



CONSULTATION PAPER 51

The Fit and Proper Regime in Part 3 of the Central Bank Reform Act 2010

Submission of William Fry

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The new fitness and probity regime established by the Central Bank Reform Act 2010 ("the Act") represents an important part of the new regulatory structure currently being developed by the Central Bank of Ireland in response to the financial turmoil of recent years.

We are pleased therefore to participate in the public consultation process relating to "CP51: The Fit and Proper Regime in Part 3 of the Central Bank Reform Act 2010" ("the Paper").

Our submission represents the views of the firm but also reflects feedback from clients in the financial services industry.

We have divided our submission into three sections as follows:

- 1 General Comments
- 2 Specific Comments on (a) the draft Regulations set out in Appendix 1 of the Paper and (b) the draft Fitness and Probity Standards set out in Appendix 2 of the Paper; and
- 3 Answers to the Specific Questions raised in the Paper.

1. General comments

1.1 Controlled Functions:

Based on feedback from our clients the predominant view is that the definition of controlled functions in the draft Regulations is excessively broad and will generate uncertainty as to who is caught.

Section 20(1) of the Act enables the Central Bank to make regulations prescribing functions as "controlled functions".

Section 20 (2) goes on to provide a list of criteria to be applied in prescribing functions as "controlled functions".

The draft Regulations prescribe the functions set out in Schedule 1 as controlled functions. Schedule 1 however simply repeats the criteria outlined in Section 20 (2) of the Act.

We would have thought that the Act envisaged that the Regulations issued by the Central Bank would specify particular functions as controlled functions rather than restating the criteria set out in the Act.

One of the criteria outlined in the Act and repeated in Schedule 1 of the draft Regulations is: "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 difficulty with this provision is that it is so broad it could catch junior members of staff.

In catching junior staff the Regulations would place unreasonable burdens on regulated entities and also presumably go beyond what is contemplated by the Act or by the requirements of financial regulation.

It would appear from CP51 that the objective of the Central Bank is to ensure that persons holding senior roles are caught within the definition of controlled functions¹.

In order to avoid undue burden being placed on regulated entities we would suggest that the Regulations confine "controlled functions" to pre-approval controlled functions and personnel falling within the statutory criteria who report directly to persons carrying out pre-approval controlled functions. Such an approach would catch appropriately senior personnel and lend certainty to the regime.

1.2 Timing: On the basis of feedback from clients we would have a concern as regards the timing of the transition to the new regime. Transition will require the following:

1.2.1 a due diligence review of all staff performing controlled functions;

1.2.2 the maintenance of records of the individuals who are carrying out pre-approval controlled functions and controlled functions on transition to the new regime together with the necessary due diligence undertaken;

1.2.3 the submission of a list to the Central Bank of those individuals who are carrying out pre-approval controlled functions; and

1.2.4 the signing off by firms that the individuals on the list are fit and proper.

This represents a considerable undertaking particularly for large organisations and is coming at a time when many of these organisations are transitioning to the new code of corporate governance recently promulgated by the Bank.

Considering that the draft Regulations setting out fitness and probity standards have not yet been finalised, it strikes us that it would be appropriate to consider having a longer transition period between the date the new Regulations are finalised and the date they come into effect.

See also our comments at 1.10 below.

1.3 Service Level Commitment: Several clients have expressed the view that given the more comprehensive and rigorous nature of the new regime and the exacting requirements it imposes on industry, the Bank should commit to dealing with applications within a certain time frame. In this regard it would be helpful if the Bank would confirm its willingness to

¹ See reference on page 2 (paragraph 2) and page 4 (paragraph 3(d)).

provide a commitment in relation to the process under the new regime along the lines of the commitment in the Stakeholder Protocol issued in June 2007 in respect of the old regime.

- 1.4 Secretary: The draft Regulations specify a Company Secretary as a pre-approval controlled function. While we acknowledge the appropriateness of designating the secretary as a controlled function and the fact that the secretary is specifically referred to in the Act, nevertheless we would query the inclusion of corporate secretaries.

There would be many corporate secretaries in the industry particularly in the funds sector. Frequently these companies would be formed and controlled by law firms or accountancy firms.

The Act appears to envisage that those who carry out pre-approval controlled functions are natural as opposed to legal persons. For example Section 23(2)(e) provides that a prospective appointee to a pre-approval controlled function can be compelled to attend before a specified officer or employee of the Bank for interview. Such a provision clearly contemplates a natural rather than a legal person.²

We would suggest therefore that the Bank would consider excluding corporate secretaries completely or excluding corporate secretaries all of whose directors are subject to regulation by professional bodies (for example lawyers, accountants etc.).

- 1.5 Fitness – competence and capability: There is little or no reference to in-house training in the section of the Paper dealing with Fitness. In some cases it might be permissible to enable a candidate to cure a potential deficiency in a particular area of knowledge by appropriate training at an early stage. This point is particularly pertinent if the definition of controlled function remains as provided for in the current draft Regulations.

- 1.6 Financial soundness: We acknowledge that financial soundness in an entirely appropriate subject for review in the context of fitness and probity. Some allowance should be reflected in the Regulations, however, for financial difficulties arising from the recent financial crisis, particularly the collapse in property prices. Persons who have suffered financial setbacks as a result of the general economic malaise rather than as a result of personal economic mismanagement should not be judged unduly harshly.

- 1.7 On-line Questionnaire: We welcome the provision for an online questionnaire. We have been asked by clients to enquire whether it could be published in draft form prior to finalisation. We would respectfully be of the view that the current model is comprehensive and fit for purpose and that only minor adjustments are merited to it.

² Also in the draft standards there is reference to a person's physical or mental health. Further in paragraph (e) on page 5 of the Paper it is clearly anticipated that individuals as opposed to corporate entities are to be appointed to PCFs and CFs.

- 1.8 Foreign Appointees: Presumably in assessing an application for approval to act as a PCF, the fact that the applicant was approved for appointment to a similar or substantially similar position by a regulatory authority in another jurisdiction (particularly within OECD countries) will be taken into account by the Bank.
- 1.9 Solvency II: The Solvency II Directive (Directive 2009/138/EC) is scheduled to become law in all EU Member States from 1 January 2013. Article 42 of that Directive makes provision for the fit and proper requirements that will apply to “persons who effectively run the undertaking or have other key functions”. Furthermore Article 43 deals with how a Member State authority must accept certain types of evidence as adequate proof of good repute in respect in respect of nationals of other Member States. Having regard for Articles 42 and 43 it would be important for the Central Bank to ensure that any requirements it imposes in the context of CP51 are consistent with and not in excess of the Solvency II regime.
- 1.10 Employment Law Considerations. The new regime will impose additional obligations on businesses in the financial services industry which they will have to reconcile with their legal obligations as employers, both under employment law in general and under their contractual arrangements with employees who serve or will serve in controlled functions. We are concerned that issues may arise for employers in a number of areas:
- 1.10.1 Data Protection. An employer may only retain personal data relating to employees for as long as it is necessary and relevant. It would be appropriate, for example, to remove from a personnel file a disciplinary warning which has expired. However, such a warning, even where long since expired, may be a matter to be considered in establishing a person’s probity under the proposed regime (Section 4.1(c) of the Draft Fitness and Probity Standards).
- Further, the physical and mental capability of a person to perform a controlled function must be established (Section 3.2(f) the Draft Fitness and Probity Standards) which will require employers to obtain and process sensitive medical information in a more invasive manner than may currently be contemplated as between employer and employee.
- 1.10.2 Information/Privacy/Confidentiality. The information required to be sought in order to demonstrate a person’s fitness and probity is detailed and comprehensive and, in terms of information related to a person’s prior employments, is significantly more than the information that would generally be requested or obtained by a prospective employer. Prospective employers will face difficulties obtaining the information required. For example, information may be subject to confidentiality undertakings e.g. the circumstances in which a person resigned from an employment (Section 4.1(d) of the Draft Fitness and Probity Standards). A former employer may consider that it is constrained from providing information about a

complaint made against a person relating to regulated activities (Section 4.1(b) of the Draft Fitness and Probity Standards), in order to protect the confidentiality of its own affairs. A former employer may also be concerned about the risk of defamation claims if a person were determined to be unfit on the basis of information provided by it that has any subjective element.

1.10.3 Dismissal/Suspension. It is inevitable that a person who holds an existing controlled function and fails to meet the fitness and probity standard would have to be removed from that function and dismissed by his employer. It is not a certainty that such a dismissal would constitute a fair dismissal under the Unfair Dismissals legislation or permitted grounds for termination under the person's employment contract and an employer may therefore face a claim for compensation arising from the dismissal.

The new regime also provides for the suspension of the holder of a controlled function pending investigation of his fitness and probity by the Bank. Suspension in such circumstances may not be contemplated in the contractual arrangements in place between the person and his employer and may expose the employer to a claim for breach of contract.

A longer transition period between the date the Regulations are finalised and the date they come into effect would greatly assist employers as it would allow time to identify these and similar concerns and address them where possible by implementing new policies and procedures and/or seeking to alter existing contractual arrangements to take account of them.

1.11 Garda Clearance: We note that appropriate Garda clearance may be required of applicants where deemed necessary. Could you please confirm what the appropriate Garda clearance would be and the circumstances in which this would be deemed necessary? Is the Central Bank satisfied there is a legal basis for requesting applicants to obtain Garda clearance (or equivalent clearance in the context of non-Irish applicants) and that a Garda clearance may be used in these circumstances (i.e. in connection with recruitment, employment or a contract for services)? Further, is the Central Bank comfortable that the Gardai (or equivalent policing authorities in other jurisdictions) are in a position to process appropriate clearances in a timely manner so as not to unduly delay the application process?

2. (a) Draft Regulations

Regulation 9(1) of the draft Regulations provides that a person shall be taken to perform a function where the regulated financial service provider is with respect to that function, "accustomed to act in accordance with the directions or instructions of the person in

question". Regulation 10 also provides that references to a director shall include a shadow director.

We would query these provisions. Is it anticipated that regulated entities would seek prior approval before "appointing" a shadow director or a person who "controls" a regulated financial service provider from outside that entity? Presumably having parties exercising control over "controlled functions" outside the regulated entity and not subject to the control of the regulated entity runs counter to good regulation. Accordingly, it strikes us that it might be more appropriate to deal with this in primary legislation, i.e. by providing that a controlled function will remain at all times subject to the control of the regulated entity.

In relation to draft Regulation 10 we would suggest using the Companies Act definition of director, ie any person occupying the position of director by whatever name called (i.e. a "de facto director").

2. (b) Draft Standards of Fitness and Probity

We would suggest the following:

- (i) providing a cut off point in clause 4 so that events prior to a certain date (excluding cases of fraud or dishonesty or other serious criminal convictions) would be excluded from consideration. Some cut off point may also be appropriate for 5.2(a) and (g);
- (ii) including a reference in clauses 4.1(c), 4.1(j) and 4.1(p) to due consideration being had to the outcome of any investigation;
- (iii) restricting 4.1(e) to involuntary strike offs;
- (iv) replacing the word 'and' on the second last line of clause 4.1(h) with the word "or";
- (vi) providing a carve-out in 4.1(g) for summary road traffic offences;
- (vii) deleting the reference to misrepresentation in 4.1(i) and 4.1(k) as misrepresentation can at law be innocent as well as fraudulent and the word fraud is already contained in those sub paragraphs (or alternatively adding the word "fraudulent" before "misrepresentation");
- (viii) adding the word "demonstrably" before "un-cooperative" in 4.1(m)³.
- (ix) adding "or by a court of law" after "by the Bank or other regulatory authority" in 4.1(q);
- (x) inserting the word "financial" before the word "affairs" in 5.1; and

³ With respect, the reference to being "un-co-operative with the Bank" is somewhat subjective.

- (xi) including a reference to the winding up on grounds of insolvency of an entity referred to in 5.2(g) whether in the State or elsewhere.

3. Replies to Particular Questions in CP51

- (a) Do you consider any PCFs or CFs should be removed from the list? If so, the reasons why?

See our comments at 1.1 above.

While we do not have strong views on the matter we would query whether it is necessary to include the Chairman of the Nominations Committee as "a pre-approval controlled function". This creates something of a "double-gatekeeper" role for the Bank.

- (b) Do you consider any other positions or functions should be added to the list of CFs and PCFs?

No.

- (c) Should we formally exempt specific categories of staff from the definition of CF?

See Comments at 1.1 above.

- (d) 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)?

We think that such guidance would be helpful.

In particular we have been advised to enquire what due diligence will be required to establish compliance with Clause 3(f) (i.e. physical and mental health).

- (e) Do you consider that the standards as set out in Appendix 2 of the Consultation Paper ("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 any additional standards or considerations to add?

See comments at 2(b) above.

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

There appears to be a large degree of overlap between 4.1(a) and 4.1(o)

- (g) Do you consider that the Standards specified are sufficiently clear to be adopted by firms for their internal Fit and Proper process?

See comments at 2(b) above.

- (h) We are considering the benefit of providing guidance on the statutory Standards. Such guidance will be provided on a non-statutory basis and would take account of responses received to this consultation. Comments are therefore also invited as to whether non-statutory guidance would be useful to firms. If so, what issues should the guidance cover to assist firms in carrying out their own fit and proper test for persons proposed or holding both PCFs and CFs?

Statutory guidance would be helpful.

A handwritten signature in black ink, appearing to read 'Barry Conway', written in a cursive style.

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