

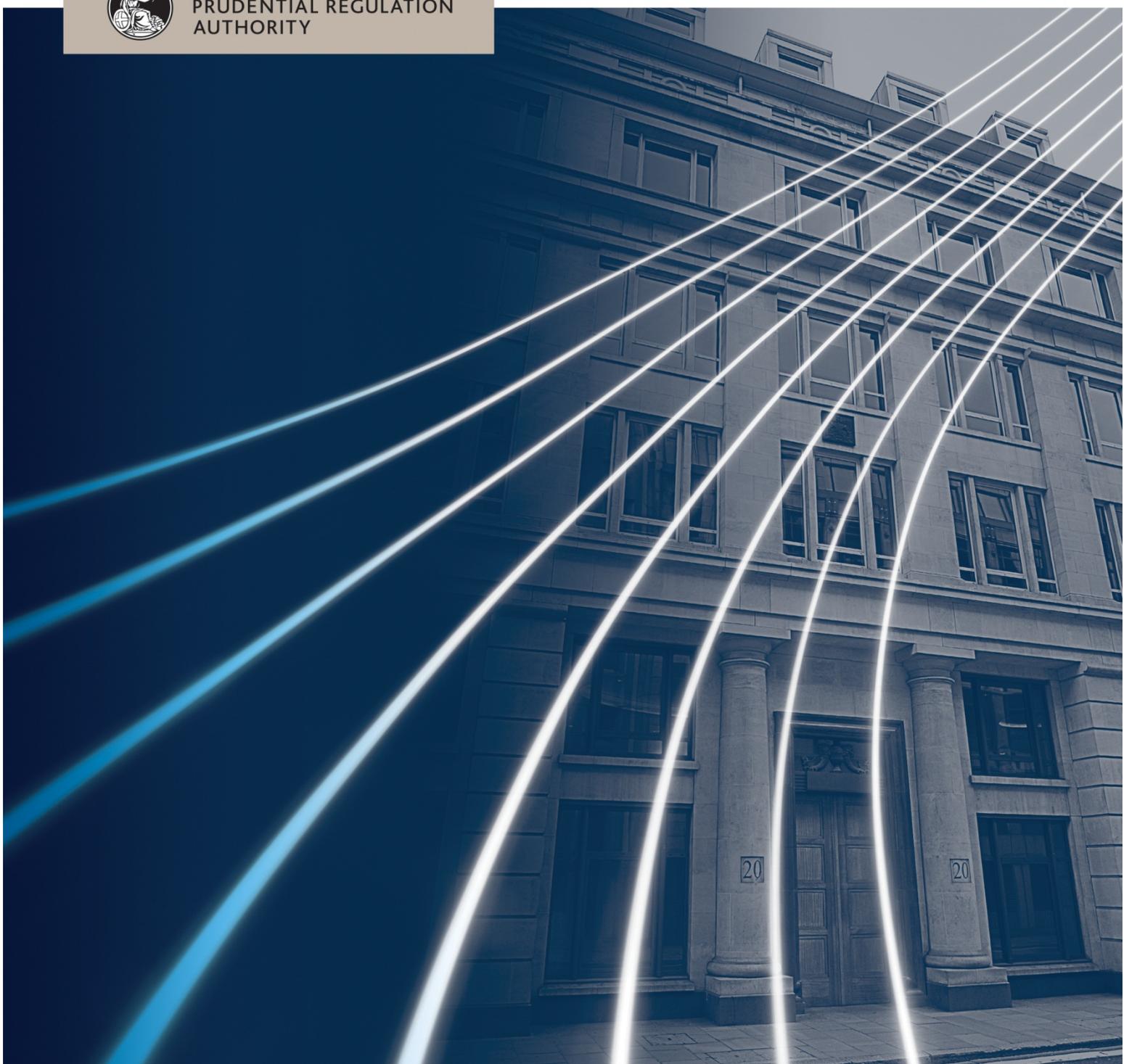
Policy Statement | PS9/16

# Strengthening individual accountability in banking: responses to CP1/16, and the Certification Part of CP29/15

March 2016



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This policy statement contains final rules on the notification of Conduct Rules breaches for individuals in scope of the Senior Managers and Certification Regimes for UK banks, building societies, credit unions and PRA-designated investment firms.



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## 1 Overview

### 1.1 This Prudential Regulation Authority (PRA) policy statement (PS):

- provides feedback on responses to Consultation Paper 1/16 - *Strengthening individual accountability in banking: amendments to notification rules and forms*;<sup>1</sup> and
- sets out the amended definition of the term 'significant risk taker' in the PRA's Certification rules as proposed in Consultation Paper 29/15 –*Occasional consultation paper*.<sup>2</sup>

1.2 In CP1/16 the PRA proposed a series of amendments to the *Conduct Rules: Notifications and Applications and Notifications* Parts of the PRA Rulebook and Forms C, D and L.<sup>3</sup> The aim of the proposed amendments was to update these rules and forms in light of the proposed changes to the Senior Managers and Certification Regimes (SM&CR) in the Bank of England and Financial Services Bill (the Bill).<sup>4</sup> In particular, the proposed removal of section 64B(5) of the Financial Services and Markets Act 2000 (FSMA), which would have required banks, building societies, credit unions and PRA-designated investment firms, collectively referred to as 'relevant authorised persons' in section 71A of FSMA as amended by the Financial Services (Banking Reform) Act 2013 ('Banking Reform Act'),<sup>5</sup> to notify the PRA and/or FCA if they knew or suspected that an individual performing a Senior Management Function (SMF) ('senior manager') or otherwise subject to the regulators' conduct rules had failed to comply with any such rules.

1.3 The Financial Conduct Authority (FCA) consulted simultaneously on identical amendments to Forms C and D (which are shared with the PRA) and equivalent changes to its rules and Form H, which is an FCA-only form.<sup>6</sup>

1.4 Separately, in CP29/15 the PRA proposed to amend the definition of 'significant risk taker' in the PRA's *Certification* Parts, which defines the functions that fall into scope of the PRA's Certification regime. The proposed amendment sought to align the definition of 'significant risk taker' more closely to the definition of 'material risk taker' (MRT) in Commission Delegated Regulation (EU) No 604/2014 (MRTs Regulation)<sup>7</sup> and the PRA's *Remuneration* rules.<sup>8</sup> The amendment will further the PRA's policy aim of aligning the scope of the Certification regime as closely as possible with the MRT population.

### 1.5 Appendix 1 of this policy statement contains:

- the revised final rules in *Conduct Rules: Notifications*;
- amended Forms C, D, and L; and

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1 PRA Consultation Paper 1/16, 'Strengthening accountability in banking: amendments to notification rules and forms', January 2016; [www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp116.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp116.aspx).

2 PRA Consultation Paper 29/15 'Occasional Consultation Paper', August 2015; [www.bankofengland.co.uk/pr/Pages/publications/cp/2015/cp2915.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/cp/2015/cp2915.aspx).

3 [www.prerulebook.co.uk/rulebook/Content/Chapter/302395/08-12-2016](http://www.prerulebook.co.uk/rulebook/Content/Chapter/302395/08-12-2016).

4 <http://services.parliament.uk/bills/2015-16/bankofenglandandfinancialservices.html>.

5 [www.legislation.gov.uk/ukpga/2013/33/contents/enacted](http://www.legislation.gov.uk/ukpga/2013/33/contents/enacted).

6 FCA Consultation Paper CP16/1, 'Consequential changes to the Senior Managers Regime', January 2016; [www.fca.org.uk/news/cp16-01-consquential-changes-to-senior-managers-regime](http://www.fca.org.uk/news/cp16-01-consquential-changes-to-senior-managers-regime).

7 [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ%3AJOL\\_2014\\_167\\_R\\_0003](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ%3AJOL_2014_167_R_0003)

8 PRA Policy Statement 12/15, 'Strengthening the alignment of risk and reward: new remuneration rules', June 2015; [www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps1215.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps1215.aspx).

- the amended definition of ‘significant risk taker’ in the *Certification* rules.

1.6 This PS is aimed primarily at ‘relevant authorised persons’. However, in light of the proposed extension of the SM&CR to all PRA-regulated firms in the Bill, it may also be of interest to insurance firms.

1.7 The PRA is required by FSMA to have regard to any representations made to the proposals in a consultation, to publish an account, in general terms, of those representations and its response to them, and to publish details of any significant differences in the rules as made. Chapter 2 summarises responses to CP1/16 and sets out the PRA’s response. Following consideration of the representations, no material changes to the rules originally proposed in CP1/16 are being made.

## 2 Responses to CP1/16

### Background and original proposals

2.1 The Banking Reform Act introduced two statutory requirements into FSMA for relevant authorised persons to notify the PRA and FCA of breaches of the conduct rules by individuals subject to such rules:

- Section 64B(5), which required these firms to notify the regulators of actual or suspected breaches of the conduct rules; and
- Section 64C, which required these firms to notify the regulators of disciplinary action relating to a breach of the conduct rules. Section 64C defines disciplinary action as the:
  - a) issuing of a formal written warning;
  - b) suspension or dismissal of the person; and/or
  - c) reduction or recovery of any of the person’s remuneration.

2.2 Section 64B(5) of FSMA attracted comment during the development and implementation of the SM&CR for relevant authorised persons. In particular, firms highlighted the challenges of having to report suspected conduct rule breaches to the regulators. Consequently, HM Treasury is proposing to remove this requirement in the Bill. HM Treasury also proposes to replace the ‘presumption of responsibility’ in sections 66B(5) and (6) of FSMA with a duty of responsibility.

2.3 The proposed deletion/replacement of these provisions is subject to ongoing Parliamentary discussions on the Bill. However, following HM Treasury’s publication of The Financial Services (Banking Reform) Act 2013 (Commencement No. 9) (Amendment) Order 2015,<sup>1</sup> neither section 64B(5) nor sections 66B(5) and (6) of FSMA will enter into force when the remaining provisions of the SM&CR commence for relevant authorised persons on 7 March 2016.

2.4 HM Treasury decided to keep section 64C in the statute book. Unlike section 64B(5), section 64C is linked to firms’ internal disciplinary processes which, in principle, should make it clearer for firms to know at which point a notification needs to be made.

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<sup>1</sup> [www.legislation.gov.uk/uksi/2015/2055/contents/made](http://www.legislation.gov.uk/uksi/2015/2055/contents/made).

2.5 CP1/16 proposed amendments to the PRA's applications and notifications rules as well as to Forms C, D and L, in order to ensure that the PRA's rules and forms reflect the statutory position at the time of commencement.

2.6 In parallel with CP1/16, the PRA published a revised version of Supervisory Statement 28/15 *Strengthening individual accountability in banking*, which was amended to take account of the fact that the presumption of responsibility will not come into force on 7 March 2016. The PRA will consider whether the guidance relating to reasonable steps in SS28/15 should be reviewed and republished after the Bill receives royal assent.

### **Responses to the consultation**

2.7 The PRA and FCA collectively received eight responses to CP1/16. All of the respondents supported the proposed amendments to the *Applications and Notifications* and *Conduct Rules: Notification* rules and Forms as they considered that they would make the framework for notifying breaches of the conduct rules under the SM&CR more consistent, effective and proportionate.

### **Section 64C of FSMA**

2.8 A number of respondents requested further clarification regarding the point at which regulators should be notified of relevant disciplinary action pursuant to Section 64C of FSMA. In particular whether:

- internal appeals against the disciplinary action should affect the timing of the notification; and
- suspensions imposed as part of an investigation into alleged misconduct should be notified.

### **Impact of appeals on the duty to notify under section 64C**

2.9 Some respondents noted that notifications under section 64C should only be submitted once the disciplinary process has been completed, including any internal appeals, a process which can in some cases take months from the initial finding of misconduct and relevant disciplinary action to conclude. Respondents also noted that there could be 'possible employment and human rights implications of notification prior to a finding of fact being made'.

2.10 The purpose of the notification requirements in sections 64C and the corresponding PRA rules is to ensure that the PRA is promptly informed of misconduct by those individuals with the greatest potential impact on a firm's safety and soundness, such as senior managers and other MRTs.

2.11 To wait for individuals to complete all available internal appeals processes or for the period for making such an appeal to lapse before a notification under section 64C can be made would frustrate the effectiveness of these notification requirements.

2.12 Consequently, and consistent with the language of section 64C, notifications must be made at the point at which the relevant internal disciplinary action is first taken by the firm.

2.13 Moreover, these notification requirements should be read in conjunction with the PRA Fundamental Rules and the Conduct Rules for individuals and senior managers, which state 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 (Fundamental Rule 7);
- individuals must be open and co-operative with the FCA, the PRA and other regulators (Conduct Rule 3); and
- senior managers must disclose appropriately any information of which the FCA or PRA would reasonably expect notice (Senior Managers Conduct Rule 4).

2.14 Furthermore, the concerns around employment law and human rights focused on the risks arising from making a disclosure before a finding of fact had been made. However, under section 64C of FSMA, disclosures will only have to be made once the firm has reached the stage of actually taking disciplinary action, which means that it will need to have made a prior finding of fact.

2.15 The PRA nonetheless acknowledges the importance of adhering to a firm's disciplinary procedures and fair procedures in the conduct of disciplinary matters. Therefore, where an individual has appealed against a finding of misconduct giving rise to a notification under section 64C or expressly indicated to the firm his intention to do so, firms should include notification of this in the relevant form (Form C, D or L). It will be the firm's responsibility to update the PRA on any subsequent appeal by the individual, and the outcome of any appeal (including the discontinuance of such an appeal).

#### Duty to notify the regulators following a 'suspension'

2.16 Section 64C lists suspensions as a form of disciplinary action that must be notified to the PRA.

2.17 Some respondents to CP1/16 noted that suspensions are commonly used during investigations into alleged misconduct by individuals. Such investigations may or may not culminate in disciplinary action. For instance, a trader suspected of mis-marking his positions could be suspended for a few days or weeks while the firm carries out internal investigations. Respondents sought clarification on whether suspensions imposed as part of an ongoing, uncompleted investigation should be reported to the regulators.

2.18 Section 64C of FSMA requires firms to notify the regulators of a suspension or dismissal of an employee only when imposed as a disciplinary action following a confirmed breach of the conduct rules. Consequently, suspensions imposed to facilitate an investigation into alleged misconduct do not need to be reported under section 64C of FSMA, but those imposed following a concluded breach of the conduct rules do. For instance, using the example above, if the firm subsequently finds that the trader had in fact mis-marked his positions and suspends him while they decide what further action to take, the suspension would need to be reported within the period specified in our rules.

2.19 This reporting requirement is without prejudice to any other regulatory and/or criminal law reporting requirements that the firm may have in such circumstances, to which different reporting timeframes apply

#### Next steps

2.20 The final rules in this policy statement reflect the statutory position at the time of commencement of the SM&CR for relevant authorised persons on 7 March 2016. However,

subject to the outcome of Parliamentary debates on the Bill, the PRA will consider whether it should consult on additional, longer-term rules and guidance.

2.21 For example, as noted by some respondents to CP1/16, Notified Non-Executive Directors (NEDs) are currently not directly subject to the conduct rules and accompanying notification requirements.

2.22 However, as at the date of publication of this policy statement, the Bill proposes to expand the scope of the conduct rules to include all directors of regulated firms, as well as senior managers and employees of authorised firms, which is consistent with certain requirements in CRDIV and MiFID II that apply to all members of CRR and MiFID firms' boards. For instance the requirement that the PRA must be notified about the fitness and propriety of NEDs outside the SMR stems from similar requirements in CRDIV and MiFID II. In the event the Bill receives Royal Assent and this provision is included, the regulators will consult on these proposals in order to reflect the revised statutory position.

### **3 Definition of 'significant risk taker' – CP29/15**

3.1 As reflected in the consultation papers listed below, the PRA's intention throughout the development of the SM&CR has been to base the scope of its Certification regime on the criteria used to define material risk takers (MRTs) for remuneration purposes, which is in turn set out in the MRTs Regulation and comprises a:

- catch-all subjective definition covering all categories of staff whose professional activities have a material impact on an institution's risk profile (Article 2 of the MRTs Regulation);
- set of defined qualitative criteria (Article 3 of the MRTs Regulation); and
- set of defined quantitative criteria (Article 4 of the MRTs Regulation), which can be overridden in specified circumstances.

3.2 The PRA's proposed definition for significant risk takers was set out on in Consultation Paper 14/14 - *Strengthening accountability in banking: a new regulatory framework for individuals*<sup>1</sup> and confirmed in Policy Statement 16/15 - *Strengthening individual accountability in banking: responses to CP14/14, CP28/14 and CP7/15*<sup>2</sup>. The original definition of significant risk taker took into account the qualitative and quantitative criteria in Articles 3 and 4 of the MRTs Regulation but did not reference the catch-all definition in Article 2 of the MRTs Regulation.

3.3 In CP29/15 the PRA consulted on amending the definition of 'significant risk taker' in the Certification rules to align it further to the definition of MRT in the Remuneration rules by also reflecting the wording of Article 2 of the MRTs Regulation. Responses to that consultation were generally supportive of the clarity that the amended definitions would bring.

3.4 Although the revised definition of significant risk taker is wider than the original definition set out in PS16/15 and could theoretically lead to an increase in the number of employees that firms would need to certify under the PRA's rules, the revisions are justified as more clearly consistent with its stated policy. Moreover most, if not all, employees likely to be covered by

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1 PRA Consultation Paper CP14/14, 'Strengthening accountability in banking: a new regulatory framework for individuals', July 2014; [www.bankofengland.co.uk/prapages/publications/cp/2014/cp1414.aspx](http://www.bankofengland.co.uk/prapages/publications/cp/2014/cp1414.aspx).  
2 PRA Policy Statement PS16/15, 'Strengthening individual accountability in banking: responses to CP14/14, CP28/14 and CP7/15', July 2015; [www.bankofengland.co.uk/prapages/publications/ps/2015/ps1615.aspx](http://www.bankofengland.co.uk/prapages/publications/ps/2015/ps1615.aspx).

the enlarged revised definition are likely to already be subject to Certification under the FCA's rules, which have a wider scope.

3.5 Appendix 1 contains the amended definition of 'significant risk taker' in the Certification Part of the PRA Rulebook.

## **4 Cost benefit analysis**

4.1 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.

4.2 The PRA considers that the final rules published in this policy statement do not differ significantly from the drafts published for consultation.

## Appendices

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- 1** PRA Rulebook: CRR Firms, Non-CRR Firms: Individual Accountability (No. 1) Instrument 2016, available at:  
<http://www.bankofengland.co.uk/pr/Pages/publications/ps/2016/ps916.aspx>

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  - 2** Form C, available at:  
<http://www.bankofengland.co.uk/pr/Pages/authorisations/smr/default.aspx>

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  - 3** Form D, available at:  
<http://www.bankofengland.co.uk/pr/Pages/authorisations/smr/default.aspx>

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  - 4** Form L, available at:  
<http://www.bankofengland.co.uk/pr/Pages/authorisations/smr/default.aspx>
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