



## EMPLOYMENT E-BRIEFING

# PRA AND FCA FINAL RULES ON REGULATORY REFERENCES: STRENGTHENING ACCOUNTABILITY IN BANKING AND INSURANCE

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### 1. OVERVIEW

The FCA and the PRA have published new policy statements relating to regulatory references under the new accountability regimes for banks and insurers which will come into force on **7 March 2017** (FCA [PS16/22](#) and PRA [PS27/16](#)).

The new rules aim to strengthen accountability within the banking and insurance sectors and form part of the new Senior Managers and Senior Insurance Manager regimes introduced in March 2016 for deposit takers and Prudential Regulation Authority investment firms and Solvency II firms and large non-directive insurers.

#### At a glance

The new rules require relevant firms to:

- request and provide employment references, using a set form containing information on candidates' conduct and expressing a view on fitness and propriety in respect of recruits to "relevant functions"; and
- comply with the new rules for all candidates being recruited to senior management functions, senior insurance management functions, FCA-controlled functions or significant harm functions (certifications).
- The new rules will come into force on 7 March 2017. The change will coincide with the implementation of the full certification regime and application of the Conduct Rules to "other conduct staff" which apply to deposit takers and PRA/FCA dual-regulated firms.

### Table of Contents

1. OVERVIEW	1
2. SCOPE OF REGULATORY REFERENCE REQUIREMENTS	3
3. SUMMARY OF COMBINED FCA AND PRA REGULATORY REFERENCE REQUIREMENTS	4
5. OTHER RECENT DEVELOPMENTS	7
6. SOURCES	8
7. CONTACTS	8

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### Application

The new rules will apply to Banks and insurers (all deposit takers and PRA/FCA dual-regulated firms, except non-Solvency II Directive firms ("Small NDFs")). See table 1 below.

## Background

The FCA and PRA consulted jointly on requirements for all PRA/FCA dual-regulated firms except small non-Solvency II Directive firms ("Small NDFs") to request and provide employment references using a set form containing information on candidates' conduct and fitness and propriety when recruiting individuals into certain functions (collectively referred to as "relevant functions"). The consultation closed in December 2015.

In February 2016, the regulators published PS5/16 containing a first tranche of PRA and FCA rules establishing an interim framework for the provision of regulatory references. This became effective on 7 March 2016 for the Senior Managers and Certification Regime (SMCR) and Senior Insurance Managers Regime (SMIR). The rules require firms to:

- upon request, provide references to other regulated firms containing all relevant information of which they are aware as soon as reasonably practicable; and
- if they are considering hiring a candidate into a function subject to the regulatory reference rules, take reasonable steps to obtain appropriate references covering at least the candidate's past six years of service from current and previous employers and (if different) from any organisations at which that person had served as, or was currently, a non-executive director (NED).

The aim is to encourage firms to build on regulatory requirements by developing best practice to prevent and tackle misconduct, assess fitness and propriety and exchange relevant information on individuals.

## The FCA and PRA's new rules on regulatory references

The FCA's amended rules state that the obligation to provide a reference on receipt of a request includes candidates for pre-approved, certified, and certain PRA-specified roles. References must be relevant and subject to due process to ensure fairness.

The PRA and FCA final rules:

- Contain a standard reference template including mandatory information that must be included such as:
  - name, contact details and reference number of firm providing reference;
  - individual's name;
  - date;
  - whether the individual performed a significant harm function or been an approved person at the firm;
  - whether the individual performed one of a number of specified roles (e.g. notified non-executive director or key function holder (other than a controlled function));
  - whether the firm has taken any disciplinary action against the individual which amounts to a breach of any individual conduct requirements or relate to the individual not being fit and proper to perform a function;
  - whether the firm concluded that the person was not fit and proper; and
  - any information which may be relevant to the assessment of whether the person is fit and proper.

The above information should cover the period beginning six years before the date of the reference request. Firms are able to start using the template before 7 March 2017.

- Provide that the requirement to disclose all relevant information also relates to the period six years from the date of the reference request. The policy statement makes clear that firms need to apply judgement on a case-by-case basis: for example, taking account of existing Handbook guidance that refers to the number of upheld complaints against the individual. Firms will also be subject to the general obligation on employers that references are clear, fair and accurate, and need to consider other relevant legislation, such as those relating to the

rehabilitation of offenders and spent convictions where appropriate. However, the final rules confirm that the obligation to provide a reference does not require a firm to disclose information that has not been properly verified.

- State that there is no time limit for misconduct that is serious: serious matters should always be disclosed, even they took place more than six years ago. In practice, this means that when responding to a reference request, firms will need to check to see if their records show any serious matters at any time beyond the past six years, and disclose it accordingly. The FCA and the PRA have issued joint guidance, which provides non-exhaustive examples of what might constitute ‘serious’ for this purpose.
- Clarify that the Regulators expect firms to disclose information that they reasonably consider to be relevant.

^ [Back to top](#)

## 2. SCOPE OF REGULATORY REFERENCE REQUIREMENTS

**Table 1 - Scope of the regulatory reference requirements**

FULL-SCOPE REGULATORY REFERENCE FIRMS	RELEVANT FUNCTIONS
Banks Building societies Credit unions PRA-designated investment firms including third country CRR firms in relation to the activities of their establishments in the UK ('incoming third-country branches')	Senior Management Functions ('SMFs') Certification functions Notified-non executive directors ('Notified NEDs')
Solvency II insurance firms the Society of Lloyd's Lloyd's managing agents Third country branch undertakings (other than Swiss general insurers) in relation to the activities of their establishment in the UK ('third-country branch undertakings') UK ISPVs Large NDFs	Senior Insurance Management Functions ('SIMFs') FCA Controlled Functions Other Key Function Holders ('KFHs') Notified NEDs

Note that the only PRA-regulated firms that will not be full-scope regulatory reference firms are Small NDFs, although they will remain subject to certain requirements such as the obligation to provide employment references containing all relevant information of which they are aware upon request by another regulated firm, albeit not in the Template.

^ [Back to top](#)

### 3. SUMMARY OF COMBINED FCA AND PRA REGULATORY REFERENCE REQUIREMENTS

**Table 2**

REQUIREMENT	BANKS AND INSURERS	SMALL	FCA ONLY-AUTHORISED FIRMS
PROVIDE A REFERENCE UPON REQUEST IN RELATION TO CANDIDATES OF THE FOLLOWING ROLES: SMFS, SIMFS, CFS, CERTIFICATION FUNCTIONS, KEY FUNCTION HOLDERS AND NOTIFIED NEDS	YES	YES	YES
REQUEST REFERENCES GOING BACK SIX YEARS	YES	NO	NO
INCLUDE MANDATORY INFORMATION IN THE REFERENCE (GOING BACK SIX YEARS)	YES	NO	NO
INCLUDE ALL RELEVANT INFORMATION IN THE REFERENCE (GOING BACK SIX YEARS, UNLESS SERIOUS WHEN THERE IS NO TIME LIMIT)	YES	YES	YES
PROVIDE THE REFERENCE IN A MANDATORY TEMPLATE	YES	NO	NO
UPDATE REFERENCE IF APPROPRIATE, SIX YEARS FOLLOWING RESIGNATION (INCLUDING ANY NOTICE PERIOD SERVED)	YES	NO	NO

[^ Back to top](#)

## 4. Q&A

### Content of references

- **What is all "relevant information"?**

The PRA gives some examples of matters which a firm may consider serious enough to warrant inclusion in the "all relevant matters" section of the template (above and beyond the mandatory disclosures):

- a serious breach of rules directly applicable to the individual, e.g the Conduct Rules;
- misconduct that caused or led to a breach by the firm of certain important supervisory requirements, such as the Threshold Conditions;

- misconduct that resulted in enforcement action by the regulators against the firm and/or the individual concerned;
- misconduct involving serious dishonesty (whether or not it also involves a criminal act) (taking account of any applicable legal restrictions on considering such matters relating to the rehabilitation of offenders and spent convictions and related disclosures);
- conduct that would have caused the firm providing the reference ('firm A') to dismiss the individual ('P') in accordance with its internal code of conduct if it had been discovered while P was still working there; and/or
- conduct that would cause firm A not to employ P if firm A was considering P for a relevant candidate function and it became aware of it (through a regulatory reference from a prior employer or otherwise).

NB Disclosures will need to go back six years. Disclosures relating to serious matters will not be subject to a time limit.

### Obligation to request references

- **What about practical difficulties with obtaining references from overseas firms and non-full-scope regulatory reference firms in the UK?**

The FCA paper states the obligation on the requesting firms is to take reasonable steps to obtain a reference (SYSC 22.2.1(2)R). Each firm must judge what constitutes reasonable steps in the context of the circumstances of a case. The FCA guidance states that it expects that regulated firms providing a reference should normally be able to do so within six weeks.

- **What about contingent or contract workers?**

Banks and insurers should request references when recruiting any individual to perform a pre-approved role or a SHF, including contingent workers or volunteers. There is a duty on firms to ensure that staff in these roles meet the regulatory standards of being fit and proper (this is a statutory obligation in section 60A and 63F of the FSMA) and references are a key tool in achieving this.

- **What about intra-group moves?**

According to the FCA: where a group has centralised records or alternative means of sharing relevant information as part of the fit and proper assessment of candidates, firms within a group do not need to request a reference from each other. But the onus is still on the recruiting firm within the group to obtain the necessary information to satisfy their obligations to ensure the individual is fit and proper. The PRA agrees that where a full-scope regulatory reference firm hires or promotes a relevant function internally or from a firm in the same group, it would be disproportionate to require that firm to request a full regulatory reference and this is not a requirement of the PRA final rules.

- **What is the timing for obtaining references?**

Ideally, references should be obtained before an application for approval is submitted. However, the rules permit references to be obtained no later than one month before the end of the application process where this is not possible. There is an exception in both the FCA and PRA rules where the recruiting firm or the employer giving the reference would have to make a public announcement when requesting or providing a reference. In such circumstances, there is no time limit, and references can be obtained at any time during the application process.

## Obligation to provide references and mandatory disclosures

- **How onerous are the requirements to disclose breaches of an individual conduct requirement?**

The disclosure of breaches of an individual conduct requirement should mirror FSMA's revised notification requirements for banks, focusing on breaches where disciplinary action has been taken. (S.64C of the FSMA defines disciplinary action as: issuing a formal written warning; suspension or dismissal of the person; and/or reduction or recovery of any of the person's remuneration. Suspensions imposed pending an internal investigation do not constitute "disciplinary action" under s.64C.)

- **What detail is required?**

A reference should provide a factual description of the breach and its outcome. Where a firm is concerned that commercially sensitive information would be disclosed, it can apply for a waiver.

## Updating a reference

- **What is the obligation to update a reference?**

Firms only need to update the current employer (where that employer is a FSMA firm) and not any interim employers between the individual leaving the firm and their current role. This is intended to avoid the data protection concerns raised during the consultation process. The updating requirement applies to the departing employers during any notice period served between providing a reference and the individual leaving a firm; and in addition, for that employers plus other ex-employers, six years from the date the individual left the firm. NB misconduct which occurred more than six years ago, but which came to light within six years from the date the individual left the firm, may require disclosure if that misconduct is serious.

- **What triggers the need to update?**

The test is whether the new information arising: (1) would have caused the providing firm to have written the original reference differently had the information been known at the time; and (2) that difference is significant for an assessment of the fitness and propriety of the individual.

## Record-keeping requirements

- **What are the record-keeping requirements?**

Relevant firms are obliged to keep records of disciplinary and fitness and properness findings for six years. The PRA Policy Statement clarifies that the six-year time period for updating regulatory references should start on the date when the individual's employment with the firm terminates (including any notice periods, garden leave or equivalent).

- **If an employee resigns before we can finish an investigation, do the reference requirements mean we will have to finish that investigation?**

The Regulators have not mandated disclosure where an employee has left whilst under investigation. In addition, firms are not required to disclose information which has not been properly verified. That said, firms will be required to say if they have concluded that an individual was not fit and proper, and if they have any other information which they reasonably consider to be relevant to the hiring firm's assessment of fitness and propriety. If an investigation has not been finished, a firm may be in the difficult position of not having concluded the person was not fit and proper, but also not being comfortable they could themselves certify them as fit and proper, which may be information they should disclose to the hiring firm. Firms may therefore choose to finish the investigation (giving the employee the chance to input) in order to be able to answer these questions conclusively. In other circumstances, where the only reasonable option is to drop

the investigation, firms will need to carefully consider whether, given the particular facts, they should disclose that an investigation was opened but not finished.

^ [Back to top](#)

## 5. OTHER RECENT DEVELOPMENTS

### [PRA consultation on amendments to the senior managers and certification regime](#)

On 28 September 2016, the PRA issued a consultation paper on amendments and optimisations to the SMCR and the SIMR (CP34/16). CP34/16 can be found [here](#). The PRA seeks views by 9 Jan 2017 on amendments to its Rulebook.

### [FCA discussion paper on overall responsibility and the legal function under SMCR](#)

On 28 September 2016, the FCA published a discussion paper for comments by 9 January 2017 on overall responsibility and the legal function under the SMCR (DP16/4), which can be found [here](#).

### [PRA policy statement on buy-outs of variable remuneration](#)

The PRA has also published policy statement PS26/16: 'Buy-outs of variable remuneration', containing final rules which are intended to ensure that the buy-outs do not undermine existing rules on malus and clawback, allowing employees to avoid the proper consequences of their actions.

See our incentives group ebulletin setting out the requirements [here](#). PS26/16 can be found [here](#).

### [PRA expectations on remuneration](#)

The PRA has also published consultation paper CP33/16: 'The PRA's expectations on remuneration', which proposes to create a unified supervisory statement on remuneration. This would consolidate three existing supervisory statements; provide additional guidance on other elements of remuneration; and confirm the PRA's expectation that firms need to adhere to the requirements set out in the EBA Guidelines on Sound Remuneration Policies from 1 January 2017. CP33/16 can be found [here](#).

### [Whistleblowing in UK branches: PRA consultation and FCA proposals](#)

In addition, consistent with industry best practice, the PRA has published consultation paper CP35/16: 'Whistleblowing in UK branches', which contains proposals to extend, where possible, existing whistleblowing rules to ensure people working at UK branches of banks and insurers are aware of how safely to raise concerns they may have to the regulator, and challenge poor practice and behaviour. These rules will apply to UK branches of non-EEA deposit-takers and both EEA and non-EEA insurers, including reinsurers, from September 2017. CP35/16 can be found [here](#). The FCA has similarly issued [CP 16/25](#) "Whistleblowing in UK branches of overseas banks". The proposals are that (i) UK branches of overseas banks tell their UK-based employees about the FCA and PRA whistleblowing services; and (ii) where a branch of an overseas bank sits alongside a UK-incorporated bank that is subject to the UK whistleblowing rules, the UK-based staff of that branch should be informed of the subsidiary's whistleblowing arrangements. The FCA does not propose requiring UK branches of overseas banks to implement any other of the rules related to whistleblowing, although these represent good practice guidance for these firms.

^ [Back to top](#)

## 6. SOURCES

- Strengthening accountability in banking and insurance: PRA requirements on regulatory references (part II) (Policy Statement [PS27/16](#)) (September 2016)
- Strengthening accountability in banking and insurance: regulatory references final rules (Policy Statement [PS16/22](#)) (September 2016)

^ [Back to top](#)

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