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Financial services regulation and employment law
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INTRODUCTION

1. This paper addresses some of the key issues employment lawyers face when advising employees and employers in the financial services industry. I concentrates on the 'approved persons regime' and the PRA/FCA's proposals on whistleblowing. It also touches on the new system for the regulation of individuals working in finance that will apply only to banks, and to an extent insurers, from 7 March 2016. This paper does not address the remuneration code, which controls the bonuses of individuals working in banks, for reasons of space.

2. The financial services industry has two regulators with responsibilities for conduct matters: the Financial Conduct Authority ("**FCA**") and the Prudential Regulation Authority ("**PRA**"). The PRA regulates only banks, insurers and nine biggest investment banks. The FCA regulates all financial services firms. Consequently, firms regulated by the PRA are 'dual-regulated', whereas firms regulated only by the FCA are 'solo-regulated'.

3. The key Act of Parliament is the Financial Services and Markets Act 2000, known as "**FMSA**" and pronounced 'FiSMA'. The FCA Handbook and PRA Handbook[1] are also important sources of regulatory requirements. The Handbooks are rules made by the regulators, which FSMA requires firms and certain individuals to comply with. The key sections of the FCA and PRA Handbooks for employment lawyers are FIT, APER and SUP.

THE APPROVED PERSONS REGIME

Introduction

4. At present, the regulatory regime primarily bites on 'controlled functions'. There are two types of controlled function (section 59(5) FSMA):

    a. A "*significant influence function*" ("**SIF**"), which is a function that is "*likely to enable the person responsible for its performance to exercise a significant influence on the conduct of the authorised person's affairs*": s.59(7B).

    b. A "*customer dealing function*": which is a function that involves the person dealing with the authorised person's customers or the customers' property in a manner substantially connected with the carrying on of the activity: s.59(7B).

5. Each controlled function has a code. For example, CF1 is the director function, and is a SIF function. There is only one customer dealing function – CF30. The remainder are SIFs. The detail of the FCA and PRA specified controlled functions is set out in SUP 10A of the FCA Handbook and SUP 10B of the PRA Handbook.

[1] The PRA Handbook is slowly being converted into a 'PRA Rulebook'.

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Applications for approval: law

6. By section 59 of FSMA, firms must take reasonable care to ensure that no individual undertakes a controlled function without approval from the 'appropriate regulator'. For dual-regulated firms, the appropriate regulator is the PRA (with the FCA's consent), and for solo-regulated firms, the appropriate regulator is the FCA: section 59(4) FSMA.

7. Breach of section 59 gives rise to the following sanctions:

    a. The individual undertaking the controlled function without permission is liable to have a financial penalty imposed upon them: s. 63A FSMA.

    b. The firm would be in breach of a relevant requirement imposed by FSMA, with the result that the disciplinary sanctions regime in Part XIV of FSMA would be engaged, which could entail a fine, public censure or suspension of permission.

8. A person requires approval in respect of each controlled function he or she is to hold.[2] This is because the fact that a person is approved for one purpose does not bring all his or her other activities within controlled function for which he or she has been approved. See SUP 10A.4.3G, and more generally section 59(1) and 59(2) FSMA.

9. Appointments for less than 12 weeks, where the appointment is to provide cover for a temporary or reasonably unforeseen absence, do not require approval: SUP 10A.5.6 R and 10B.5.1 R.

10. There are special rules for professional services firms, insolvency practitioners, credit firms with limited permission, appointed representatives, overseas firms, and EEA firms which are beyond the scope of this paper.

The practicalities of making an application

11. It is for the firm to apply for an individual to carry on a controlled function, not the individual candidate or a parent company: see section 60 FSMA and SUP 10A.13.5G, 10B.11.6G.

12. (Note, however, that the forms specified by the regulators (described below) require the individual in respect of which the application for approval is made to sign a declaration confirming the accuracy of the information given by the firm so far as it relates to him (see SUP 10A Annex 1, question 10). It is a criminal offence to knowingly or recklessly provide a regulator with information which is false or misleading in a material particular: section 348 FSMA.[3])

13. Approval must be given by the appropriate regulator before the individual begins to carry on the controlled function. If the individual does carry out a controlled function, then both the firm and the individual are liable to have a financial penalty imposed upon them (see above). Consequently:

[2] One exception to this general rule is the systems and controls function (CF28), and significant management function (CF29), which a person who holds a FCA governing function (subject to certain exceptions) automatically holds: see SUP 10A.6.3G

[3] Such conduct would also be likely to breach PRIN.

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a. Firms recruiting individuals to undertake controlled functions must offers of employment conditional on approval from the appropriate regulator.

b. So far as possible, applicants should not resign from their existing positions until approval has been granted by the appropriate regulator. If approval is not forthcoming, they will have no job to go to.

14. The regulators have three months from the point at which it receives a complete application to determine an application under Part V FSMA: section 61(3A) FSMA.

15. However, if an application is not 'complete', the 'clock is stopped': section 61(4) FSMA. In other words, the regulator's deadline is three months from the point at which it has a complete application. The deadlines differ, however, if the application under Part V was made at the same time as the firm applied for authorisation under Part 4A: s.61(3A)(a). The regulators have considerable discretion in determining whether an application is complete: see section 60(3).

16. Applications for approval should be made on Form A. Depending on the circumstances of the individual, either the 'Short Form A' or 'Long Form A' may be required to be completed: see the notes[4] produced by the FCA and PRA for the specifics. Most applicants for approval are required to submit Long Form A, which asks questions relating to the individuals fitness and propriety.

17. A withdrawal of an application for approval must be made on Form B (see SUP 10A.13.19R), but an application may only be withdrawn with the consent of the individual in respect of which the application has been made (section 61(5) FSMA). Forms C to E concern respectively ceasing to perform a controlled function (Form C; more on which below); changes to personal information or application details (Form D); and the internal transfer of an approved person (Form E): see SUP 10A.12.2G. Further details on how to make applications are provided by SUP 10A.16.

The determination of applications

18. Section 61(1) provides that a regulator will only grant an application for approval if "*it is satisfied that the person in respect of whom the application is made is a fit and proper person to perform the function to which the application relates*".

19. The regulators apply a section of the FCA/PRA Handbook called FIT to assess whether a person is a fit and proper person. Note that fitness and propriety are assessed in relation to the function in question: a person may by reason of his skills and experience, for example, be fit and proper to be a salesman, but not a chief executive.

20. The main criteria set out in FIT for assessing applications are (see FIT 2):

    a. Honesty, integrity and reputation;
    b. Competence and capability;
    c. Financial soundness.

[4] http://media.fshandbook.info/Forms/notes/sup10A_imap_forma_notes_20150401.pdf

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21. The regulator may only grant the application or refuse it: section 61(3). There is no power to subject approval to limitations or conditions. Where the regulator proposes to refuse the application, it must issue a warning notice, and the process outlined in the Decision Procedure and Penalties Manual of the FCA Handbook ("**DEPP**") at DEPP 2 will apply.

Notification requirements

22. There are important notification requirements to the FCA relating to the misconduct of approved persons.

23. First, a completed 'Form C' must be submitted by the firm within seven business days of an approved person ceasing to carry on a controlled function: SUP 10A.14.8R and SUP 10B.12.10R. Second, before 'Form C' itself is submitted, a notification is required from the firm.

24. The relevant provisions in relation to the previous paragraph may be found in SUP 10A.14.10R (and SUP 10B.12.12R makes equivalent provision for the PRA):

    (1) A firm must notify the FCA as soon as practicable after it becomes aware, or has information which reasonably suggests, that it will submit a qualified Form C in respect of an FCA-approved person.

    (2) Form C is qualified if the information it contains:

        (a) relates to the fact that the firm has dismissed, or suspended, the FCA-approved person from its employment; or
        (b) relates to the resignation by the FCA-approved person while under investigation by the firm, the FCA or any other regulatory body; or
        (c) otherwise reasonably suggests that it may affect the FCA's assessment of the FCA-approved person's fitness and propriety.

25. SUP 10A.14.11G and 10B.12.13G states that the notification relating to the qualified Form C should be made, where possible, within one business day of the firm becoming aware of the information, and may be made by email, fax or telephone.

26. Where an approved person has not ceased to carry on a controlled function, SUP 10A.14.17R may nevertheless apply in respect of Form D (and 10B.14.12R makes equivalent provision for the PRA):

    If a firm becomes aware of information which would reasonably be material to the assessment of an FCA-approved person's, or a FCA candidate's, fitness and propriety (see FIT), it must inform the FCA on Form D, or (if it is more practical to do so and with the prior agreement of the FCA) by e-mail or fax, as soon as practicable.[5]

[5] Note also the notification requirements attaching to SUP 10A.14.24R in relation to complaints against employees acting as retail investment advisors.

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27. Finally, SUP 15.3.11R provides that a firm must notify the appropriate regulator of, *inter alia*, any of the following as regards itself or its approved persons:

    a. A significant breach of a Statement of Principle (*i.e.* APER or PRIN);

    b. Any breach of a requirement of or under FSMA; and

    c. The bringing of a prosecution against, or conviction.

28. SUP 10A.15.4R and SUP 10B.13.4R provide that the obligations under SUP 10A and 10B apply regardless of any agreement or arrangements (including a COT3) made between the firm and the individual on the termination of their employment, and that a firm should not enter into such arrangements.

29. By way of summary, a notification is required if the individual has ceased to perform a function; there is information which would be reasonably be material to fitness and propriety; or a significant breach of the conduct requirements that apply to individuals.

30. The obvious dangers in employment law for firms in respect of notifications is the potential to breach the implied term of mutual trust and confidence, or potentially, constructive unfair dismissal. Generally, those dangers are more theoretical than real: a notification made in good faith by a firm in accordance with its regulatory requirements is unlikely found any liability.

References

31. As is well know, there is no legal requirement for employers generally to provide a reference. If a reference is provided, whilst there is a duty to take reasonable care to ensure the information it contains is true, accurate and fair, and does not give a misleading impression, that duty is relatively limited in scope. In particular, there is no obligation at common law to provide a full or comprehensive reference: Kidd v Axa Equity & Law Life Assurance Society Plc [2000] I.R.L.R. 301.

32. Regulated firms, however, are subject to more stringent duties than under the common law. Firms are not currently required to request references, but they must provide them if requested to do so. Furthermore, when a reference is correctly requested, a firm must "*as soon as reasonably practicable, give to [the requesting firm] all relevant information of which it is aware*" (SUP 10A.15.1R and 10B.13.1R).

33. As set out above in respect of notifications, the obligation to provide a reference applies not notwithstanding any agreements or arrangements on termination (including COT3s).

WHISTLEBLOWING

The current position

34. The current position in respect of whistleblowing in financial services firms is set out in a mix of employment law provisions (some of which may be more familiar than others) and

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the FCA / PRA Handbooks. See below in respect of the FCA/PRA's proposals in this area.

35. The pure employment law 'twist' to whistleblowing in the financial services context is that the FCA and PRA are 'prescribed persons' for the purposes of a wide-range of subject matters: see schedule 1 to Public Interest Disclosure (Prescribed Persons) Order 2014/2418,[6] and section 43F of the Employment Rights Act 1996 ("**ERA 1996**").

36. Generally, the conditions for the protection of a disclosure to a prescribed person are more stringent that those which apply to internal disclosures (*e.g.* to an employer), but those conditions are substantially less stringent than the conditions that must be satisfied for a disclosure to a third party to be protected.[7] There is no requirement that the worker must have previously made a disclosure to his or her employer.

37. Specifically, a disclosure to the FCA or PRA is protected under section 43F ERA, if:

    a. It is a qualifying disclosure within the meaning of section 43B ERA 1996 (*i.e.* a disclosure of information tending to show, in the reasonable belief of the worker, is made in the public interest and tends to show one of the relevant failures listed in section 43B);

    b. The worker reasonably believes that:

        i. the relevant failure falls within the description of matters in respect of which the FCA and PRA are prescribed persons;

        ii. the information disclosed, and any allegation contained in it, are substantially true.

38. The FCA's current approach to whistleblowing is largely policy-orientated (rather than relying on rules) and concentrates on gathering intelligence from whistleblowers. The main provisions in the FCA Handbook, at SYSC 18.2.2G, currently 'encourages' firms to consider adopting internal procedures to deal with whistleblowing disclosures. See also SYSC 4.1.15R in respect of PRA-firms only. The provision with most bite is SYSC 18.2.3G:

> *The FCA would regard as a serious matter any evidence that a firm had acted to the detriment of a worker because he had made a protected disclosure (see SYSC 18.2.1G (2)) about matters which are relevant to the functions of the FCA or PRA. Such evidence could call into question the fitness and propriety of the firm or relevant members of its staff, and could therefore, if relevant, affect the firm's continuing satisfaction of threshold condition 5 (Suitability) or, for an approved person, his status as such.*

[6] In respect of disclosures before 1 October 2014, the Public Interest Disclosure (Prescribed Persons) Order 1999 (SI 1999/1549).

[7] Those conditions include: (1) The worker reasonably believes the information disclosed, and any allegation contained in it, are substantially true; (2) the worker must not have made the disclosure for personal gain; (3) one of the special conditions (see below) must be met; and (4) in all the circumstances, it must have been reasonable to make the disclosure. The special conditions are one of: (a) the worker believes he will be subject to a detriment if he makes an internal disclosure; or (b) the worker has previously made a disclosure of the same information to his employer or a prescribed person. See also section 43H as to exceptionally serious failures.

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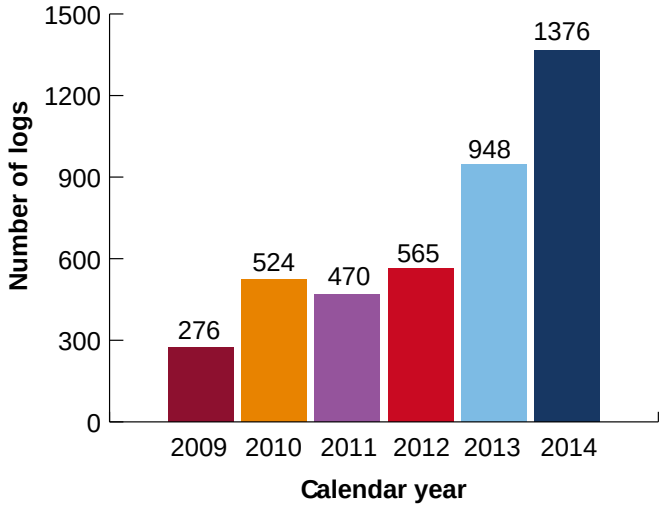
39. In other words, the FCA is indicating that an individual who victimised a whistleblower might be liable to be prohibited from working the financial services industry, and his or her firm liable to a large fine.

40. In July 2014, the FCA and PRA published a note on 'Financial Incentives for Whistleblowers' which stated the UK regulators' shared view was that the provision of financial incentives for whistleblowers would not improve the quality or quantity of disclosures the regulators receive. (It also noted of the US system of financial incentives: "*The incentives system has also generated significant legal fees for both whistleblowers and firms, although many whistleblowers are represented on a contingency basis (no award, no fee).*")

41. In the policy sphere, the FCA maintains a number of website pages regarding whistleblowing ('whistleblowers', 'how to be a whistleblower', 'the law and your rights', and 'how we use whistleblowing information') and publishes a document entitled 'How we handle disclosures from whistleblowers'. The PRA has its own webpage. Those webpages were uploaded in February 2015, and they discuss the FCA and PRA's whistleblowing units and their role.

42. The FCA's document ('How we handle disclosures from whistleblowers') evidences the growing trend for disclosures to be made direct to the FCA and PRA, as shown by this chart:

Chart 1: Whistleblowing disclosures received by FCA in 2014



43. As with whistleblowing in other sectors, its growth may to attributed to a greater degree of openness and willingness to put a stop to bad practices; or alternatively, to a greater propensity on the part of employees to use whistleblowing as part of a litigation strategy upon exit. The FCA state that 159 of the 650 whistleblowing disclosures in 2013 were 'of little value and unlikely to assist the FCA', and that 124 such disclosures were at least of 'significant value to the FCA'. The rest were, it may be surmised, merely interesting.

44. What is crucial for employment lawyers to appreciate (particularly those acting for individuals), is that careful consideration needs to be given not only to the employment relationship but also the regulatory context. Specifically, if an employee is him or herself

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implicated in the misconduct that is the subject of the whistleblowing report, there are dangers in blowing the whistle to the regulators. That may be as a result of what the regulators do with the information, although they are at pains to emphasise that the identity of an individual will be protected so far as possible. More problematic, however, is what the firm chooses to do with the information: see the section on notifications and the requirement to apply for approval above.

FCA/PRA proposals

45. In February 2015, the FCA/PRA published significant proposals relating to whistleblowing in insurers and banks (that is, banks, building societies, credit units, and PRA-regulated investment firms), known as "relevant firms".

46. The proposed changes include various requirements that relevant firms establish whistleblowing units, which are able to operate in accordance with the regulators' expectations, train employees, and to appoint a 'whistleblowers'' champion' who will ideally be the chairman of the firm to spearhead efforts to promote whistleblowing. In particular, the regulators propose to require firms to monitor whether anyone who blows the whistle is subjected to a detriment by the firm.

47. The proposals that will be of most interest to employment lawyers are as follows:

    a. That firms should be required to offer whistleblower protections to a wide range of individuals, beyond workers and the relevant failures to which the Public interest Disclosure Act 1998 ("**PIDA**") applies (see below);

    b. A requirement to include a specified passage in employment contracts and settlement agreements (see below);

    c. To require the whistleblowers' champion to inform the FCA where a firm contests a whistleblowing case and the tribunal finds in favour of the whistleblower.

48. First, regulators' proposals relating to widening whistleblower protections relates to the policies of the firm, rather than any proposal to amend PIDA. Nevertheless, those proposals are radical. In effect, under the proposals, any person should receive "the same protection" under PIDA (as a matter of firm policy) if they blow the whistle to the firm. The policy is principally aimed at individuals who may not attract PIDA protection such as volunteers, contractors, or interns, but is specifically not narrowed in the proposals. Further, the proposed whistleblowing protections will apply to almost any type of disclosure: it need be either a protected disclosure; relate to a breach of the firm's policies; or relate to behaviour likely to harm the reputation or financial well-being of the firm.

49. Second, the FCA and PRA propose that the following passage be required to be included in all employment contracts and settlement agreements:

    For the avoidance of doubt, nothing shall preclude [the employee's name] from making a "protected disclosure" within the meaning of Part 4A (Protected Disclosures) of the Employment Rights Act 1996 to the Prudential Regulation Authority, the Financial Conduct Authority or, if applicable, to an overseas

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regulator within the meaning of section 195(3) of the Financial Services and Markets Act 2000. This includes protected disclosures about topics previously disclosed to another recipient.

50. As the PRA and FCA readily acknowledge, that provision simply reflects the existing position under section 43J of the ERA 1996. Section 43J renders void any provision in an agreement between a worker and his employer (including a COT3 or similar) insofar as it purports to prevent a worker from making a protected disclosure. The regulators are concerned, however, to ensure that this is well-known amongst employees of relevant firms. It is not yet clear how this requirement will be implemented as regards existing employment contracts.

51. Finally, the regulators propose that the 'whistleblowers' champion' should be responsible for making a report to the FCA if a firm loses a whistleblowing unfair dismissal or detriment claim which it contested. This will, no doubt, be a further pressure towards settlement of employment disputes in these sectors. This proposal is less stringent, however, than those originally proposed by the Parliamentary Commission on Banking Standards, which the regulators were responding to.

52. The consultation closed on 22 May 2015, and a policy statement is expected in June 2015.

THE NEW CONDUCT REGIME FOR BANKS AND INSURERS

53. This section draws attention, briefly, to the new Senior Managers Regime and Certification Regimes that will apply to banks, building societies, credit unions and PRA-regulated investment firms (together, "banks") from 7 March 2016. Due to the scale and complexity of the changes, only a few highlights are drawn attention to here. A version of the regime (relating principally to the allocation of responsibilities) will also by applied to insurers by the PRA on the same date.

54. First, the approved persons regime will be abolished for banks. In its place, a new Senior Managers Regime ("**SMR**") will focus on the individuals at the very top of banks, that is, the board and potentially the level of management below the board. There are two key points about the SMR:

    a. Banks will be required to allocate responsibilities very clearly between individual senior managers. Each senior manager will have a 'statement of responsibility' and a 'responsibilities map' will have to be drawn up to clearly show who is responsible for what. This aspect of the regime has also been extended to insurers by the PRA.

    b. Senior managers will face a 'presumption of responsibility', or reverse burden of proof, in relation to failures at the firm that fall within the senior manager's areas of responsibility. No personal culpability will be required.

55. Second, for lower-level employees, there will no longer be a requirement for pre-approval by the regulators. Instead, the firms themselves will be required to certify that those employees are fit and proper under the certification regime. The regulator is currently

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proposing that employers should be required to take up regulatory references in respect of the last five years of an prospective employee's employment. This is intended to replace the role of the regulator in assessing the fitness and propriety of individuals for approval (which, of course, the regular will no longer do).

56. Third, the population of employees who may be disciplined by the regulators through financial penalties will be significantly wider. All employees, save for axillary employees, will be subject to new 'conduct rules'. By contrast, at present, only about 10% of bank employees are subject to the equivalent of the conduct rules (the Statements of Principle for Approved Persons).

57. The notification requirements relating to the conduct rules are significantly more onerous than under the approved persons regime. Specifically:

    a. Section 64B(5) FSMA requires that if a firm "*knows or suspects*" that a conduct rule has been contravened a notification to the FCA or PRA must be made.

    b. In addition to the current requirement for notification by means of Form C where a person ceases to perform a function by reason of suspension or dismissal, in future, if a formal written warning, a reduction or recovery of remuneration has taken place, a notification will also be required: section 64C FSMA.

58. Fourth and finally, under the new regime recruitment and departures of senior managers is likely to become more complicated and protracted. This is not least due to new requirements relating to handovers between senior managers. Banks will have an obligation to ensure that in-coming senior managers have all the information and material that they could reasonably expect to have to perform those responsibilities effectively. The FCA states that this: "*should be a practical and helpful document and not just a record… should include an assessment of what issues should be prioritised [and] should include judgement and opinion, not just facts and figures*."[8] Banks will also be required to have a policy on, and keep adequate records relating to, handovers.

59. The original proposals appeared to endorse the idea that an departing senior manager should be required to produce a 'handover certificate'. This raised concerns as to whether this would be practical for SMs leaving in difficult circumstances. Following consultation, the FCA has shifted its emphasis to the firm taking reasonable steps to ensure the predecessor provides sufficient information to the firm, so that the firm may comply with its handover obligations. Handover certificates are now referred to as one way of achieving that outcome, and it is explicitly recognised that there may be circumstances in which it is impractical to expect such a certificate to be produced by a departing senior manager. Despite that shift in emphasis, the FCA has stated that

60. The changes are wide-ranging, and require the human resources, compliance and business areas of the firm to work together (from now) to implement the new requirements.

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[8] See the proposed rules at SYSC 4.9.7G of FCA CP14/13.

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