

Strengthening accountability in banking

BSA response to PRA CP 1/16 and FCA
CP 16/1

4 February 2016

 **Building Societies**
Association

Introduction

This brief response supports the proposals in, and comments on, PRA CP1/16 and FCA CP 16/1 (the CPs), which consult on changes to rules and forms in the light of the Government's proposal to remove the requirement on relevant firms, set out in section 64B(5) FSMA, to report known or suspected breaches of conduct rules.

We also make a small number of comments on related aspects of the overall exercise, including some remaining areas of uncertainty.

This response is divided into four sections as follows –

- Background
- Conduct Breach Reporting
- Rule Changes
- Amendments to Forms.

Background

1. From its inception, the BSA has supported the *strengthening accountability in banking* exercise, which began with an investigation by the Parliamentary Commission on Banking Standards, following the financial crisis of 2007-08, and certain high-profile conduct failures in the UK banking industry - PPI mis-selling and the LIBOR rate-rigging scandal, followed by serious misconduct in relation to foreign exchange.

2. Since the regulators published draft rules, we have helped our members with a range of practical implementational materials, guidance, seminars and workshops. In turn, our sector has worked diligently to implement the new rules.

3. However, while we strongly supported the overall exercise, from the outset we consistently expressed concerns about certain aspects of the proposals; in particular, the BSA -

- argued that the exclusion of some financial services sectors, for example, mortgage introducers and intermediaries from the regime would have created an anti-competitive imbalance,
- opposed the “reverse burden of proof” in respect of alleged conduct breaches, which we regarded as contrary to fair justice, and
- objected to the requirement to report, on an individual-named basis, conduct breaches by junior staff, especially when certain senior managers would – under the earlier plans – have been excluded from the ambit of conduct rules

(for the avoidance of doubt, we believe that *all* staff and managers should act in accordance with proper standards, but it should be the responsibility of management to take reasonable steps to ensure that this happens. The previous proposal on junior staff breach reporting would have militated against the climate of trust and openness that our members seek to encourage among all staff).

4. In the light of these concerns, we were pleased that HM Treasury, in October 2015, announced changes that would (subject to the passage of new legislation) -

1. extend the regime to all sectors of the financial services industry, including insurers, investment firms, asset managers, insurance and mortgage brokers and consumer credit firms,
2. drop the "reverse burden of proof" - instead there will be a statutory duty of responsibility to be applied consistently to all senior managers across the financial services industry, and the burden of proving misconduct will rightly remain on the regulators - as with other regulatory enforcement actions,
3. remove the obligation to report all known or suspected breaches of the conduct rules by any employees to the regulators – it is this proposed change that forms the basis for the CPs, and
4. give the regulators power to make conduct rules applying to all senior managers.

Conduct Breach Reporting

5. As the CPs explain –

- section 64B(5) FSMA requires a firm to notify the regulator if it knows or suspects that an individual has failed to comply with any conduct rules;
- section 64C requires a firm to inform the regulator if it has taken certain disciplinary action.

On current plans as we understand them, the Bank of England and Financial Services Bill (the Bill) will stop the introduction of section 64B(5). The suspension of section 64B(5) will come into effect on 7 March 2016 under Financial Services (Banking Reform) Act 2013 (Commencement No 9) (Amendment) Order 2015 (SI 2015 No 2055). The statutory provision itself would then be removed once the Bill received Royal Assent.

6. However, section 64C will continue, as will the existing requirement to report material breaches (currently in SUP 15.3 <https://www.handbook.fca.org.uk/handbook/SUP/15/3.html>).

7. SUP 15.3 is well understood, but it would be helpful if the regulators could confirm whether the BSA's understanding about who, after 7 March 2016, will be defined as a 'relevant person' in the context of section 64C, is correct. This provision extends wider than the current requirement for notification via Form C, where a person ceases to perform a function by reason of suspension or dismissal. **After 7 March 2016, if a formal written warning is given, or a reduction or recovery of remuneration is imposed as a result of breach of a conduct rule, a notification will also be required.**

8. Our present understanding is that, for the PRA, senior managers and certification staff (and others carrying on those functions) will be in scope - see SS28/15 and Notifications 11.

9. We understand that the FCA covers broadly the same categories of individuals in the SUP 15.11, and also include junior conduct rules staff - SUP 15.11.13-15. This is what we believe to be the current formal policy position. However, it appears from COCON 1.1.2 (set from 7 March 2016) that junior staff are *not* to be included – they do not seem to be encompassed within any of the categories of individuals specified, and it would be helpful if this could be clarified.

10. Regarding the timing of notifications, our understanding is that –

- SUP 15.3 (PRA and FCA) continues to be **immediate**
- PRA - *senior managers and certification staff*: in each case the PRA will require a notification to be submitted within **7 business days** of the point at which the firm determines that the relevant requirement applied - Conduct Rules: Notifications: 11.2-4
- FCA – *senior managers*: is **7 business days** as above – SUP 15.11.12 and SUP 10C Annex 1, and
- FCA - *certification staff and junior conduct rules staff* is **annual** - SUP 15.11.13.

Rule Changes

11. The FCA consults on a number of changes to its Handbook, including COCON 2.3.3; SYSC 5.2.14; SYSC TP 5.3.4; SUP 10A Annex 6R and 7R, SUP 10C, 15.2.5, 15.3.14B, 15.11 and Annex 7R. For the PRA, the proposal is to amend Notifications: 11 Conduct Rules: Notifications, and Senior Managers Regime – Applications and Notifications Part: 1 - Application to Perform a Senior Management Function.

12. Having checked our own rule map regarding the exercise, we cannot identify any other Rules that would require amendment. Presumably there is nothing in DEPP that requires amendment in the current context? We note that the PRA recently revised Supervisory Statement SS28/15 and made corresponding changes in relation to conduct rules breach reporting. The changes all appear to be appropriate.

13. We have one observation regarding the revised SS28/15. Paragraph 5.34 states that “Notified NEDs are not directly bound by the Conduct Rules and are therefore exempt from the accompanying notification requirements in section 64C of FSMA and Notifications 11.2.” (also see paragraph 5.27). This will presumably *not* be the case once the Bill, subject to Parliamentary agreement, receives Royal Assent – see HM Treasury’s October 2015 policy paper (paragraph 3.9) and Bill clause 21(2)?

14. On the exercise overall, a number of changes that have occurred, or have been proposed, since PRA and FCA published, what were intended to be, final rules around mid-2015. We note that, as acknowledged by the CPs, certain matters must remain technically outstanding until the Bill receives Royal Assent, consequential regulatory rules are finalised, and the rules on regulatory references are published.

15. In view of the fact that the new regime begins on 7 March 2016, it would be helpful if the regulators could provide a list of the matters likely to be outstanding on that date and what their expectations of firms, or plans, are in respect of each. A key example is the precise, *formal* position on notified NEDs in respect the conduct rules (see above).

16. As a further example, it will take regulated firms time to implement into systems any new or amended requirements regarding regulatory references and criminal record checks. Depending on when the final rules are published there might be only weeks or days (it cannot now be much more than a month) for firms to implement relevant systems changes, training etc if they had to be effective from 7 March. Therefore, it would obviously be unreasonable to expect firms to be able to go ‘live’ in respect of such new rules on 7 March, so we urge the regulators to include, in the final rules on regulatory references, fair transitional arrangements. On the other hand, if the new rules are to be postponed, could the regulators let firms know as soon as possible, so that they can focus their efforts on elements that will go ‘live’?

Amendments to Forms

17. The FCA and the PRA both consult on amendments to Forms **C** (*notice of ceasing to perform controlled functions*) and **D** (*notification of changes to personal information or application details and disciplinary action related to conduct*).
18. The FCA consults on amendments to Form **H** (*notification of disciplinary action relating to certification employees or other conduct staff*).
19. The PRA consults on amendments to Form **L** (*notifications of disciplinary action in relation to an employee performing a certification function*).
20. All the proposed amendments all appear to be appropriate.
21. However, technical IT problems with the initial regulatory forms (ie Forms K and A) have made the early stages challenging for some firms. The PRA and the FCA have been very helpful in resolving the issues, but we hope that, going forward, lessons will have been learned so that similar technical problems do not arise when the newer forms come to be activated and used after 7 March.

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