its consultation on the Fit and Proper Regime in part 3 of the Central Bank Reform Act 2010 ('CP51' or 'Paper').

We agree that an appropriate corporate governance regime is absolutely essential to any well functioning market and we welcome the initiative to consolidate and formalise a fitness and probity regime across all industry sectors. However any and all regulatory initiatives must be meaningful, valuable and the benefits must outweigh the costs incurred.

At the outset to our response to this consultation paper we have set out our comments and observations. In addition we have outlined serious concerns we have regarding the broad scope of certain other important aspects of the proposals with particular reference to the proposed 'Controlled Function' role.

#### *Cost/Benefit analysis*

The introduction of significant new regulatory requirements should be preceded by a formal cost benefit analysis. We would expect that most financial services firms will already operate a pre-vetting process prior to hiring new employees and perform a regular review/ assessment to ensure the continued fitness and probity of its employees. For this reason, similar to any new cost burden imposed on what is already a struggling financial services industry it is incumbent on the Central Bank to ensure that the real and significant additional costs resulting from the implementation of the proposal will actually provide benefits which tangibly outweigh these costs. We question whether many of the proposals will do anything more than cause some international companies to re-consider the viability of doing business in Ireland while causing Irish firms to contract even further.

We are of the view that there is a real risk many firms may reduce the number of staff working in client facing roles due to:

- the direct additional costs associated with the administrative work required in obtaining, recording and maintaining the necessary declarations and due diligence information, the extent of which will depend on the Central Bank's interpretation of the scope of the controlled function, and

- the indirect costs that will arise due to the fact that individuals in controlled functions may demand additional compensation for the additional risk to themselves as a result of the new requirements. In addition individuals may be less willing to move internally within organizations and/or within the financial services sector as a whole and firms may not be able to attract talent from overseas into these roles. In fact the proposals may result in a brain drain from the financial services industry to other industries given the increased risks to individuals relative to their own reputation and their livelihoods from working in the financial services sector.

While we clearly understand the impetus for the Paper, we consider that both effort and expenditure would be better concentrated on those individuals with responsibility for the oversight of a firm.

In our view going forward in the financial services industry corporate governance issues are more likely to be experienced by those firms where there exists insufficient segregation of responsibilities and oversight functions. We strongly agree with the statement on page 8 of the Paper that the Central Bank will “adopt a proportionate and risk based approach in the use of our powers”. We also consider that it is essential that the Central Bank recognises the differences between categories of firms and would highlight the comments and observations we made in respect of CP41 as being relevant here.

Before proceeding to finalise any proposals we would welcome the publication of a formal cost benefit analysis regarding the expected costs for firms and the expected benefits for the market as a whole.

### *Scope*

As previously stated it is critical that the Fit and Proper Regime (‘Regime’) should be proportionate in its application and that the Fit and Proper standards are applied at an appropriate level within an organisation. Certain sections of the Paper anticipate that the Controlled Function is limited to those individuals operating in a senior position with oversight of the activities in question; however this is contradicted in other sections by stating that junior members of staff may be included within this designation. We consider that only those individuals with responsibility for the performance of the stated activities (i.e. Directors and/or senior managers) should be included within the meaning of a Controlled Function.

### *Fit and Proper Standards*

The Standards include statements regarding an individual’s financial position. While we appreciate it is essential that any Fit and Proper regime makes reference to a person’s financial position, we would caution that this must be handled in a balanced and measured way. The overriding concern a firm must have is whether or not a person’s ability to perform a role is adversely affected in a material way by the existence of financial difficulties.

### *Timing*

The proposed time table for the implementation of the proposed Regime is extremely challenging. The Paper states that the draft Regulations will be published prior to the 1<sup>st</sup> of September and that the new Regime will be implemented from the 1<sup>st</sup> of September. It is unclear how the Central Bank proposes that firms meet the implementation date without having sight of the final draft regulations. We request that a lead in time between publication of the final Regulations and implementation date is provided for.

### *Application to institutional business*

We would like to clarify the definition of “customer”. We understand this term to refer to “retail clients” as defined by MiFID or “consumer” as defined in the Consumer Protection Code and the Minimum Competency Requirements and therefore does not apply to Professional Clients or Eligible counterparties. This term should be defined or clarified.

Set out in:

- **Appendix 1** is a response to the specific questions raised by the Paper, and
- **Appendix 2** other additional comments and request for clarification in respect to certain aspects of the Paper.

For ease of reference we have repeated the questions asked in the Consultation Paper and answered each one in sequence.

We trust that this submission paper provides some valuable input to this consultative process and if you require further information or have any questions on the contents of this submission, please do not hesitate to contact me.

Yours sincerely,



Ger Knowles

Head of Regulation and Compliance

## Appendix I

### RESPONSE TO SPECIFIC QUESTIONS ASKED IN THE PAPER AND ADDITIONAL OBSERVATIONS AND QUESTIONS

#### Question 16(i) a. Do you consider any PCFs or CF should be removed from the list? If so, the reasons why?

We have answered this question in two parts in order to deal with pre Controlled Functions ('PCFs') and Controlled Functions ('CFs') separately.

#### ***Pre Controlled Functions ('PCFs')***

We don't consider that any PCFs should be removed from the list. We agree that the list of PCFs should comprise those individuals that exercise significant control over the activities of a regulated firm. This would include members of the Board and those individuals that report directly to the Board. On that basis we agree the proposed list of PCFs accurately captures all relevant roles.

#### ***Controlled Functions***

We would like to express our concern regarding certain aspects of the proposed designation of the Controlled Function.

##### ***1. Broad scope of Controlled Function designation***

The proposals provide for a very broad definition of the 'Controlled Function', it is imperative that further clarification is provided and that the scope of application should be limited to those individuals who have a significant influence over the relevant activities of a regulated firm.

Our specific observations regarding the definition are as follows:

- *"the giving of advice or assistance to a customer of the regulated financial service provider in the course of providing, or in relation to the provision of, the financial service"*
  - the term "assistance" is very broad and needs to be further explained. This definition should be limited to those individuals providing investment advice to customers [as defined by the MiFID Regulations]
- *"dealing in or having control over property of a customer of the regulated financial service provider to whom a financial service is provided or to be provided, whether that property is held in the name of the customer or some other person"*
  - We understand this term to mean those individuals that execute transactions or provide discretionary investment management services to a customer [as defined by the MiFID Regulations]
- *"dealing in or with property on behalf of the regulated financial service provider, or providing instructions or directions in relation to such dealing"*
  - We understand this term to include those individuals that deal on a proprietary basis on behalf of a firm

## Proportionality

Part 13 of CP51 states that the definition of Controlled Function is intended to capture those managers that *'have responsibility for ensuring proper process and information to customers'*. We agree with this approach and consider that the Controlled Function should apply to senior individuals responsible for the relevant departments within the firm, rather than applying to all customer facing staff. Customer facing staff are pre-vetted by a firm's own internal standards to ensure that the individual is competent for the role and must also meet the Central Bank MCR requirements. This statement is however contradicted by Question 16, part of which discusses the possibility of a reduced level of vetting for junior members of staff, indicating that junior members of staff should fall within the definition of a Controlled Function.

We consider that the persons responsible for the performance of the activities defined above should be subject to the Regime as a Controlled Function. It is not appropriate for junior members of staff to be subject to the proposals. This fact should be fully reflected in the draft regulations

## 2. Operations outside of the State

Our next comment relates to those individuals that may operate in a Branch of the regulated financial services firm based outside of the State. Section 8 part (b) of CP51 states that:

*"A CF remains a CF even if it is; carried on at an office or location outside of the State"*

In the case of Davy, we have a Branch based in the UK and therefore have a number of individuals that operate in 'controlled functions' as defined by the UK Financial Services Authority (FSA). This means that those individuals must meet the criteria set down by the FSA. The potential application of dual requirements will cause confusion and be difficult in practice to manage. It may be helpful to point out that last year we queried the application of the Minimum Competency Rules ('MCRs') and the UK Training and Competency Rules (i.e. UK equivalent of the MCRs) to those individuals operating in UK 'controlled functions'. The Financial Regulator confirmed that the Host State rules apply in this case. In other words the UK Training and Competency regime applies and not the Irish MCRs. We would suggest that this approach should be adopted for the fitness and probity Regime and those individuals should be subject to the Host State Rules.

On that basis this section should be amended to clarify that the term Controlled Function is limited to activities carried out from an establishment maintained by the firm **within** the State. If this is not possible taking the wording from the Act into account, then the Central Bank should formally recognise the UK FSA Approved Person regime.

**Question 16 (i) b. Do you consider any other positions or functions should be added to the lists of CFs and PCFs? If so, the reasons why?**

No we don't consider that any positions or functions should be added to the lists as the existing list captures all the relevant positions.

**Question 16 (1) Should we formally exempt specific categories of staff from the definition of a CF; or**

As referred to above, we consider that the Controlled Function should include those individuals with the ability to exert significant influence over activity of the firm.

**Question 16 (2) Should we provide non statutory guidance to firms on what we consider to be appropriate levels or types of due diligence which firms should carry out prior to appointing staff thereby allowing for firms to adopt varying levels of due diligence (for example providing reduced vetting for assistance roles with a lower risk profile, such as call centre staff)?**

Given the diverse nature of firms covered by the new Regulations, non statutory guidance is the preferred method to provide clarification. It is important to allow firms to adopt varying levels of due diligence in order to take into account the level of responsibility and risk attaching to the role.

**Section 8: Questions related to the proposed Standards of Fitness and Probity. We are seeking to obtain feedback on the proposed Fit and Proper Standards as set out in Appendix 2. Comments are invited in particular in response to the following questions:**

**(i) Do you consider that the Standards are comprehensive in setting the appropriate standards for fitness and probity of individuals working in the financial services industry in Ireland? If not, have you additional standards or considerations to add?**

We consider that the proposed Standards are comprehensive and do not have any additional standards or considerations to add.

**(ii) Do you consider that any of the Standards are superfluous? If so, the reasons why?**

We consider that some of the proposed standards may cause issues with regards to Employment Law and Data Protection requirements. We intend to seek legal advice as regards the application of same; however we would like to draw your attention to the specific standards that cause immediate concern.

At a general level we welcome the fact the overarching requirement is for the firm to consider whether or not the individual's ability to perform the role is adversely affected by the fact that one or more of the issues specified may be true. A firm must be able to rely on a self declaration by the relevant individual and it is important that there is clarity as to whether or not a person should disclose every potential issue or only those that he/she believes may have an impact on his/her ability to perform a role. It is important that the latter holds true.

### **Rule 3.2(f)**

*“Is capable of performing the relevant function on a continual basis having regard to his/her physical and mental health”*

We consider that this is a sensitive issue and is something that should be dealt with by the firm on a one to one basis with the individual where an issue arises having regard to relevant HR policies. It is not appropriate to have this appear as a question in a form.

### **Rule 4.1(b)**

*“the person has been the subject of any complaint made reasonably and in good faith, relating to activities that are regulated by the Bank or an equivalent authority in another jurisdiction. In considering whether or not the complaint adversely affects the person’s ability to carry out a relevant function, particular consideration shall be given to the outcome of that complaint if it has been concluded”*

This standard has a very broad interpretation as currently drafted. The term ‘any complaint’ could include any issue, grumble expressed by a client, when in fact a complaint is only relevant where it is justifiably made against an individual or firm. We consider that this rule should be amended to reflect this fact and also to allow a firm to take into account the materiality of a complaint and/or whether or not it has been upheld by an independent body.

### **Rule 4.1(g)**

*“the person has been the subject of any proceedings of a disciplinary or criminal nature or has been notified of any potential proceedings or of any investigation which might lead to those proceedings, under any law in any jurisdiction. In considering whether or not the complaint adversely affects the individual’s ability to carry out a relevant function, particular consideration shall be given to the outcome of such proceedings or investigation if it has been concluded;”*

We would highlight the fact that it is the outcome of the investigation that is important not the fact that an investigation has taken place. The wording should be amended to reflect this fact.

### **Rule 5(a)**

*‘the person is or has been unable to fulfil any of his or her financial obligations, whether in the State or elsewhere;’*

While we agree with the principles attaching to the ensuring an individual is financially sound, we would caution that this is a complex issue and it is important that the overarching requirement is whether or not the individual’s ability to perform the role is materially impacted by the existence financial difficulties.

**(iii) Do you consider that the Standards specified are sufficiently clear to be adopted by firms for their internal fit and proper process?**

As stated earlier we consider that non statutory guidance at a high level will be important in ensuring that the standards are applied in an appropriate way.

## Appendix II

### Additional questions and observations

We have a number of additional observations and queries that we consider should be dealt with prior to the implementation of the new Regulations.

1. Is there scope for the Central Bank to disagree with a firm's interpretation of those individuals that fall within the roles of PCFs?
2. Employment Law. As referred to above, we are likely to seek legal advice regarding the interaction of these requirements with relevant employment law.
3. It would be useful for the Central Bank to set standard turn around times on applications for pre-approved controlled functions. There is currently no reference to any proposed time frame in the draft Regulations.
4. We would suggest that provision be made for temporary holders of a pre-approval controlled role. For example in the event of unplanned sick leave.
5. The new Regime is due to be implemented by the 1<sup>st</sup> of September however CP51 states that the new Regulations will be published "by the 1<sup>st</sup> of September". There should be a lead in time between the new Regulations being published and the planned implementation date. Firms cannot be expected to implement the regulations based on a draft set of regulations where amendments may subsequently be made.
6. There is reference to the fact that the new Regime will operation in conjunction with the Central Bank's existing statutory powers in relation to fitness and probity. We consider that this will cause confusion and would expect that any final Regulations should supersede any previous requirements.