DP1/23 – REVIEW OF THE SENIOR MANAGERS & CERTIFICATION REGIME (SM&CR)

Response from the Employment Lawyers Association

31 May 2023

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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 6,600 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 was set up by the Legislative and Policy Committee of ELA to respond to the PRA's and FCA's review of the SM&CR. Members of the Working Party are listed at the end of this paper.

3. References in this paper to the views of ELA are intended to be inclusive of the views of the minority as well as the majority of ELA members. Whilst not exhaustive of every possible viewpoint of every ELA member on the matters dealt with in this paper, the members of the Working Party have striven to reflect in a proportionate manner the diverse views of the ELA membership.

EXECUTIVE SUMMARY

4. It is our opinion that the SM&CR is generally fit for purpose, and meets many of the aims that it was put in place to achieve. However, there are a number of amendments that we think would improve how the legislation works in practice. In particular: streamlining the application process, providing guidance on what the regulator expects from Senior Managers ('SMs') applying for specific Senior Management Functions ('SMFs') and providing further rights to approved persons in relation to regulatory references.

QUESTION 5

5. To what extent do you agree or disagree that the SM&CR has made it easier for firms to hold staff to account and take disciplinary action when appropriate against them?

Agreed, to a limited extent, but pre-existing frameworks continue to be the primary disciplinary driver

5.1. We agree that the Senior Manager & Certification Regime ('SM&CR') has, albeit in some limited circumstances, made it easier to hold some staff accountable and to take disciplinary action against them. In particular, we consider that this is true

of individuals holding Senior Management Functions ('SMFs'), to whom prescribed responsibilities have been allocated (and where a suspected failure to discharge those prescribed responsibilities could provide grounds for disciplinary action even in the absence of clear misconduct by the Senior Manager).

5.2. In addition, if 'disciplinary action' includes the application of malus and clawback to remuneration, we agree that the SM&CR may to some extent have made it easier to take disciplinary action. Although the requirement to apply malus and clawback arises under the FCA's and PRA's remuneration rules and not the SM&CR specifically, we would typically expect malus and/or clawback to be contemplated where an individual has breached a conduct rule or has been found to lack fitness and propriety. There is therefore a link between this form of disciplinary action and the SM&CR (with the SM&CR providing part of the framework for determining whether malus and/or clawback should apply).

5.3. Beyond these two examples, however, we do not generally consider that the SM&CR has made it easier to hold staff to account and to take disciplinary action against them. On the whole, our experience is that employers continue to take disciplinary decisions within their pre-existing framework – e.g. their firm-wide code of conduct and applicable policies (such as anti-bullying and anti-harassment policies) – with any SM&CR-related decisions sitting on top of that framework. For example, an employer might discipline a certified person for a breach of the firm's code of conduct. It will then separately consider whether that act of misconduct also constitutes a breach of one of the conduct rules and whether it remains satisfied that the individual is fit and proper. A conduct rule breach and/or finding of a lack of fitness and propriety does not typically drive the disciplinary outcome (or the decision to take disciplinary action in the first place). Indeed, in some circumstances there may be a mismatch between the disciplinary outcome and the regulatory outcome. For example, an employer may decide to issue a final written warning to an employee for an act of misconduct but the relevant senior manager (who has not participated in the disciplinary process) subsequently concludes that the employee is not fit and proper and cannot continue in their role. In these instances, rather than making it easier to hold staff to account, the SM&CR adds an extra degree of complexity as the employee's dismissal may be required by reason of the firm's inability to certify the employee as fit and proper to perform their role, even though the disciplinary decision was that a sanction short of dismissal was appropriate. In this situation, it may be difficult for an employer to show that it has a potentially fair reason for dismissal pursuant to s.98 of the Employment Rights Act 1996 (the underlying reason for the employer's action being misconduct, for which they would not (absent the regulatory overlay) have dismissed.

<u>Regulatory references have added additional complexity to disciplinary matters</u>

5.4. The other area of additional complexity is in relation to regulatory references (see Q.20 below), and breach reporting obligations. The potential requirement to disclose disciplinary decisions and/or concerns regarding fitness and propriety in regulatory references or to the regulator has raised the stakes when it comes to carrying out disciplinary processes, given the potentially greater negative consequences for employees. In our experience this means that disciplinary processes are often more contentious than they were previously, with a greater

likelihood of an employee challenging the process and outcome. Further, since the introduction of the SM&CR, disciplinary decision makers can be more nervous about making adverse findings in respect of an employee given the impact that these findings may have on the individual's future career prospects (both in terms of the ability to certify the individual as fit and proper and in relation to any disclosures on a future regulatory reference) rather than their decision simply resulting in an internal HR consequence. This is particularly the case where there are a number of mitigating factors or in less serious matters where the conduct may only warrant a written warning.

5.5. We also note the possible tension between the SM&CR and the regulators' desire to increase psychological safety within firms. Given the potential consequences that can arise from identification of individual failings, there may be a fear (either of triggering those negative consequences or, in some cases of reprisal) that prevents individuals from speaking up about their own or others' mistakes (or potential mistakes). This could be mitigated in part by greater clarity from the regulators as to what, for example, constitutes a failure to take reasonable steps or to exercise due skill care and diligence.

QUESTION 6

6. To what extent do the specific accountabilities of individual directors established by the Senior Managers Regime work in ways that complement the collective responsibility of the board of directors or decision making committees? Are there ways this could be improved?

In certain respects, it has caused uncertainty amongst directors

6.1. The specific accountabilities of individual directors established by the Senior Managers Regime allow the FCA, firms and individuals to identify clearly who has been allocated ultimate responsibility for a given area from a regulatory standpoint. We acknowledge that, if it is otherwise unclear who is accountable for a particular failing, this named responsibility has some advantages from an enforcement perspective as it provides at least one individual that can potentially be held accountable. However, our experience is that the existence of these specific accountabilities has caused some potential uncertainty as to the scope of collective responsibility. In a worst case scenario, there is a risk that directors or decision-making committees could consider themselves to be free from responsibility for a particular issue because of the allocation of specific accountability to a named director and this can encourage a culture of finger pointing rather than committees collectively focusing on what may have gone wrong and how issues can be addressed and/or avoided in future.

6.2. We consider that some further guidance on this topic (with specific examples of the intended interaction of individual and collective accountability) would be helpful. As an example, setting out further specific guidance around the accountability for firm culture and how individual responsibility interacts with the board's collective responsibility (e.g. in setting tone from the top) would be helpful.

QUESTION 12

7. How could the process for senior management function ("SMF") approvals be further improved?

Streamline the Application Process

7.1. First, we comment on approval timelines. We note that the 'Authorisations operating service metrics 2022/23 Q4' for SM&CR approvals shows 'red' for three of the four quarters in 2022, the remainder being 'orange'. This reflects our experience that the regulators are often not approving individuals within the prescribed statutory timescales of within 90 days (or 12 weeks). In our view, it should be possible to significantly improve these outcomes.

7.2. One of the reasons for the tardiness with which approvals take place is the regulators' ability to 'stop-the-clock' when it believes it is necessary to request further information pursuant to section 60(4) of the Financial Services and Markets Act 2000 ("**FSMA**"). The use of this provision leads to a high level of uncertainty for regulated firms and applicants. In some cases, this results in a regulated firm withdrawing support for a candidate because of the process' inefficiencies or in anticipation of a potential refusal rather than because of any issues with the applicant suitability for the SMF, which gives rise to an unintended 'chilling effect' on prospective candidates. Our members have also observed that on occasion requests are made for what appears to be superfluous information (which again has the effect of stopping the clock on prescribed timescales. We suggest that HM Treasury consider repealing this provision and replace it with a hard deadline of three months, or at least, that the regulators set out guidelines to limit its use. This would result in a fairer approach and would ensure that applicants are not dissuaded from making or continuing with applications for unintended reasons, and would remove or control a significant statutory basis on which the delays in approvals are justified.

7.3. Short form A and form E are used for individuals who are currently already approved to perform an SMF (or have recently held approval to do so), who wish to apply to hold another SMF or a similar SMF at a different firm. We suggest that the application processes for these forms are simplified and/or that a 'fast stream' is created for applications made using these forms (for example by the regulator stating that it will complete reviews made on these applications forms within 6 weeks). Some further potential streamlining recommendations are as follows:

7.3.1. the regulator ceases to request interviews from applicants using these forms, as this does not seem proportionate given the information the regulator should already have about the relevant candidates; and

7.3.2. in respect of SMs who are taking on a different, but similar SMF – to the extent that the SM does not require specific technical expertise and/or experience for the new SMF, for example SMF17 – the regulator could consider whether a simple notification from the firm would suffice, instead of an application. Especially, in situations where, in the

regulator's experience, the SMF that the applicant currently holds and the one they are applying for are similar.

Provide further guidance on specific SMF

7.4. Second, the regulator should publish further guidance in respect of what in particular is required for applicants who wish to take on a specific SMF. Providing more comprehensive guidance on the criteria for each SMF would result in regulated entities putting forward candidates more in line with what the regulator would expect to see, and potentially reduce application review times. Whilst it is no doubt true that the circumstances of each firm and individual differ that is not a legitimate reason for the current total absence of published guidance.

Provide anonymity in the SMF application process

7.5. Third, anonymity in the SMF application process may also make the process fairer and increase the competitiveness of the market. At present the refusal of an application generally becomes public shortly after the regulator makes a decision (i.e. issues a Decision Notice). A public decision by a regulator not to approve a person will likely have significant adverse consequence for the individual's career. The consequence of this is that very few individuals challenge the regulators' decision-making as regards approvals. It is also likely that some individuals may be dissuaded from applying for SM roles and this is likely to adversely impact on the diversity of SMFs within regulated firms.

7.6. We note, for example that the FCA's May 2015 'Data Bulletin' stated that: "*Between 1 April 2014 and 31 March 2015 no applications were refused. However, in this time 214 applications were withdrawn during the vetting process*". We have been unable to find more contemporaneous data. However, this reflects our experience, and suggests that the regulators face no effective check on their decision-making as regards approvals, because so few such decisions are challenged. The overwhelming majority of such applications are withdrawn.

7.7. We suggest that regulators and government should consider whether anonymity in this process should be extended to further within the process, or for decisions to be published anonymously. An example of where it may not be proportionate to publish a decision not to approve is in circumstances where the reason for refusing approval is a lack of technical expertise, rather than any conduct issues.

QUESTION 14

8. To what extent do you agree or disagree that the 12-week rule sufficiently helps firms to manage changes in SMFs?

The 12 week rule's scope should be officially widened

8.1. The 12-week rule, as drafted in SUP 10C.3.13 R, allows an individual to cover for an SM without being approved, where the absence is temporary or reasonably unforeseen and the appointment is for less than 12 weeks. In our experience,

this rule is liberally interpreted and tends to be used simply for any temporary or permanent appointment pre-approval.

8.2. Strictly, the 12-week rule does not assist a regulated entity in the scenario where an individual is needed to take over from an SM long term. Take for example a scenario where an overseas' employee has been chosen to takeover the SMF of a SM, and the regulated entity would like the overseas' employee to be able to begin working immediately. The current 12 week rule does not explicitly allow for this practice, and it would be helpful if the regulator would issue guidance on whether the 12 week rule can be used in this way (as we find that many regulated entities attempt to use the 12 week rule in this way). Similarly, it would be appreciated if the regulator could issue guidance on whether an application could be 'front-loaded' so that approval can be sought and provided prior to the current SM in charge of the relevant SMF relinquishing the relevant SMF.

8.3. We also note that given that the 12-week timescale for approval is often not adhered to, the period chosen for the temporary approval regime (i.e. the 12-week rule) should be reviewed. Sometimes, the '12-week rule' is insufficient in duration.

QUESTION 15

9. To what extent do you agree or disagree that the regulators have in place:

a) an appropriate set of SMFs to achieve the aims of the SM&CR?

9.1. In respect of question 15 a) there are no obvious gaps.

b) an appropriate set of Prescribed Responsibilities to achieve the aims of the SM&CR??

9.2. We considered the adoption of an HR SMF, but concluded that this could give rise to issues similar to those that were debated (historically and at length) in relation to Legal, with the result that few, if any, HR functions would fall solely within the scope of any proposed HR SMF. This is because, in practice, we tend to find that issues such as the number of employees within a business unit or the experience/skill/knowledge sets of said employees are dealt with by the individuals responsible for the relevant business units acting in conjunction with HR, with the head of the business unit being ultimately responsible.

QUESTION 16

10. To what extent does the Duty of Responsibility support:

a) personal accountability?

10.1. In practice, we have found that the Duty of Responsibility does materially support personal accountability (we believe this is probably as a result of the consequences of breach).

b) better conduct of Senior Managers

10.2. In practice, we have found that the Duty of Responsibility does make firms and individuals more focused on conduct (again probably as a result of the consequences of breach).

QUESTION 17

11. To what extent do you agree or disagree that Statements of Responsibilities and Management Responsibilities Maps help to support individual accountability?

11.1. We consider that Statements of Responsibilities and Management Responsibility Maps do materially help to support individual accountability because they clarify who is (or should be) responsible for doing what. However, additional care and focus is required where a firm's operational and/or organisational structures (including at an individual level) are in a state of flux or change. Any regulatory guidance, distilled from cases, would be welcome.

QUESTION 18

12. To what extent do you agree or disagree that the Certification Regime is effective in ensuring that individuals within the regime are fit and proper for their roles?

12.1. We agree that the Regime is quite effective in ensuring individuals are fit and proper for their roles, but we have the following additional views:

12.1.1. there is a perception by firms and their legal advisers that there is a lack of guidance provided by the regulators to reflect the experience of the firms and the reports that the firms have provided to the regulators, and that there is a limited number of publicly available enforcement decisions;

12.1.2. the regulatory guidance should be updated, in particular to include more recent examples of where issues have arisen and how they should be addressed/resolved; and

12.1.3. problems can arise where SMFs are not available to Core firms and where a firm does not want to re-categorise as Enhanced. The problem with having a smaller number of SMFs available for Core Firms means that they can end up with a small number of individuals having a disproportionately broad range of responsibilities without the option of splitting out these responsibilities in the same way as they could if they were Enhanced Firms.

QUESTION 20

13. To what extent do you agree or disagree that regulatory reference help firms make better informed decisions about the fitness and propriety of relevant candidates?

13.1. We made a submission, dated 23 February 2021, in response to the PRA Evaluation of the Senior Managers and Certification Regime December 2020

Paper1 (ELA 2021 Response). This included comments under the heading "The Lack of Guidance and Inconsistent Use of Regulatory References". This present response reiterates points made in the ELA 2021 Response.

13.2. As a direct answer to Question 20, it is our experience that the regulatory reference regime has certainly put issues relating to fitness and propriety (F&P) at the heart of the recruitment process in the regulated sector. Accordingly, it is surely the case that the risk of "rolling bad apples" has been reduced as a result of the introduction of the regulated reference regime.

13.3. However, we do have concerns as to whether the regulatory reference regime achieves fair outcomes for every individual and whether it might have the effect of filtering out from the regulated sector people who may, in fact, be not only fit and proper but potentially productive employees. In our experience this is particularly the case for more junior employees who have less of a "network" in the financial services sector to assist with a job search.

13.4. One key issue with regulatory references arises as a result of the inconsistent approach by firms to non-financial misconduct (NFM), in terms of whether particular behaviours amount to a breach of the Conduct Rules or go to F&P. This particular issue was addressed in the ELA 2021 Response referred to above under the headings "NFM is Relevant to Fitness and Propriety" and "Lack of Guidance and Inconsistency in Respect of NFM".

13.5. In the ELA 2021 Response, we identified two issues in relation 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?"

13.6. The first issue 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, due to the uncertainty firms face as to whether disclosure of NFM is actually required, and if so, in what circumstances. Indeed, the PRA website[2] provides that *"Firms are required to disclose all matters relating to a candidate's fitness and propriety. If a firm is not sure whether something may have an impact on a candidate's fitness and propriety, the information should be disclosed. We take non-disclosure very seriously and may consider it to be evidence of current dishonesty. If in doubt, disclose."*

13.7. At the other end of the scale, some employers provide references which are unhelpfully short, verging on cryptic. This is often because such firms are (rightly) concerned about on-going regulatory issues or potential (or on-going) litigation or

[1] https://www.elaweb.org.uk/law-and-practice/consultation-responses/ela-response-pra-evaluation-senior-managers-and
[2] https://www.bankofengland.co.uk/prudential-regulation/authorisations/senior-managers-regime-approvals

grievances from impacted employees, their confidentiality obligations (including to third parties) or other legitimate concerns. However, those particularly short references leave the recipient firms and the subjects of references in a difficult position. Recipient firms have no means of further investigating such cryptic references because the relevant issues occurred at the other firm, and individuals in such circumstances will struggle to convince recipient firms to 'take a risk' on them in such circumstances.

13.8. The second issue is a lack of consistency in the way in which firms consider what has been disclosed in a regulatory reference. It is our experience that hiring firms (and in particular SMFs with responsibility for or oversight of hiring decisions) are often very 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 apply: 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: (a) 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 (b) 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.

13.9. We refer to the absence of any formal mechanism for an individual to challenge the content of or have a right of reply in relation to a regulatory reference. Indeed, an individual does not normally have a right to receive a copy of any regulatory reference. The regime for data subject access requests under the UK GDPR has a specific exclusion in relation to "*a reference given (or to be given) in confidence for employment, training or educational purposes*". The exemption covers the personal data within the reference whether processed by the reference giver or the recipient (paragraph 24, Schedule 2, of the Data Protection Act 2018), but note in the ICO's recent Q&A[3] on DSAR's the ICO stresses that "*It is important to note that this only applies to references that you give in confidence"*; so in principle if it is made clear that the reference is not being provided in confidence it can be provided in response to a DSAR; equally if it is unclear whether it has been provided in confidence the ICO sets out what should be taken into account when assessing whether the reference should be provided in response to the DSAR.

13.10. As a result, this has led to individuals potentially having to threaten court proceedings, such that court rules relating to pre-action disclosure might be

[3] https://ico.org.uk/for-organisations/uk-gdpr-guidance-and-resources/employers/sars-qa-for-employers/#process

engaged, allowing the individual to demand a copy of a reference about themselves. Many employers provide a copy of a regulatory reference at a relatively early stage in such correspondence, but it is unfortunate (and entails unnecessary costs being incurred by all sides) that individuals are often forced to engage lawyers to threaten litigation merely to secure a copy of a reference that has been submitted in respect of them.

13.11. In the context of negotiated exits of individuals pursuant to statutory settlement agreements a practice has developed of the employer providing (for information purposes) a copy of the form of regulatory reference that it intends to give the departing employee. Clearly the employer cannot fetter itself as to what they would say in a reference and does not do so for the purposes of negotiation. However, the provision of non-binding wording does at least give the departing individual (and their advisers) the opportunity to provide comments on the wording, which sometimes is a significant issue given the brevity of many such references.

13.12. It can be the case that the employer suggests wording that contains statements which are all factually accurate but which give a more negative impression of the individual than is justified. To illustrate this point, a reference might be factually accurate in stating that the individual was dismissed for breaching an employer's data / confidentiality policy. However, it might also be factually accurate to state that the breach was a one off, that no clients were adversely affected and the employer expressly concluded that the matter did not amount to a Conduct Rule breach. The employee in this example might wish to suggest to the ex-employer that the regulatory reference should include some or all of the additional information, in order to provide a more balanced impression.

13.13. In our experience, regulated employers are typically well aware of the common law duty to their former employees (and the recipient firm) to exercise due skill and care in the preparation of the reference and some take the view that this general duty will normally require a firm to have given an employee an opportunity to comment on the information in a reference. Some employers assert that this duty has been met where the individual has had the opportunity to set out their version of events in the course of a disciplinary process, which we understand is the regulators' intention given the guidance provided at SYSC 22.5.5G. However, for the reasons mentioned above, a brief description in a regulatory reference of the outcome of the disciplinary process may not necessarily give a fair impression of the overall circumstances. The lack of an opportunity to comment on the draft reference itself is, therefore, a significant issue for all subjects of regulatory references that are not completely "clean" (i.e. make any comment at all on the individual).

13.14. Finally, we are also aware of a handful of instances of a small number of 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). Whilst this is not common practice, we are aware 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 the approaches taken by firms to Question G (in contrast to the body of formal Notices from the FCA and PRA in particular individual cases, which is effectively building up "case law" on other matters) increases this need for guidance from the regulators.

Recommendations

13.15. Having regard to the issues identified above, we make the following suggestions, namely that there be:

13.15.1. We suggest that the regulators should apply a materiality threshold for Question G. In other words, instead of "*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?*", then question should be "*Are we aware of any other information that we reasonably consider to be relevant and material to your assessment of whether the individual is fit and proper?*" We would point out that representatives of both employees and employers consider this to be a helpful and fair rebalancing of the template questions, because (amongst other things) it increases certainty for all parties and would reduce the significant variations seen across and within firms in practice at present. 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 would certainly be helpful even in the absence of a change to the template. For example, in general terms, do the regulators consider there to be a 'low' or 'high' threshold for the disclosure of information in response to Question G, in general terms?

13.15.2. Further clarity from the regulators that an adverse regulatory reference does not, in and of itself, preclude a firm from recruiting and certifying 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 mentioned above) may be one practical means of achieving such clarity;

13.15.3. Consideration given to an alternative approach which requires all firms, in any reference where a response is provided to Question G, to also provide any relevant positive commentary on a candidate's F&P. Such an approach could require firms to go beyond a one-line response,

addressing issues such as disciplinary record, mitigating factors, issues arising outside of work, and the firm's view of the person's competence and capability;

13.15.4. Consideration given to whether individuals who are subject to the regulatory reference regime might have a right, on request, to be provided with a copy of any regulatory reference which is provided about them i.e. that there be an exception to paragraph 24, Schedule 2, of the Data Protection Act 2018, where the regulatory reference does not fall within the recent guidance given by the ICO on references that can be disclosed;

13.15.5. Consideration to be given to whether individuals should be given a formal right of reply or comment upon a reference within a prescribed timeframe, where that reply is to be given not to the author of the reference but to the recipient of the reference. This would in effect formalise the individual's role in the regulatory reference process. At present, notwithstanding the fact that a regulatory reference is about an individual, that individual has no formal part to play in the process of references being provided, and (as stated) has no right even to see a copy of the reference;

13.15.6. 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 (or other employment) dispute (rather than for the purposes of the regime);

13.15.7. Further guidance as to how firms can satisfy the general duty to exercise due skill and care and the extent to which firms are required to give an employee an opportunity to comment on information in a reference – i.e. is this always met by the individual having had the opportunity to set out their version of events in the course of a disciplinary process.

13.15.8. Consideration to be given as to the provision of further guidance for firms where it is unable to complete an investigation into a possible misconduct issue because the individual resigns, is unable to participate due to sickness, or refuses to co-operate.

13.16. We make these suggestions partly on account of the fact that we consider that the regulatory reference regime is, in general, relatively harsh on individuals and affords firms a significant degree of power. ELA's members act for both employers and employees and the consensus is that from a legal point of view, the regulatory reference regime would likely benefit from a small rebalancing in favour of individuals along the lines of the suggestions we have made above that would not undermine the underlying policy aim of preventing 'rolling bad apples'.

QUESTION 21

14. To what extent do you agree or disagree that the Conduct Rules are effective in promoting good conduct across all levels of the firm?

14.1. We agree to a limited extent. In our experience:

14.1.1. the requirements relating to the conduct rules have significantly increased the awareness of, and consideration of, the regulatory implications of any particular conduct issue, in addition to the employment or commercial implications of such conduct; and,

14.1.2. the training in the conduct rules has had an impact on individuals. That training has ensured that the potential application of the conduct rules is at least in the back of employees' minds throughout their employment.

14.2. However, for both employees and employers a firm's policies and procedures, such as the disciplinary and compliance policies are the principle drivers of behaviours and conduct. Conduct rules are, effectively, a 'bolt-on' issue for both parties, after the primary issues of adherence to the firm's mainstream policies is considered.

14.3. We make the following further comments on the conduct rules.

14.4. First, the conduct rules lack guidance in critical areas. In particular, there is a mis-match between the lack of guidance in (e.g.) the FCA's COCON sourcebook relating to the conduct rules on the one hand, and the regulators' public comments on the other, as to what kinds of non-financial misconduct amounts to acting without integrity. This is a significant 'grey area', where we see widely varying practices between firms and across time. We note that the Upper Tribunal in Frensham v FCA [2021] UKUT 0222 (TCC) cast significant doubt over the extent to which non-financial misconduct in a person's personal life – even of a grave criminal character – could impact upon a person's integrity for regulatory purposes. We therefore invite the regulators to grasp the nettle and clarify this issue through guidance including the extent to which SM and certified person are expected to self-notify conduct/issues arising outside the workplace and timing of such notifications.

14.5. Second, for firms that are not SM&CR banking firms, the application of COCON is restricted by COCON 1.1.7A. The relevant provisions of that rule provide that COCON only applies to conduct that forms part of, or is for the purpose of "the SM&CR financial activities of the firm." SM&CR financial activities means regulated activities or an activity carried on in connection with (or held out as being for the purposes of) a regulated activity (whether current, past or contemplated). We understand that this provision was likely intended to operate as a proportionate limitation on the SM&CR regime for such firms. In practice, however, we have found it creates difficult issues of line-drawing. Problems which we have encountered include assessing whether (for example), work dinners, social occasions, expenses claims, and other activities connected to a person's work to varying degrees fall within this provision or not. Given the fact that fitness and propriety assessments have no such boundary, it is also a limitation that seems to lack a practical rationale.

14.6. Third, we note that fitness and propriety and the conduct rules use common concepts, most obviously through the common concept of 'integrity'. There is a

lack of guidance as to the inter-relationship between the conduct rules and fitness & propriety. Firms commonly proceed on the footing that a single breach of the 'integrity' conduct rule must mean that a person is not fit & proper, out of an abundance of caution. It is unclear, in the absence of any guidance on this issue, whether this is the proper interpretation (at least on a blanket basis).

14.7. Fourth, we note that assessments of whether a breach of a conduct rule has taken place (and therefore must be notified to the regulators and declared on regulatory references) are solely made by firms. There is no guidance from the regulators as to how this assessment should take place, and there is no mechanism for an individual to challenge such an assessment. Specifically:

14.7.1. Firms vary widely in their approach to the assessment of whether a conduct rule has been breached. Some firms treat the question of whether a conduct rule has been breached as being 'appealable', just as a disciplinary finding is appealable. Other firms make no provision whatsoever to challenge such assessments (it is, for example, simply a matter for compliance to decide). The lack of any formal mechanism to challenge such decisions may contribute to bad decision-making in some instances, and to the lack of consistency in outcomes referred to above. We note, for example, that in principle an individual could raise a grievance about a decision relating to the conduct rules, but there is no obligation for an employer to determine such a grievance, and post-termination, many will not do so; and,

14.7.2. Given the wide variation between firms both in procedure and substance (e.g. in relation to non-financial misconduct), this has the potential to lead to injustice and unfair treatment of individuals as well as 'bad apples' potentially remaining in post and/or being given 'clean' regulatory references that facilitate the move to other regulated firms. It is for the government and regulators to weigh this potential injustice against the objectives of minimising the risk of poor conduct in financial services and the costs which firms would incur in relation to any such challenges to their decision-making.

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