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ELA L&P Committee: PRA Evaluation of the Senior Managers and Certification Regime December 2020 Paper

Response from the Employment Lawyers Association

23 February 2021

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INTRODUCTION

1. The Employment Lawyers Association (ELA) is an unaffiliated and non-political group of specialists in the field of employment law. We are made up of about 6,000 lawyers who practice in the field of employment law. We include those who represent Claimants and Respondents/Defendants in the Courts and Employment Tribunals and who advise both employees and employers. ELA's role is not to comment on the political merits or otherwise of proposed legislation or calls for evidence. We make observations from a legal standpoint. ELA's Legislative and Policy Committee is made up of both Barristers and Solicitors who meet regularly for a number of purposes, including to consider and respond to proposed new legislation and regulation or calls for evidence.

2. A Working Party chaired by Alistair Woodland (Clifford Chance LLP) was set up by the Legislative and Policy Committee of ELA to comment on the PRA Evaluation. Members of the Working Party are listed at the end of this paper.

3. The Working Party comments below only on Recommendation 1 in respect of Conduct and Regulatory references.

EXECUTIVE SUMMARY

4. The ELA Working Party would welcome further guidance from the PRA on the following matters: -

- when non-financial misconduct is relevant to an assessment of fitness and propriety, and/or amounts to a conduct rule breach;
- when a matter should properly be classified as a breach of the conduct rules relating to integrity or due skill care and diligence; and
- the disclosures that should be made in regulatory references, the potential misuse of regulatory references and the threshold to be applied by hiring firms in receipt of a qualified regulatory reference.

***Examine the scope for clarifying expectations related to misconduct reporting in notifications and regulatory references. Engage with industry so that regulatory references are used in an appropriate manner*.**

5. There are two areas in which we suggest further guidance would be helpful. The first relates to non-financial misconduct (**NFM**). The second relates to borderline issues as between 'integrity' cases and 'due skill care and diligence' cases.

NFM is Relevant to Fitness and Propriety

6. It is clear to firms that NFM such as harassment (including but not limited to sexual harassment) and bullying may be relevant to a firm's assessment of (i) an individual's fitness and propriety (**F&P**) and (ii) whether an individual has breached one or more of the FCA Conduct Rules or the PRA Conduct Standards (collectively referred to as the **Conduct Rules**). This has been made clear by the FCA in a number of speeches and "Dear CEO" letters. For example, in September 2018, Megan Butler, FCA Executive Director sent a letter to House of Commons' Women and Equalities Committee. The letter addressed the issue of sexual harassment, noting that the FCA regarded it as misconduct that falls within the scope of the FCA's regulatory framework. Megan Butler stated that sexual harassment and other forms of NFM can amount to a breach of the Conduct Rules (indicating that such conduct may amount to an integrity issue). The letter was followed by a speech in December 2018 by Christopher Woolard, FCA Executive Director of Strategy and Competition during which Mr Woolard stated that "the way firms handle non-financial misconduct, including allegations of sexual misconduct, is potentially relevant to our assessment of that firm, in the same way that their handling of insider dealing, market manipulation or any other misconduct is".

7. In January 2020 a "Dear CEO" letter from Jonathan Davidson, FCA Executive Director of Supervision, Retail and Authorisations, was published regarding NFM. Although the letter was addressed to the wholesale general insurance sector, it is indicative of the FCA's approach to non-financial misconduct across the industry as a whole. Mr Davidson noted that NFM and an unhealthy culture is a key root cause of harm within financial services and that a firm's handling of NFM is a strong indicator of its culture.

8. So, it is very clear that NFM may be relevant in terms of F&P and the Conduct Rules. In some (limited) circumstances it will be incontrovertibly the case that NFM will go to the heart of F&P and be a clear breach of one or more of the Conduct Rules. For example, instances of egregious misconduct (such as that seen in the recent case of Russell Jameson who was convicted of criminal

offences involving the making, possession and distribution of indecent images of children[1]). However, the vast majority of firms will fortunately never experience such clear cut cases. It is more likely that NFM will be of a (relatively speaking) less serious nature, such as forms of harassment or instances of workplace bullying. This creates significant challenges for firms in determining how to categorise staff behaviours across a broad spectrum of NFM. This difficulty is compounded by the fact that (at least insofar as F&P is concerned) firms also need to take account of activities taking place in employees' private lives.

Lack of Guidance and Inconsistency In Respect of NFM

9. Beyond the clear public messaging referred to above there is a dearth of guidance for firms in terms of when NFM will go to an individual's F&P and/or amount to a Conduct Rule breach. The FIT guidance in the FCA Handbook contains a non-exhaustive list of factors to which firms should have regard in making F&P assessments. All of the examples relate to financial misconduct and there is no express reference to any forms of NFM. Similarly, the non-exhaustive list of conduct that may amount to an integrity breach in terms of the Conduct Rules focus purely on traditional forms of financial misconduct. This uncertainty and lack of guidance means that firms are making difficult judgement calls in relation to what is a very subjective and nuanced area. Whilst it is appropriate that firms articulate their own culture and set their own tolerance levels, this lack of clarity is problematic for a number of reasons, including:

9.1 The inherent subjectivity means that different firms are taking very different approaches to the issue of whether certain behaviours go to an individual's F&P and/or whether such behaviours amounts to a breach of the Conduct Rules. This inconsistency within the market can result in unfair outcomes for individuals in certain firms where their conduct is treated far more seriously than it would be by other employers in the same sector.

9.2 The inconsistency referred to in point 9.1 above has a direct impact on the nature and extent of a firm's disclosures in the context of a regulatory reference. In short, those firms who take a stricter approach to NFM in the context of F&P and/or the Conduct Rules are more likely to make adverse disclosures in a regulatory reference as compared to those firms who either take a more lenient approach or who fail to appreciate that certain 'grey area' forms of NFM are relevant from a regulatory perspective.

[1] Final Notice 2020: Russell David Jameson (fca.org.uk)

9.3 This inconsistency means that firms who have taken a stricter approach to NFM as it relates to F&P/Conduct Rules will appear to have higher instances of regulatory misconduct and poor culture as compared to their peers (when in fact this is not the case and it may be that the reverse is true).

9.4 It may be the case that the lack of clarity results in some firms failing to identify when particular behaviours do in fact amount to a Conduct Rule breach and/or an issue going to F&P. This may contribute to underreporting of Conduct Rule breaches (we note that the PRA report at page 14 refers to a "modest" level of conduct notifications to date, and it may well be the case that the root cause of this is the aforementioned lack of understanding).

In light of the above we consider that the current situation is unsatisfactory. There is a lack of clarity in terms of whether, when and to what extent NFM will go to an individual's F&P and/or amount to a breach of one or more of the Conduct Rules. Whilst we recognise that the Regulators cannot (and should not) be overly prescriptive, the high degree of subjectivity (and potential lack of awareness within certain firms) has the potential to create significant inconsistencies and therefore unfair outcomes for firms and individuals. We would therefore welcome further guidance from the regulators on the issue of NFM as it relates to F&P and the Conduct Rules. For example, it would be helpful for the existing guidance (i.e. the FIT2 Main Assessment Criteria and the COCON Specific Guidance on the Conduct Rules) to be updated so as to include non-exhaustive examples of the types of NFM that may be relevant from an F&P and/or Conduct Rules perspective.

Lack of Guidance as to Integrity

10. As to the question of 'integrity' and 'due skill care and diligence', the line between the two is unclear for both firms and individuals. That is very significant because firms rightly understand integrity to be an extremely serious matter (such that any suggestion of a lack of integrity will almost inevitably result in the withdrawal of an offer), whereas questions of due skill and diligence are in all cases relative to the expectations of the role in question. The basis on which a firm decides that a matter is an 'integrity' matter rather than merely 'due skill and diligence' is unclear, and appears sometimes to relate to a tactical or commercial decision on the part of the firm who may be in dispute with the individual. In that regard, we recognise that the PRA has stated in Supervisory Statement 28/15 in a footnote that "The PRA does not believe it is necessary to provide guidance on what it means to act with integrity." With respect, in the context of regulatory references, that approach is unhelpful. As stated, the question of whether a matter goes to a person's integrity is generally considered to be critical in a regulatory reference

and/or fitness & propriety context. We are aware also that this is a matter on which there is a significant quantity of case-law. In the absence of clear guidance from the PRA, it is clearly open for firms to interpret that case-law in divergent ways, and sometimes significantly divergent ways. We therefore invite the PRA to provide guidance on what it means to act with integrity, and on the borderline between 'integrity' and 'due skill care and diligence'.

The Lack of Guidance and Inconsistent use of Regulatory References

11. One key issue with regulatory references arises as a direct result of the inconsistent approach by firms to NFM, in terms of whether particular behaviours amount to a breach of the Conduct Rules (or go to F&P). This particular issue is already addressed above. This section therefore focuses on the particular question around whether regulatory references are being used in an appropriate manner (one of the concerns being that regulatory references may be used in ways that are unnecessarily punitive).

12. We have identified four key concerns with the regulatory reference regime. The first one is covered under the heading of "Conduct" above. Two of the issues we have identified relate to Question G of the SYSC22 Regulatory Reference template (Question G), which reads as follows:

"*Are we aware of any other information that we reasonably consider to be relevant to your assessment of whether the individual is fit and proper?"*

13. Firstly, in our experience there is a lack of consistent understanding across the industry in terms of the type of information that ought to be disclosed under Question G. Some firms appear to treat Question G as a "catch-all" provision, and therefore tend to disclose a wide range of information much of which cannot reasonably be said to be relevant to the new firm's F&P assessment. In our experience this is particularly likely where the information relates to NFM and where there has been no actual finding of misconduct or wrongdoing. For example, we are aware of one firm which disclosed details of a bullying allegation made against a senior employee, even where the allegation had not been upheld (but where there had been a finding that the individual could have been more empathetic in their management style). This resulted in the employee's job offer being withdrawn.

14. Secondly, we are also aware of some firms using Question G tactically, in the context of potential disputes with departing employees. For example, where there is a potential dispute relating to breaches of post-employment contractual restrictions (e.g. non-compete or non-solicitation clauses). We are aware of a

number of firms who, in the context of pre-action correspondence, have used the threat of an adverse regulatory reference (most commonly a narrative under Question G) to their advantage in the context of negotiations relating to private contractual matters. Some of these firms may be using the regulatory reference regime as a litigation tactic whereas others may genuinely find it extremely difficult to decide whether such matters ought to be included in a regulatory reference or not. As such we consider that some guidance from the regulators would greatly assist firms in deciding what information can (and should) be included. This will give firms more confidence and certainty and should reduce the scope for disclosures being made erroneously (whether intentionally or otherwise), thus creating a greater consistency across the industry and mitigating the risk of employees with good conduct records finding themselves in an impossible situation. We consider that the absence of any public register or record of firm's approaches to Question G increases this need for guidance from the regulators.

15. Lastly (and as a more general point) it is our experience that hiring firms (and in particular SMFs with responsibility for or oversight of hiring decisions) are overly cautious in relation to disclosures made in a regulatory reference. Firms and individual SMFs can be extremely nervous about hiring an individual where the regulatory reference includes any adverse information whatsoever. Rather than exercising judgement, taking into account the range of information available (and not treating the reference in isolation), some firms are holding new recruits to a standard of perfection and rejecting applicants where any form of adverse disclosure is made on the regulatory reference (including Question G disclosures). In practice this can involve them applying more stringent approaches to new recruits than they do to their own staff, and more significantly still, means that these firms are adopting higher standards than the regulators themselves would do: regulators often point out that they themselves take into account a range of factors when deciding whether to grant individual regulatory approvals, and that a negative disclosure does not necessarily preclude an individual nonetheless receiving regulatory approval This issue is compounded by (1) the lack of understanding around NFM and its significance vis-à-vis F&P/Conduct Rules (which results in inconsistent approaches to the completion of the regulatory reference template) and (2) the tendency of some firms to treat Question G as a catch-all mechanism and therefore "over share" by providing information that is arguably irrelevant from an F&P perspective.

16. We consider, having regard to the issues identified above, that firms would greatly benefit from:

    16.1 Guidance from the regulators around the type of information that may be relevant in terms of Question G (and the type of information that will not

normally be relevant), and in particular, the threshold for the disclosure of information. For example, does the PRA consider there to be a 'low' or 'high' threshold for the disclosure of information in response to Question G, in general terms?

16.2 Guidance from the regulators around the potential misuse of the regulatory reference regime, for example where threats of an adverse reference are made wholly or mainly due to a private contractual dispute (rather than for the purposes of the regime);

16.3 Further clarity from the regulators that an adverse regulatory reference does not, in and of itself, preclude a firm from recruiting a particular individual (i.e. comfort from the regulators that firms should take a holistic approach to their recruitment due diligence and should not hold candidates to a standard of perfection). Guidance as to the relevant threshold to be applied (as set out in the first bullet point above) may be one practical means of achieving such clarity.

16.4 An alternative approach might be to require all firms, in every reference, to provide a positive commentary on a candidate's fitness and propriety in response to Question G. Such an approach could require firms to go beyond a one-line response, addressing issues such as disciplinary record, issues arising outside of work, and the firm's view of the person's competence and capability.

Members of ELA Working Party

Alistair	Woodland	Clifford Chance	(Chair)
Michael	Anderson	Lewis Silkin	
Patrick	Brodie	RPC	
Steven	Cochrane	CMS	
Anna	Greenley	Devereux Chambers	
Holly	Insley	Freshfields	
Corrie	Leitch	Barclays	
Jean	Lovett	Linklaters	
Julie	Morris	Slater Gordon	
Tom	Ogg	11 KBW	
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