

Fit and Proper

David Hunt | 30 September 2016

Introduction

Prior to 7 March 2016, the Financial Conduct Authority (**FCA**) was responsible for assessing the fitness and propriety of those working within financial services in approved roles.

However, under the new Senior Managers and Certification Regime (**SMCR**), which applies to deposit takers and Prudential Regulation Authority (**PRA**) designated investment firms, there has been a shift in responsibility from the FCA to the firms themselves.

This change means that the FCA will no longer keep a central public register of certified persons and relevant firms falling within the new regime will no longer have to file a form A seeking approval for employees in approved roles. Instead, relevant firms need to:

- be satisfied that their Senior Managers are fit and proper prior to seeking approval for them;
- consider, at least once a year, whether there are any grounds for the regulators to withdraw approval for any of their Senior Managers;
- certify, by no later than 7 March 2017 (and then annually thereafter), that their certified employees are fit and proper;
- continue to consider, on an ongoing basis, whether Senior Managers and certified employees remain fit and proper throughout their employment.

It is currently envisaged that the SMCR and the above requirements will be extended out to cover all Financial Services and Markets Act firms from 2018 onwards.

What are the specifics of the rules?

The specific requirements are as follows:

Certified Persons	Senior Managers
<p>SYSC 5.2.4/SYSC 5.2.6: from 7 March 2017 a firm must now take reasonable care to ensure that no employee of the firm performs a significant harm function in relation to the carrying out by that firm of a regulated activity, unless the employee has a valid certificate issued by that firm to perform the function to which the certificate relates. A firm may issue a certificate to a person only if the firm is satisfied the person is fit and proper to perform the significant harm functions.</p> <p>SYSC 5.2.17: where an individual changes roles, the new role may have different requirements relating to (1) personal characteristics (2) competence, knowledge and experience (3) qualifications and (4) training, and the firm should therefore reassess fitness and propriety</p>	<p>FCA FIT 1.2.1: before a firm makes an application for the FCA's approval of a designated senior manager function, the firm must be satisfied that a person is fit and proper to perform that function (a similar rule is set out within PRA fitness and propriety 2.1).</p> <p>FCA SUP 10C.14.24: at least once a year a firm must consider whether there is any grounds for the FCA to withdraw approval (and to notify the FCA if there are grounds for any withdrawal)</p>

How do you assess whether someone is fit and proper?

The relevant factors which go to an individual's fitness and propriety are as follows:

- (1) Honesty, integrity and reputation;
- (2) Competence and capability;
- (3) Financial Soundness; and
- (4) Personal characteristics (which is a new factor).

Further guidance in relation to each of these areas can be found within the *Fit and Proper test for Approved Persons sourcebook* (FIT) and within the PRA Rulebook and its Supervisory Statement SS28/15 (albeit the PRA guidance is very limited). Some guidance has also been provided by the Upper Tribunal when ruling on contested cases around fitness and propriety under the old regime (more on which below).

By way of a summary of the relevant guidance, taking each of the relevant factors in turn:

Honesty, integrity and reputation

The guidance within FIT states that firms should look at issues such as:

- whether the individual has been convicted of a criminal offence (including the nature of any offence, when it was committed, whether there is evidence of the individual having been rehabilitated etc). (The FCA has an exemption under the Rehabilitation of Offenders Act 1974 which allows it to ask questions of individuals requiring approval regarding both spent and unspent convictions. However, whilst this will still be relevant for the approval of Senior Managers, it is less clear whether questions around spent convictions (or indeed standard DBS checks) can be put to/required of certified employees, given the approval of such individuals now rests with the employing firm and not the FCA. This is clearly an area which needs to be clarified within a new exceptions order to the Act);
- whether they have been subject to an adverse finding in civil proceedings (particularly in connection with investment or other financial business, misconduct, fraud or the formation or management of a body corporate);
- whether they have been the subject of, or interviewed, in respect of any investigation or disciplinary proceedings by a regulator;
- whether they have contravened any of the requirements and standards of the regulatory system or other regulatory authorities;
- whether they have been the subject of any justified complaint relating to regulated activities;
- whether they have been dismissed or asked to resign or resigned from employment or from a position of trust, fiduciary appointment or similar;
- whether they have ever been disqualified from acting as a director or disqualified from acting in any managerial capacity;
- whether, in the past, they have been candid and truthful in all of their dealings with any regulatory body and demonstrated a readiness and willingness to comply with the requirements and standards of the regulatory system and with other legal, regulatory and professional requirements and standards.

When looking at specific cases involving allegations of dishonesty, the Upper Tribunal has, unhelpfully, given conflicting views on whether the civil test should be applied, which is a single objective test, based on the view of the reasonable person (see ***Twinsectra Limited –v- Yardley*** [2002] UKHL 12), or whether the criminal, "combined", test should be applied, which involves an objective test and then a subjective one (see ***R v Ghosh*** [1982] 2 QB 1053).

On the issue of integrity, the Upper Tribunal has made the following comments making it clear that honesty and integrity are slightly different things:

- ***Hoodless and Blackwell -v- FSA*** (2003) FSMT 007: "In our view "integrity" connotes moral soundness, rectitude and steady adherence to an ethical code. A person lacks integrity if they are unable to appreciate the distinction between what is honest or dishonest by ordinary standards."
- ***First Financial Advisors Limited -v- FSA*** (2012) UKUT B16 30 (TCC): "Even though a person might not have been dishonest, if they either lack an ethical compass or their ethical compass to a material extent points them in the wrong

direction, that person will lack integrity."

- **Batra v- FCA** [2014] UKUT 214 (TCC) "a lack of integrity does not necessarily equate to dishonesty One example of a lack of integrity not involving dishonesty is recklessness as to the truth of statements made to others who will or may rely on them or wilful disregard of information contradicting the truth of such statements."

Competence and Capability

The guidance within FIT states firms should look at:

- whether the individual satisfies the relevant FCA training and competence requirements;
- whether they have demonstrated by experience and training that they are suitable to perform their role; and
- whether they have adequate time to perform their role.

This issue is, however, fairly vague and therefore very malleable. It also raises difficult issues in terms of, for example, identifying the line between being incompetent/incapable and failing to meet the standards a particular firm might choose to set for its employees.

Financial Soundness

In theory, this should be the easiest factor to assess and the FIT guidance states firms should look at:

- whether the individual is subject to a judgment debt or award that remains outstanding or has not been satisfied within a reasonable period; and
- whether the individual has ever been adjudged bankrupt or been involved in related processes or proceedings.

Personal Characteristics?

As this is a new criterion there is little guidance to assist. However, it does bring to the fore questions of whether, for example, issues relating to bullying and/or harassing behaviour or issues of ill health will now be relevant when assessing fitness and propriety.

At what specific stages do you need to assess fitness and propriety?

On recruitment

When an employee is being recruited to a relevant role, a firm should assess fitness and propriety via:

- pre-employment checks (for example, obtaining references which go back at least 5 years, carrying out pre-employment screening, media checks, credit checks etc);
- self-declarations by the employee (for example, following similar questions that were in the old Form A);
- assessing, to the extent reasonably possible, competence and capability at

interview.

Annually

In addition, as stated in my introduction, firms are then also required to carry out an annual assessment of an individual's fitness and propriety and, in the case of certified employees, only issue/reissue their certificates if it is satisfied as to their fitness and propriety. Normally, this process will be tied to the appraisal process (albeit, unlike appraisals sometimes are, the process cannot be postponed or missed altogether) and is again likely to involve pre-employment type checks, consideration of competency as part of the appraisal review (including, for example, whether the employee is undertaking relevant training and keeping up to date) and self-declarations from the employees.

More generally

There is also, outside of the recruitment and annual review processes, an ongoing duty to consider fitness and propriety, which is where issues can potentially become more difficult. For example, it should be assessed as part of any of the following:

- on reviewing the completion of probationary periods;
- as part of disciplinary proceedings;
- as part of performance proceedings;
- when reviewing sickness absence and ill health; and
- when there has been a material change to a person's role.

What if a firm decides not to certify?

Where a firm decides not to certify, it must give notice in writing to the employee setting out the steps it intends to take and reason for its decision (SYSC 5.2.13). There is, however, no general requirement to notify the regulator unless disciplinary action has also been taken as a result of a breach of a conduct rule (more on which below).

Where a certificate is not renewed, the firm must then take reasonable steps to ensure that the employee ceases to perform the certification function in question.

In relation to Senior Managers, if a firm becomes aware of information which could affect the fitness and propriety of a Senior Manager, it must notify the PRA and FCA as soon as possible (see FIT 1.3.4A and the PRA Rulebook: Fitness and Propriety, 4.4).

Where an issue has been identified which goes to a relevant individual's fitness and propriety, it should also be included in any subsequent regulatory reference (given the obligation to include all information the firm providing the reference is aware of relevant to the assessment of fitness and propriety) (see SUP 10A.15).

The cross over with the Conduct Rules

Senior Managers and certified employees are also subject to the PRA and FCA's

conduct rules (the FCA's rules also apply to other employees not in ancillary roles which are not specific to the financial services business of the employer).

The specific conduct rules are as follows (with rules 1 to 5 applying to all the employees in scope and rules SM1 to SM4 applying to just Senior Managers):

Rule Number	Requirement	Which regulator imposes the rule?
1.	You must act with integrity.	PRA/FCA
2.	You must act with due skill, care and diligence.	PRA/FCA
3.	You must be open and cooperative with the FCA, PRA and other regulators.	PRA/FCA
4.	You must pay due regard to the interests of customers and treat them fairly.	FCA
5.	You must observe proper standards of market conduct.	FCA
SM1.	You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively.	PRA/FCA
SM2.	You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively.	PRA/FCA
SM3.	You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively.	PRA/FCA
SM4.	You must disclose appropriately any information of which the FCA or PCA would reasonably expect notice.	PRA/FCA

There is additional specific guidance on each conduct rule, within the FCA's Code of Conduct Sourcebook (COCON) and the PRA's Supervisory Statement SS28/15.

What are firms' responsibilities in relation to the Conduct Rules?

In terms of the relevant firms' own responsibilities, it is obliged to:

- make sure those subject to the rules know they are subject to the rules;
- provide suitable training around the rules;
- notify the regulator when it has taken formal disciplinary action (e.g. a formal written warning, a suspension, dismissal or a sanction reducing remuneration) against a person in response to any act, failure to act or circumstance which amounts to a breach of a conduct rule.

In relation to the obligation to notify, this can be done on an annual basis, using form H for FCA certified employees (the relevant period running 30 September 2016 to 31 August 2017 and then 1 September to 31 August thereafter). A running record will therefore need to be taken by firms of notifiable disciplinary action taken during the year.

In relation to Senior Managers and PRA certified employees, relevant disciplinary action must be notified within 7 business days (using form C or form D for Senior Managers and form L for PRA certified employees)).

Where notifications have been made, it is also worth firms bearing in mind that this could then result in the regulators scrutinising firm's assessments around the fitness and propriety of individuals who have been disciplined for breaches of conduct rules. It therefore makes sense to retain notes and to be ready to justify decisions on, for example, renewals of certified employees' certificates.

Some interesting issues/questions

The requirements set out above raise a number of interesting questions for relevant firms to consider:

- Who is best placed to make assessments around fitness and propriety?
- Should firms be including compliance on disciplinary panels (and other similar panels)?
- When does poor performance become incompetence?
- Will firms carry out the annual assessment as part of the appraisal process? What if an appraisal doesn't happen?
- Will firms offer appeals where an individual is not certified?
- Should legal representation be offered to employees attending disciplinary hearings?

If you require further information on anything covered in this briefing please contact [David Hunt](mailto:david.hunt@farrer.co.uk) (david.hunt@farrer.co.uk ; +44(0)203 375 7214), or your usual contact at the firm on 020 3375 7000. Further information can also be found on the [Employment](#) page on our website.

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