

Policy Statement | PS27/16

Strengthening accountability in banking and insurance: PRA requirements on regulatory references (part II)

September 2016



BANK OF ENGLAND
PRUDENTIAL REGULATION
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This policy statement contains PRA rules and a supervisory statement to implement the second and final set of proposals on regulatory references following PRA Consultation Paper 36/15. The first set was contained in Policy Statement 5/16.

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1 Overview

1.1 This Prudential Regulation Authority (PRA) policy statement (PS) provides feedback to those responses relating to the proposals on regulatory references in consultation paper (CP) 36/15 'Strengthening accountability in banking and insurance: regulatory references'¹ that were not addressed in the first set of final policy in PS5/16 'Strengthening accountability in banking and insurance: Implementation of SM&CR and SIMR; and PRA requirements on regulatory references'.²

1.2 This PS should be read in conjunction with Financial Conduct Authority (FCA) PS 16/22, 'Strengthening accountability in banking and insurance: regulatory references', which contains the FCA's equivalent final rules and guidance on regulatory references, as well as PS5/16.

1.3 This PS includes:

- final sets of new and revised PRA rules on regulatory references (Appendix 1 for Relevant Authorised Persons (RAPs), Appendix 2 for insurers);
- a revised Regulatory Reference Template (the 'Template')(Appendix 3);³ and
- revisions to supervisory statement (SS) 28/15, 'Strengthening individual accountability in banking'⁴ (Appendix 4) and SS35/15, 'Strengthening individual accountability in insurance'⁵ (Appendix 5), setting out the PRA's expectations of how full-scope regulatory reference firms should comply with the rules included in PS5/16 and this PS.⁶

1.4 This PS is relevant to all PRA-authorised firms and candidates for roles in scope of the regulatory reference requirements (referred to as relevant functions in this PS).

Background

1.5 In CP36/15, the FCA and the PRA ('the regulators') consulted jointly on requirements for all PRA/FCA dual-regulated firms except small non-Solvency II Directive firms ('Small NDFs') (collectively referred to as 'full-scope regulatory reference firms' in the Glossary to the PRA Rulebook) to request and provide employment references using a set form containing information on candidates' conduct and fitness and propriety (referred to as 'regulatory references') when recruiting individuals into certain functions (collectively referred to as 'relevant functions') (see Table 1 in Chapter 2).

1.6 The proposals in Chapter 2 of CP36/15 sought to implement a recommendation by the Fair and Effective Markets Review (FEMR) for the regulators to 'consult on a mandatory form for regulatory references, to help firms prevent the 'recycling' of individuals with poor conduct records between firms'.⁷

1 October 2015, www.bankofengland.co.uk/pr/Pages/publications/cp/2015/cp3615.aspx.

2 February 2016, www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps516.aspx.

3 Available at <https://www.handbook.fca.org.uk/handbook/SYSC/22/Annex1.html>.

4 PRA Supervisory Statement 28/15 'Strengthening individual accountability in banking', January 2016 www.bankofengland.co.uk/pr/Pages/publications/ss/2016/ss2815update.aspx.

5 PRA Supervisory Statement 35/15 'Strengthening individual accountability in insurance', August 2015; www.bankofengland.co.uk/pr/Pages/publications/ss/2015/ss3515.aspx.

6 SS35/15 does not currently apply to Large NDFs. As part of the proposed extension of the SM&CR to all firms authorised under FSMA, the PRA will consulting on extending this supervisory statement to Large NDFs over the coming months.

7 Bank of England, August 2015; <http://www.bankofengland.co.uk/markets/Documents/femrjun15.pdf>.

1.7 The consultation period for CP36/15 closed on 7 December 2015. The regulators received thirty responses, most of which supported the proposed policies' key objective of ensuring that employment references that pass between firms when certain individuals move roles are an effective tool for employers to assure themselves that they are hiring fit and proper people.

1.8 However, several respondents also noted that certain proposals in CP36/15 could have wider legal consequences; engaging in particular contract, data protection, employment and human rights law as well as confidentiality obligations.

1.9 The regulators concluded that addressing these issues was important to ensure that their final rules for regulatory references were effective, legally sound and proportionate.

1.10 Consequently, 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; and
- committed to publishing as soon as feasible a second and final tranche of rules covering those areas where feedback to CP36/15 remained under consideration.

1.11 The first tranche of rules on regulatory references became effective on the commencement date of 7 March 2016 for the Senior Managers and Certification Regime (SM&CR) and Senior Insurance Managers Regime (SIMR). These rules, which were consulted on during the development of both regimes and are set out in PS16/15,¹ PS22/15² and PS26/15,³ 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 five 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).

1.12 Essentially, PS5/16 transferred the requirements that existed under the Approved Persons Regime (APR) from SUP10B in the PRA Handbook to the PRA Rulebook and updated them to reflect the new functions created by the SM&CR and SIMR, such as 'Certification functions'⁴ and 'Notified NEDs'.⁵ The rules in PS5/16 did not prescribe a template for the provision of regulatory references.

Structure of this PS

1.13 Chapter 2 of this PS provides feedback on responses relating to the proposed scope of the regulatory reference requirements.

1 PRA Policy Statement 16/15, 'Strengthening individual accountability in banking: responses to CP14/14, CP28/14 and CP7/15', July 2015, www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps1615.aspx.

3 PRA Policy Statement 22/15, 'Strengthening individual accountability in insurance: responses to CP26/14, CP7/15 and CP13/15', August 2015, www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps2215.aspx.

3 PRA Policy Statement 26/15, 'The prudential regime, and implementation of the Senior Insurance Managers Regime, for non-Solvency II firms', November 2015, www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps2615.aspx.

4 www.prarulebook.co.uk/rulebook/Glossary/FullDefinition/52563/03-08-2016.

5 www.prarulebook.co.uk/rulebook/Glossary/FullDefinition/66847/03-08-2016.

1.14 Chapter 3 provides feedback on responses relating to the proposals for requesting regulatory references.

1.15 Chapter 4 provides feedback on responses relating to the proposals for providing regulatory references and the use of the Template.

1.16 Chapter 5 provides feedback on responses relating to the proposals to update regulatory references where appropriate.

1.17 The requirements in the rules accompanying PS5/16 and this PS establish a common regulatory framework for PRA-regulated firms to obtain and provide regulatory references. However, regulatory references are primarily a tool for firms, not for the regulators. Consequently, the PRA believes that there is scope for firms and trade bodies 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 Banking Standard Board's (BSB) consultation on proposed voluntary guidelines to help with the assessment of Fitness and Propriety of employees in Certification functions is an example of such industry initiatives.¹

1.18 Whereas the rules in PS5/16 were substantially a continuation of the requirements in the APR with limited enhancements, implementing the rules in this PS will require firms to upgrade their processes and systems.

1.19 In response to industry feedback to CP36/15 calling for either a transitional period or staggered commencement of the requirements on regulatory references, the regulators have agreed that the rules in this PS will become effective on 7 March 2017 (alongside other SM&CR-related FCA requirements such as the implementation of the 'full' Certification Regime and the rolling out of the Conduct Rules to a wider range of employees). The PRA considers that this transitional period is appropriate given the phased implementation of the regulatory reference requirements and the fact that some of the most challenging requirements, such as the requirement to update regulatory references, will only apply once the rules have been in force for a period of time.

1.20 Firms are able to start utilising the Template before 7 March 2017 and, in light of the wider policy objectives of this PS, may find it good practice to do so.

1 BSB Consultation Paper – Certification Regime: Fitness and Propriety, 8 June,
<http://www.bankingstandardsboard.org.uk/bsb-certification-regime-fitness-and-propriety-consultation/>.

2 Scope of the regulatory reference requirements

2.1 Table 1 lists the firms that will be full-scope regulatory reference firms and thus required to request and provide regulatory references using the Template and the relevant functions performed or to be performed by persons to which these obligations will apply (collectively ‘relevant functions’).

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

2.2 As proposed in CP36/15, 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 (see Chapter 3). The rationale for not applying the full regulatory reference requirements to Small NDFs is that, unlike small banks, building societies and credit unions, Small NDFs are not currently subject to the full SIMR.

2.3 Once the SM&CR is extended to all other firms authorised under the Financial Services and Markets Act 2000 (FSMA),¹ as provided for by the Bank of England and Financial Services Act 2016,² the regulators will consider whether to extend some or all of the full regulatory reference requirements to Small NDFs.

¹ <http://www.legislation.gov.uk/ukpga/2000/8/contents>.

² <http://www.legislation.gov.uk/ukpga/2016/14/contents>.

3 Requesting regulatory references

3.1 In CP36/15, the regulators consulted on requiring full-scope regulatory reference firms that were seeking to appoint someone to a relevant function to request regulatory references from all current and former employers; organisations at which they served as, or were currently, a NED; and, if different, any firms at which the candidate had performed an SMF, SIMF, CF, Certification function, other KFH or Notified NED function in the previous six years.¹

3.2 Most respondents to CP36/15 supported these proposals, but a number of them:

- noted the potential legal difficulties of obtaining information on individuals' conduct and fitness and propriety from overseas employers and non-full-scope regulatory reference firms in the United Kingdom;
- challenged the need to require full-scope regulatory reference firms to request full regulatory references when appointing someone to relevant functions internally or from entities within their group; and
- highlighted potential issues with the proposal to require certain full-scope regulatory reference firms to obtain regulatory references before applying to the PRA and/or FCA for pre-approval of an SMF or CF, including the potential triggering of market-sensitive, regulatory notification requirements for listed firms under Listing Rule 9.²

3.3 As part of the development of the SM&CR and SIMR, the PRA introduced a requirement on full-scope regulatory reference firms that were considering hiring a relevant function to 'take reasonable steps to obtain appropriate regulatory references covering at least the past five years' from that person's current and previous employers and any organisations at which they had served as, or were currently a NED.³

3.4 Building on these requirements, the rules in this PS extend:

- the period for requesting references to the prior six years of employment; and
- the scope of the requirement to request references to include Solvency II firms and Large NDFs where the candidate is being considered for a role as a KFH.

Requesting regulatory references from overseas firms

3.5 Respondents to CP36/15 noted that, due to local legal restrictions, obtaining information on individuals' conduct and fitness and propriety from firms outside the United Kingdom may sometimes not be possible.

3.6 While the PRA requires full-scope regulatory reference firms to take reasonable steps to obtain references from all current and former employers, it is aware that such legal restrictions may exist.

1 Whether the requirements to seek and provide references arise depends on the function that the candidate is being considered for at the prospective employer; not the roles which they may have held in previous employers. If the individual is being considered for a relevant function position for the first time in their career, the requirements referred to in this PS and PS5/16 will apply.

2 <https://www.handbook.fca.org.uk/handbook/LR.pdf>.

3 CRR: Capital Requirement Regulation firms - Fitness and Propriety 2.7; Solvency II Firms: Insurance – Fitness and Propriety 2.5 and Non-Solvency II Firms: Large Non-Solvency II Firms – Fitness and Propriety 2.5.

3.7 Accordingly, while full-scope regulatory reference firms must take reasonable steps to obtain information from overseas firms, the PRA will take into account any demonstrable, relevant legal impediments when assessing whether firms are complying with this requirement.

3.8 Chapter 6 in SS28/15 and Chapter 5 in SS35/15 set out the steps which the PRA expects full-scope regulatory reference firms to take in respect of candidates who are or have previously been based overseas.

Internal or intra-group hires

3.9 CP36/15 proposed that firms ‘may need to seek a reference even where they are recruiting an individual from within their own firm or from another group company’. A number of respondents argued that this would be unduly burdensome and urged the regulators to drop the requirement to obtain full regulatory references for internal and intra-group hires and promotions.

3.10 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.

3.11 The PRA’s final rules therefore provide that a full-scope regulatory reference firm (Firm A) is not required to obtain full regulatory references when appointing an individual to one of its relevant functions from a firm or firms which are part of their same group, provided that the group’s internal policies and procedures allow Firm A access to all the information it requires to assess the candidate’s fitness and propriety (subject to any applicable laws). The quality and quantity of information that full-scope regulatory reference firms should have access to via their groups’ records and processes should be equivalent to that which would otherwise be contained in a regulatory reference.

Time for obtaining a regulatory reference

3.12 Respondents to CP36/15 pointed out that it may not always be possible for full-scope regulatory reference firms to obtain a reference before applying to the regulators for pre-approval on behalf of an SMF, SIMF or CF.

3.13 For instance, if the current employer of a candidate for a relevant function is listed in the United Kingdom, the candidate’s resignation may trigger an obligation on the employer to issue a regulatory notification under Listing Rule 9.¹ Typically, the candidate may want to wait until they have obtained regulatory pre-approval for their proposed SMF or SIMF (or an indication that such pre-approval is likely to be forthcoming) before resigning from their current role. A regulatory reference request from a prospective employer in these circumstances could alert the relevant function’s current employer of their impending resignation thereby triggering the disclosure obligation.

3.14 The statutory obligation in section 60A of FSMA on relevant authorised persons to satisfy themselves that candidates for an SMF are fit and proper before applying to the PRA for pre-approval on their behalf applies irrespective of the circumstances.²

1 In particular, LR 9.6.11 <https://www.handbook.fca.org.uk/handbook/LR/9/6.html>.

2 A similar, non-statutory obligation for insurers exists in Insurance - Fitness and Propriety <http://www.prarulebook.co.uk/rulebook/Content/Part/212600/18-07-2016>.

3.15 However, if a firm cannot obtain the necessary references prior to making an application for approval as an SMF/SIMF because doing so would trigger a market-sensitive notification requirement, they will be required to do so before the candidate can be approved by the PRA.

3.16 If a firm cannot obtain the necessary references prior to making an application for approval as an SMF/SIMF due to any other legitimate reasons, besides market-sensitive notification requirements, it will need to obtain and consider all references necessary to confirm its conclusions as to the candidate's fitness and propriety no later than one month before the application is due to be determined.

3.17 Chapter 6 in SS28/15 and Chapter 5 in SS35/15 set out the steps that the PRA expects full-scope regulatory reference firms to take if they cannot obtain all necessary references before applying to the PRA for pre-approval on an SMF's or SIMF's behalf. In particular, if any of those references reveal previously unknown adverse information about the candidate's fitness and propriety including, if justified, revoking an offer of employment terminating the individual's employment.

4 Providing regulatory references

4.1 CP36/15 proposed that, upon receipt of a request from another full-scope regulatory reference firm relating to a relevant function, full-scope regulatory reference firms provide a regulatory reference using the Template.

4.2 This obligation would arise regardless of:

- the circumstances and manner in which the individual left the firm; and/or
- any agreement or arrangement which the firm and the individual may have entered into prior to or upon termination of employment.¹

4.3 Most respondents to CP36/15 supported the introduction of a template but raised questions relating to amount and type of information it should contain.

Mandatory information

4.4 CP36/15 proposed to require full-scope regulatory reference firms to set out the following mandatory information in the Template (including a requirement to expressly state where there was no relevant information to disclose):

- Actual (but not suspected) breaches of the PRA Conduct Rules, FCA Conduct Rules (COCON), Conduct Standards and Statements of Principle and Code of Practice For Approved Persons (APER) in the past six years. This proposal derived from the, at the time, applicable notification requirements for relevant authorised persons in section 64B(5) of FSMA.
- Disciplinary action relating to breaches of the rules and standards listed above (including a description of the basis for, and outcome of the disciplinary action) taken:
 - in the six years preceding the request for a regulatory reference; or
 - between the date of the request for a regulatory reference and the date the reference is given. This proposal derived from the notification requirement for relevant authorised persons in section 64C of FSMA.
- Whether the firm had concluded, at any point in the six years prior to the request for a regulatory reference, that the candidate was not fit and proper to perform a function. This proposal derived from the requirements which the Rulebook and, in the case of relevant authorised persons FSMA, places on firms to assess the fitness and propriety of SMFs, SIMFs and CFs.

4.5 Shortly after PS5/16 was published, the Bank of England and Financial Services Act 2016 repealed section 64B(5) of FSMA but retained section 64C of FSMA.²

4.6 To reflect the revised statutory position, the regulators have deleted the draft rules and sections of the Template which derived from section 64B(5) of FSMA.

1 Fitness and Propriety 5.4 and Insurance -Fitness and Propriety 3.5 actually forbid full-scope regulatory reference firms from entering into agreements or arrangements that limit their ability to disclose information required by the regulatory references requirements.

2 <http://www.legislation.gov.uk/ukpga/2016/14/section/24/enacted>.

4.7 Consequently, full-scope regulatory reference firms will be required to include information on breaches of the Conduct Rules/Standards and, where relevant, APER or other relevant historic rules in the mandatory information section of the Template only if they result in disciplinary action. The definition of disciplinary action for these purposes mirrors that in section 64C of FSMA and is applied both for relevant authorised persons and insurers.

All relevant information

4.8 In addition to specifying mandatory information which would need to be disclosed in regulatory references, CP36/15 proposed to retain the pre-existing requirement under the APR for full-scope regulatory reference firms to provide 'all relevant information' if requested to do so by another full-scope regulatory reference firm. To enable this, the draft Template included a separate 'all relevant information section'.

4.9 A number of respondents asked the PRA and FCA to clarify what exactly they would be required or expected to disclose in the 'all relevant information section'.

4.10 Information in the 'all relevant information' section of the template should not duplicate anything disclosed in the 'mandatory information' section. This section aims to capture additional information relevant to the requesting firm's assessment of the candidate's fitness and propriety.

4.11 However, the 'all relevant information' section can be used to provide further background on a breach disclosed in the 'mandatory information' section, such as mitigating circumstances and/or subsequent corrective action or good conduct by the individual. It follows that information in the 'all relevant information' section does not always have to be 'negative'.

4.12 Like disclosures in the 'mandatory information' section, disclosures in the 'all relevant information' section will need to go back six years. However, disclosures relating to serious matters will not be subject to a time limit. It is important that firms also take into account all relevant legal requirements, such as those relating to the rehabilitation of offenders and spent convictions where appropriate when considering what it should disclose.

4.13 Firms should make their own assessment of the seriousness of the matter on a case-by-case basis. Some non-exhaustive examples of matters which a firm may consider serious enough to warrant inclusion in the 'all relevant information section' include but are not limited to:

- a serious breach of rules directly applicable to the individual, ie 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 requirements 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).

4.14 The 'all relevant information' section can also include, where appropriate, information on events that did not culminate in formal disciplinary action or a formal finding that the individual was not fit and proper.

Legal duties

4.15 When considering what information and level of detail to include in regulatory references, firms need to comply with their legal obligations.

4.16 It is the responsibility of firms to develop internal policies and processes that ensure compliance with both their legal and regulatory obligations.

4.17 Several respondents to CP36/15 suggested that one possible way to ensure that full-scope regulatory reference firms comply with their legal requirements when providing regulatory references may be to give individuals who do or did hold relevant functions an opportunity to comment on prejudicial allegations capable of inclusion in a regulatory reference ('right to comment').

4.18 It is ultimately for firms to decide whether a right to comment is appropriate taking into account the individual circumstances of each case. Fairness will normally require a firm to have given an employee an opportunity to comment on information in a reference.

4.19 Giving individuals holding relevant functions a right to comment on allegations capable of inclusion in a regulatory reference does not in itself equate to giving them a right to edit or veto the contents of a regulatory reference.

4.20 Similarly, if an individual refuses to comment on allegations having been given a reasonable opportunity to do so, this may not, in itself, prevent the firm from including these allegations in a regulatory reference.

4.21 The PRA's Rules provide that a firm is not required to disclose information that has not been properly verified. A firm supplying a reference owes a duty to its former employee and the recipient firm to exercise due skill and care in the preparation of the reference. References should be true, accurate, fair and based on documented fact.

4.22 If a reference refers to misconduct/includes adverse information about the candidate, then this should have been properly investigated by the firm, and the firm should have reasonable grounds for believing that the misconduct has taken place. The reference should not be based on unproven allegations and a simple suspicion should not be included in a reference.

Other FCA-authorized firms

4.23 While FCA-authorized firms will not be subject to the full regulatory reference requirements outlined in this PS, they are currently subject to an FCA requirement to disclose all relevant information of which they are aware if another PRA or FCA regulated firm asks

them for a reference or other information in connection with the appointment of a relevant function.¹

4.24 Given the similarities between this requirement and the PRA requirement on full-scope regulatory reference firms, the FCA will apply its rules and guidance relating to the provision of ‘all relevant information’, in a manner which is aligned to the PRA’s own requirements and expectations, to all the firms it regulates.

4.25 Table 2 sets out which requirements will apply both to full-scope regulatory reference firms and FCA-authorized firms and which will only apply to the former.

Table 2: Comparison of requirements for full-scope regulatory reference firms and other FCA-authorized firms

Requirement	Banks and insurers	Small non-directive insurance firms	FCA only-authorized 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

¹ SUP 10A.15 References and accurate information <https://www.handbook.fca.org.uk/handbook/SUP/10A/15.html>.

5 Updating regulatory references

5.1 In CP36/15, the PRA consulted on requiring full-scope regulatory reference firms and all NDFs to revise regulatory references they had given in the previous six years if they became aware of matters that would cause them to draft that reference differently, if they were doing so at the present time.

5.2 The aim of this proposed requirement was to provide a mechanism to alert subsequent employers of prior misconduct by individuals appointed to relevant functions, which is only discovered after their departure.

5.3 Nonetheless, this proposal attracted the greatest amount of challenge and feedback in responses to CP36/15, including:

- reservations about the proposed six-year time limit and concern about its potential impact on firms' record-keeping policies and processes for former employees; and
- apprehension about the potential confidentiality, contractual, data protection, employment and human rights law implications of having to pass an updated reference down a chain of subsequent employers in cases where an individual performing a relevant function moves firm more than once in six years.

5.4 While the PRA and FCA will retain both the requirement to update regulatory references in the circumstances outlined above, and the proposed six year period in which they will be required to do so, they have made a series of amendments and clarifications in response to industry feedback, which are discussed in the remainder of this chapter.

Time period for updating references

5.5 A number of responses to CP36/15 suggested that the six-year time period for updating regulatory references was onerous and would require costly upgrades to firms' record-keeping policies and processes. Several respondents suggested reducing the period to one-two years.

5.6 Respondents also asked the regulators to clarify whether the period for updating references should be counted from the date the individual ceased to be employed by the firm, or from the date the reference was provided.

5.7 Recent scandals involving serious and systematic misconduct, including those which prompted the establishment of FEMR, went on for several years before firms detected and acted upon them.

5.8 Consequently, the PRA considers that in order for the requirement to update regulatory references to be effective in preventing the recycling of individuals with poor conduct records throughout the financial services sectors, it must cover a relatively long period. Therefore, the regulators will keep the six-year time limit for updating regulatory references.

5.9 The final rules included in this PS clarify that the six-year period for updating regulatory references should start on the date when the individual's employment with the firm terminates (including any applicable notice periods, garden leave or equivalent). It is also worth highlighting that, notwithstanding the six-year fixed updating period, disclosures in a regulatory reference may include misconduct or other matters that occurred more than six years ago, but which came to light within the period during which the updating provision applies (if sufficiently serious) (see Chapter 3 above).

Updating references where the individual moves multiple times in six years

5.10 A large number of respondents to CP36/15 argued that the requirement to update regulatory references could give rise to confidentiality, data protection, employment law and human rights issues, particularly in cases where an individual moves firms multiple times within a six year period.

5.11 For instance, consider a situation where an individual in a relevant function (P) moves from firm A to firm B, to firm C, to firm D within a six year period. For the purposes of this example, all firms are full-scope regulatory reference firms and firm D is the current employer.

5.12 Firm A unveils information which, following an internal investigation confirms that P committed serious misconduct during their employment. Consequently, firm A deems it appropriate to update the references it provided to firms B-D. However, firms B and C no longer employ P and, under UK data protection law, could be deemed to no longer have a 'legitimate interest' in the updated information.¹

5.13 Under the regulators' final rules, a firm providing an updated reference will only be required to provide it to the individual's current employer (in this case, firm D) but not to any other firms at which the individual may have been employed in the period between leaving the firm providing the updated reference (in this case, firm A) and joining his current employer.

5.14 This requirement does, however, need to be considered alongside the following requirements:

- a firm seeking to provide an updated regulatory reference to a relevant function's current employer must make reasonable enquiries as to the identity of that employer; and
- where a firm unveils misconduct, existing rules and statutory provisions require it and the individuals therein to notify to the PRA irrespective of whether the individual(s) involved remain employed by that firm. These rules include:
 - Fundamental Rule 7 (and Principle 11 of the FCA's Principles for Businesses),² which states that a firm must deal with its regulators in an open and cooperative way and must disclose to the PRA appropriately anything relating to the firm of which the PRA would reasonably expect notice.³
 - Individual Conduct Rule 3 and Senior Manager Conduct Rule 4 (and their insurance equivalents), which require individuals to 'be open and co-operative with the FCA, the PRA and other regulators and Senior Managers to 'disclose appropriately any information of which the FCA or PRA would reasonably expect notice'.
 - Insurance – Fitness and Propriety 4.3, which states that a Solvency II insurer must inform the PRA as soon as practicable of any information that would reasonably be expected to be material to the assessment of a current or former KFH's fitness and propriety.

1 Schedule 2 of the Data Protection Act 1998 <http://www.legislation.gov.uk/ukpga/1998/29/schedule/2>.

2 <https://www.handbook.fca.org.uk/handbook/PRIN.pdf>.

3 <http://www.prarulebook.co.uk/rulebook/Content/Part/211136/22-06-2016>.

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- Large non-Solvency II firms – Fitness and Propriety 4.3 and Non-Solvency II Firms – Fitness and Propriety 4.3 which reproduce the rule above in the context of Large NDFs and Small NDFs.

6 Cost-benefit analysis

6.1 Section 138J(5) of FSMA requires the PRA to publish a cost benefit analysis of any changes to the consultation proposals which the PRA considers to be significant.

6.2 Annex 3 to CP36/15 included a cost benefit analysis of the PRA's proposals for regulatory references. Overall, the analysis concluded that 'these proposals will give firms the information that they need to better assess the fitness and propriety of candidates for these important roles. For Certification roles, the assessment of an individual's suitability will be made solely by the firm, so these requirements will be particularly useful. Although firms may be concerned about the loss of pre-approval of individuals by the regulator, the proposed disclosure rules should allow greater accountability and personal responsibility, leading to fewer conduct breaches and better behaviour within the industry'.

6.3 Responses to CP36/15 raised the following concerns about the cost implications of the proposals:

- Some firms argued that the proposals could result in increased times and administration costs for internal promotions. In response, the PRA has relaxed its requirements on firms to obtain full regulatory references for internal or intra-group hires (see Chapter 2 above).
- Firms also noted that complying with the proposals in CP36/15 would require them to develop and implement new or revised systems and processes. The proposed transitional in period in Chapter 1 recognises that firms will indeed need to upgrade their HR, IT and record-keeping processes and systems to comply with the requirements on regulatory references.
- Finally, respondents noted that the proposals could give rise to a greater number of employee disputes and heightened litigation risk. In order to help firms mitigate this, the regulators have made the following amendments and clarifications to their original proposals:
 - Following the deletion of section 64(B)(5) of FSMA, the regulators amended their rules and template so that firms will only be required to disclose breaches of the Conduct Rules in the 'mandatory information' section if they result in internal disciplinary action.
 - The regulators have also limited the requirement to disclose information on incidents older than six years in the 'all relevant information' section of the template to cases involving serious matters, and provided indicative, non-exhaustive examples of what this might entail.
 - Finally, the regulators have limited the requirement to provide updated regulatory references (where warranted) only to a relevant function's current employer. A substantial amount of the feedback on the potential ongoing costs of the proposals in CP36/15 related to the practical implications of having to send updated references down a chain of subsequent employers. Therefore, this change to the PRA's final rules should address one of respondents' key concerns.

6.4 The remaining requirements set out in this PS do not differ significantly from the drafts published for consultation and, in some cases, have been made less prescriptive or rigid in response to feedback. The extension of the look-back period for regulatory references from

five to six years was already proposed and envisaged in CP36/15 as was the final scope of the regime.

Competition and impact on mutuals

6.5 The PRA does not consider that the changes between the draft published for consultation and the final rules published here will have a significantly different impact on mutuals compared to other types of firm.

6.6 The PRA does not consider that its final requirements for regulatory references will have an adverse impact on competition. While the requirements will apply to all relevant authorised persons, the number of relevant functions will increase in line with the size and complexity of the firms thereby helping to ensure a proportionate application.

Appendices

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- 1 **PRA RULEBOOK: CRR FIRMS: NON-CRR FIRMS: FITNESS AND PROPRIETY AMENDMENT INSTRUMENT 2016, available at:
www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps2716.aspx**

 - 2 **PRA RULEBOOK: SOLVENCY II FIRMS, NON-SOLVENCY II FIRMS: SENIOR INSURANCE MANAGERS REGIME AMENDMENT INSTRUMENT 2016, available at:
www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps2716.aspx**

 - 3 **Regulatory Reference Template, available at:
www.handbook.fca.org.uk/handbook/SYSC/22/Annex1.html**

 - 4 **Update to SS28/15 'Strengthening individual accountability in banking', available at:
www.bankofengland.co.uk/pr/Pages/publications/ss/2016/ss2815update2.aspx**

 - 5 **Update to SS35/15 'Strengthening individual accountability in insurance', available at:
www.bankofengland.co.uk/pr/Pages/publications/ss/2016/ss3515update.aspx**
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