

Our Ref: CMcD/LD

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

20th of May 2011

Re: Response to Consultation Paper CP 51- The Fit and Proper Regime in Part 3 of the Central Bank Reform Act 2010 (CP51)

Dear Sir/ Madam,

Firstly, we would like to welcome the opportunity to make submissions in relation to CP51. As part of our review of CP 51, we sought input from our clients and also consulted within the Deloitte network of international firms on the requirements and guidance in other jurisdictions as regards parallel regimes in operation in those jurisdictions.

The matters set out in this response are a summary of the feedback we received.

In Part A, we will review the conceptual framework of this consultation and the underlying rationale and general principles that need to be addressed. Part B comprises our comments and questions on individual aspects of the CP51.

PART A: CONCEPTUAL FRAMEWORK

Drivers behind reform and the rationale underlying CP51

CP51, which focuses on part 3 of the Central Bank Reform Act 2010 ('the Act'), provides an insight into the requirements of the Central Bank and its intention to issue a Code on Fitness and Probity pursuant to its power under section 50 of the Act. The review of the supervision of senior personnel in financial services providers arises as a response to shortcomings in respect of such supervision in the past, which came to light in the aftermath of the financial crisis. It must be acknowledged that these failings are not solely attributable to the financial service providers but also resulted from intentional aspects as well as a lack of governance and supervision by the Government and the Financial Regulator. We appreciate at this point that in the absence of clear guidance on these issues, the Central Bank has now taken steps to engage with the sector and intends drafting a Code to provide a statutory basis on which appropriate standards and safeguards can be implemented going forward.

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The need for proportionality

Regulation is both welcome and necessary in the realm of financial service provision. However, we are mindful that in imposing restrictions and obligations on financial service providers, the Central Bank of Ireland (CBI) must ensure that a balance is struck between the need to regulate and supervise these firms for the protection of consumers and the Irish economy; and the impact of this regulation on the market and the cost and restrictive nature of regulation in terms of the firm's ability to carry on business in a viable manner. Throughout these submissions we will refer to this requirement of proportionality.

The definition of a 'Regulated Financial Service Provider'

This term is central to the application and scope of both the Central Bank Reform Act 2010 and CP51. However, there is no clear definition of what constitutes a regulated financial service provider. We request that further guidance be provided on this issue, if not a statutory definition, in order that entities can readily identify whether they come within the ambit of the proposed regime on Fitness and Probity.

The definitions of a Controlled Function and a Pre-Approval Controlled Function

What is included in a 'Controlled Function' (CF) and a 'Pre-Approval Controlled Function' (PCF)? Whilst we note that there is a list of examples of such functions in schedule 1 of the Consultation Paper, we believe that more fleshed-out definitions will be required in order to better guide the regulated firms in developing their processes and procedures to comply with the Fitness and Probity regime.

'Financial Soundness' and 'Conduct to be Honest, Ethical and Act with Integrity'

Further guidance is required on how a firm should assess a CF or PCF's credit worthiness and how it should approach the issue of whether the individual is the subject of any criminal investigation or proceedings or whether the individual has a criminal record. Would it be sufficient for a firm to impose a requirement of periodic self-declaration on the individuals performing these functions? If so, would an annual declaration be sufficient? If frequent monitoring is required, how regularly should this information be requested from the individuals concerned? Will employers be required to conduct independent investigations into these matters? If so, please provide further guidance on this also.

Queries raised by clients in relation to CFs and PCFs

- A number of obligations are imposed on firms in respect of qualifications etc of the CF or PCF but the CF and PCF may be the only person with access to the required information. To a large extent, the firm will be relying on the individual to comply with requests with information and will then attempt to verify information provided but this may not always be possible.
- The definition of a 'Controlled Function' is very broad. For example, it includes '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'. Because this is so broadly defined could a 'Controlled Function' encompass a teller in a branch assisting a customer? We

contend that this definition goes too far and further guidance is required in narrowing the scope of controlled functions that must comply with the Fitness and Probity requirements. We appreciate that internally the firm will have in place onboarding and ongoing checks in this respect but these are internally managed and controlled without the risk of a CBI breach.

- Has consideration been given to tiering in the implementation of the Code on a risk basis over a longer period?
- Can strong consideration be given to including in the Code equivalence with other similarly regulated jurisdictions for directors and non-executive directors?
- Where personnel move between offices or roles that are designated as a CF, for only a short period of time, or on a temporary basis, will there be an exception from the fit and proper regime based on a de minimus period of time where a CF role is performed (e.g. a maximum number of days per year)?
- Will there be an exemption where, in exceptional circumstances, a firm can appoint an individual to perform a CF, on a temporary basis and for a limited period of time, until a replacement individual is appointed to perform the CF concerned?

Comparison with other jurisdictions' approach

As part of our review, we feel it is important that this consultation paper be considered in conjunction with other jurisdictions to ensure that the standards applied are in line with relevant codes and practices currently in place or being developed across other related jurisdictions and EU member states, for example the 'approved persons' regime in the Financial Services and Markets Act 2000 in the UK.

We believe it is vital that the relevant bodies co-operate on an international level in the area of fitness and probity of regulated individuals in order to ensure that Ireland is not placed at a competitive disadvantage within the global financial services industry, due to overly cumbersome requirements when compared to their European or other counterparts.

Outsourcing

We would welcome suggestions and guidance on the issue of services that are outsourced by the financial services firm but are classed as a Controlled Function (CF) or a Pre-approval Controlled Function (PCF). In particular, further guidance is sought on the following points:

- Is it permissible to outsource any/all CFs and PCFs?
- What level of due diligence will be required to be carried out by the relevant firm in respect of individuals in the outsource firm?
- What level of ongoing supervision will be deemed to meet the obligations of the firm under the proposed regime?

Firms established in another jurisdiction and governed by the law of that other jurisdiction but having a branch in Ireland that provides the services within the ambit of CP51

Where a firm is established outside of Ireland and regulated by an equivalent body in that other jurisdiction but has a branch here must it comply with the Irish standards for fitness and probity in respect of those employed in its Irish branch?

Removal of an Executive/ Non-Executive Director or Employee

Under what powers does the CBI propose to exit pre-existing PCFs or CFs from regulated firms? Section 2.3(f) of CP51 refers to regulatory action in respect of both CFs and PCFs including 'suspension, removal or prohibition' of an individual. Is it proposed that the power to remove an individual will be derived from section 43 of the Central Bank Reform Act 2010; the power to issue a prohibition notice? Furthermore, this section applies to CFs only. Information on the statutory basis for the power of suspension or removal in respect of existing PCFs would be useful.

Employment Law considerations

Under the Central Bank Reform Act 2010, a suspension notice [section 27(4)] or prohibition notice [section 43(11)] does not alter the rights of any person to remuneration or benefits and provides that those rights will be determined in accordance with the relevant obligations. Further guidance is required on this issue for employers in the financial services sector.

Retrospective review and action

Another important consideration which does not appear to have been addressed fully in CP51 is the issue of whether the Fitness and Probity Code will apply retrospectively. Will the Central Bank conduct a retrospective review or take action against firms for retrospective breaches of the Fitness and Probity Code once it comes into force? If this would be an exception rather than the rule, we recommend guidance be issued on any triggers that might lead to this retrospective review.

Timelines

The Central Bank proposes to implement the requirements set out therein with immediate effect from the 1st of September 2011. Given the extensive obligations set out in the consultation paper, we would submit that a transition period should be allocated in order to allow firms to assess the impact of CP51 for them and to prepare for compliance with the new fitness and probity regime. This would avoid a situation where firms would be pursued for breaches without having had sufficient opportunity, in terms of time, funds and resources available to comply with the new requirements. The final Regulations and Standards are to be published by the 1st of September 2011, the same date specified for commencement. We request clarification on the effective date for implementation. Please also clarify whether the deadline for submission of the list of individuals performing PCFs will be set in the Regulations as the 31st of December 2011 and whether this deadline will remain the same on an annual basis for the submission of this list to the Central Bank.

PART B: DETAILED COMMENTS AND OBSERVATIONS

This part of our response takes individual provisions of CP51 and documents comments on those provisions.

Question/ Rationale	Comments
<p>Section 4.8(a) A more detailed definition of a Controlled Function is recommended.</p> <p>(Rationale: too broad/ unclear)</p>	<p>Further guidance is required as to what is a 'controlled function'. In particular, what constitutes 'giving of advice or assistance' and what the definition of the word 'property' includes?</p>
<p>Section 4.16(1) - Should non statutory guidance be provided as to what level of due diligence will be sufficient for the purposes of controlled functions?</p> <p>(Rationale: proportionality, transparency)</p>	<p>We believe this is required in line with the underlying principle of proportionality and in order that firms will have a clear understanding of the level of investigation and due diligence that is expected of them prior to appointing an individual to a CF or selecting an individual for pre-approval as a PCF by the Central Bank. Due to the severe penalties envisaged in the Central Bank Reform Act 2010, the financial service providers must be provided with sufficient information and guidance to enable them to adopt the required procedures and processes.</p>
<p>Section 4.16(2) - Should specific categories of staff be formally exempt from controlled functions?</p> <p>(Rationale: clarity for firms, transparency)</p>	<p>We request further guidance in relation to this issue. There are merits to exempting categories of staff levels, in that they will simplify the process for firms in recruiting staff and will assist in the development of different procedures and systems to be put in place internally, depending on the type of staff member being recruited. However, on the other hand, applying entire exemptions can be difficult in situations such as those envisaged in CP51 where an individual could be carrying out a CF but might not be designated as one of the prescribed categories of staff who are subject to the fitness and probity requirements. This could lead to a risk that some individuals could slip through the net thus exposing the firm to the possibility of a breach with the Central Bank's requirements, albeit inadvertently. The overriding principle is one of risk management and requirements imposed on firms must be justified and proportionate in relation to the objective of protecting consumers and the economy.</p>
<p>Section 5.17- Further guidance is required on the draft Standards of Fitness and Probity attached at Appendix 2</p>	<p>The draft Standards appended to CP51 provide guidance in Appendix 2, Section 2. These standards are quite general and more information is required, for example, on the level of</p>

<p>(Rationale: to provide sufficiently clear guidance to allow firms to implement the required standards in their processes)</p>	<p>qualifications that will be sufficient to meet the requirements of Fitness and Probity.</p>
<p>Section 5.21- The definition of probity is too broad- further guidance required.</p> <p>(Rationale: to provide sufficiently clear guidance to allow firms to implement the required standards in their processes)</p>	<p>The consultation paper itself states that ‘probity is broader than any attempted definition or list of qualities’. We recommend that this concept be narrowed and a more detailed definition of the term be provided in order to allow affected service providers to comply with their obligations.</p>
<p>Section 5.27 – Can the specific review of the fitness and probity of persons who continue in their roles in PCFs (from 1st of January 2012) in regulated financial service providers who have received State financial support be upheld and justified?</p> <p>(Rationale: discrimination, proportionality)</p>	<p>This provision appears to be prima facie discriminatory; as it will individually test all senior officials in these specific financial service providers alone. Is this not tantamount to imposing a higher standard on these individuals and a higher burden of proof in respect of their fitness and probity to hold these positions than on other individuals in equivalent positions in other institutions?</p> <p>Can this be upheld in light of constitutional concerns and the principles of natural justice?</p>
<p>Section 6.35- There is an obligation on boards of regulated firms to sign off when submitting the lists of CFs and PCFs that they are satisfied that the individuals concerned are fit and proper to perform their respective roles. Should there be some qualification/ provision in this certification that the concerned firm is relying, to some degree, on the information provided by the individual.</p> <p>(Rationale: proportionality, fairness)</p>	<p>To a large degree the individual performing the CF or PCF will be the one with access to the information which will decide on his/her fitness and probity. Although such information may be verifiable by the firm, this may not always be the case.</p>
<p>Draft Fitness and Probity Standards; Appendix 2; section 4- a number of these probity requirements relate to complaints/ charges/ disciplinary matters that may have had no fair basis.</p> <p>(Rationale: proportionality, privacy, procedural fairness)</p>	<p>In a situation where a person was the subject of a complaint which later transpired to be ill- or unfounded should these even be considered in this context? Again, the issue of proportionality must be considered in light of the risk element of this aspect of the test as this requirement appears to be in direct conflict with the rights of the individual concerned. Although consideration will be given to the outcome of any investigations etc, the question must be posed; should these be considered at all?</p> <p>The criteria set out are very broad and far-reaching. We recommend that a list of relevant questions be published as a guideline for firms in order to assist them in both the recruitment</p>

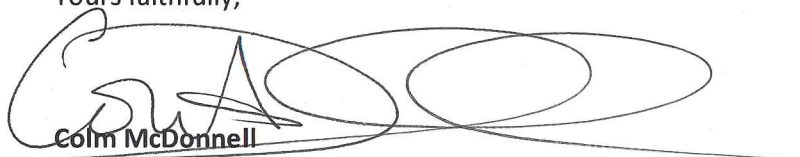
	process and in the ongoing monitoring of individuals to ensure Fitness and Probity standards are met.
<p>The obligations set out in CP51 are of an ongoing nature, therefore we welcome your comments in relation to how often checks should be done to ensure that individuals still meet the Fitness and Probity requirements.</p> <p>(Rationale: to provide clear guidance to firms in implementing the Fitness and Probity standards)</p>	<p>To achieve the goals of more stringent risk management and minimising detriment to both consumers and the Irish economy, it is important that firms are adequately informed to allow them to not only be compliant but in so being to ensure that the systems they introduce achieve the aim of sufficiently monitoring and supervising individuals performing the regulated roles. It would therefore be beneficial, we feel, if the Central Bank could issue some guidance on the monitoring obligations. There is an obligation to sign off on individuals as being fit and proper on an annual basis. Does this indicate that an annual review of key individuals is sufficient?</p>

In the aftermath of the financial crisis and in order to improve the regulatory position going forward, a fit and proper regime in Ireland is acknowledged and welcomed as a vital tool to effectively manage risk in the financial services sector. In our view, it is a matter of striking a balance between what is deemed necessary for the protection of the economy and consumers without being unduly burdensome on firms in terms of resources, costs and time. Indeed, at section 3 of CP51 the Central Bank undertakes to adopt a proportionate and risk based approach in the use of its powers.

Finally, we request some guidance as to how it is envisaged that the fitness and probity requirements will interact with other existing regulatory requirements, for example minimum competency requirements, the relevant corporate governance codes and administrative sanctions. We note in section 3 of CP51 it is stated that the new fitness and probity regime will operate in addition to existing statutory powers.

We understand that the closing date is the 20th of May 2011 and we look forward to receiving a response from the Consultation Team in due course. To this end we would welcome the opportunity to engage further with you on this matter.

Yours faithfully,



Colm McDonnell
Partner