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Welcome

What does Fit & Proper hold for your firm?

The Central Bank has now published finalised Guidance for firms on implementing the revised Fit & Proper regime. At Compliance Ireland, we've never before seen a piece of financial regulation cause such a stir among our clients. There are big revisions here from the draft Guidance. So we've taken a bit of time to consider what it all means and digest the implications for you. Our thoughts are below.

Central Bank News

Guidance on Fit & Proper finalised

The Central Bank finalised its implementation guidelines with respect to the new fitness and probity regime on 23rd November 2011. The Central Bank has made numerous changes to the draft guidelines that were circulated on 1st September 2011. The changes to the guidelines are designed to address the many difficulties that firms had encountered in attempting to practically implement the requirements of the Fit and Proper regime.

The Central Bank is to be congratulated for not being afraid to revise their requirements in light of industry comments – this is an improvement, not a retreat.

However, the manner in which it has chosen to achieve this raises questions about the commitment of the Central Bank to carry out its functions in a law-based manner. The purpose of the guidelines is to assist regulated financial service providers (RFSP) in complying with their obligations in relation to the Fit and Proper standards. However the guidelines do not over ride any existing primary or secondary legislation or binding code. Some of the changes announced in the guidelines conflict with the stated requirements of the Statutory Instrument laying out the Control Functions (CFs) and Preapproval Control Functions (PCFs). While the Bank has it within its own power to issue an amending Statutory Instrument, the same issue could also be said to arise with some of the provisions set out in the Central Bank Reform Act 2010 (CBRA). Are we to see a situation where the Central Bank explicitly states in non-mandatory guidance that provisions of an Act of the Oireachtas are to be ignored?

INTRODUCTION

While the Bank should be applauded for its pragmatic approach to dealing with the Fit and Proper standards, until the legislation is amended to reflect the guidelines, RFSPs will be in the unwelcome position that their actions, while complying with the guidelines, could be blatantly contravening legislation, Regulations and binding Code. The Central Bank has indicated that an amending Statutory Instrument is imminent. However, amending an Act is not so readily achieved. This Article will attempt to assess the impact that the final guidelines will have on affected firms.

EXEMPTIONS

Initially, the draft guidelines only contained one exemption to the Fit and Probity regime. This 'Call Centre' exemption affected people who followed a prescribed script or course of action without discretion. Therefore, in the draft guidelines, the full rigour of the regime applied to all other functions of the RFSP. The final guidelines have added another three exemptions to the list.

The first of these is where a person is performing a control function (CF) or a pre-approved control function (PCF) on behalf of an RFSP from another EEA country and which provides services in Ireland on a cross border or branch basis. A real life example of this would be 'National Irish Bank' which is a trading name of a Danish bank regulated by the Danish FSA. Under the old regime, everybody in the Danish bank in a CF or

PCF role apart from the call centre staff would have been subject to the Fit and Proper regime, since the bank has a branch operating in Ireland. Under the new guidance, they are now exempt. This must be a huge relief for organizations that are now exempted under this section as it means that they do not have the headache of going to Directors or Executive Management in their own country and persuading them that they have to demonstrate to a foreign financial regulator in Ireland that they were "fit and proper" to do their job. This is a welcome development but surely it will require the CBRA to be amended to be legally permitted.

The second exemption is for a person performing a function in a separate legal entity but part of the Group structure, who may exercise significant influence over a CF or PCF in an Irish registered RFSP who is part of the same group. This would affect, for example, an Irish Registered RFSP who is part of an American Group. Under the old regime, Group management of the American parent, who exercised significant influence over a CF or PCF in the Irish RFSP, would fall within the scope of the Fit and Proper regime. Under the new guidelines, they don't. Again, this is a welcome development and the Central Bank are to be congratulated on the deftness with which they have modulated their position to avoid undesired unintended consequences.

Finally, an exemption exists where an Irish RFSP outsources CF and PCF functions to another RFSP under a written agreement, whether in Ireland, elsewhere in the EEA or elsewhere in the world. A real life example of this would be an Irish fund manager outsourcing its administration to another RFSP. Under the old regime, the CF's and PCFs of the outsource administrator would fall within the scope of the Fit and Proper regime and employees at that firm carrying out the roles would be required to satisfy both their employer and its clients of their fitness and probity. They are now exempt.

DISCLOSURE

The Central Bank has rowed back on the initial disclosure requirements for PCFs. RFSP's were to have disclosed the identities of persons carrying out PCF functions and that the firm was able to demonstrate that they were Fit and Proper by 1st December 2011. The new guidelines state that the CEO of the RFSP now only needs to submit a list of the persons in PCF functions by 31st December 2011 and they have until 31st March 2012 to confirm they have completed all related due diligence.

This clearly dilutes and goes against what the Statutory Instrument defining the CFs and PCFs (the Regulations) states. Although, PCFs in situ on 1st December 2011 did not have to get pre-approval from the Bank, the Fit and Proper standards apply in full from that date. If the RFSP could not satisfy itself (and demonstrate its satisfaction) that the PCF was "fit and proper", then that person is simply not permitted to carry on in that role. The final guidelines only look for a list of PCFs that are in situ on 1st December 2011 and allow the RFSP four months to certify its due diligence. Legally the RFSP needs to be in a position to evidence its satisfaction with persons in PCF roles, but the Central Bank has indicated with a nod and a wink that it will not seek to police this until April 2012, contrary to its statutory obligations.

OUTSOURCING TO AN UNREGULATED ENTITY

Where unregulated entities that propose themselves for outsourced activities for the CFs of an RFSP, the Central Bank has indicated an expectation that they should include compliance with the Fit and Proper standards and Part 3 of the CBRA as a critical part of their Human Resources procedures. Where a service level agreement (SLA) is in place, it will be necessary to amend the SLA to comply with the Fit and Proper standards regime when the SLA is updated or within 12 months, whichever comes sooner. The RFSP must satisfy themselves on reasonable grounds that the persons performing the CFs comply with the Fit and Proper standards, but the unregulated entity is only required to provide sample documentation to demonstrate compliance. While this is a pragmatic approach and will cut the workload of the RFSP in that they will not have to complete a full audit of all persons performing outsourced CF functions, they should still be wary as they remain responsible for compliance with their obligations under Section 21 of the CBRA. In other words, while it is a relaxation on the RFSP workload, the Central Bank may still prescribe administrative sanctions for breaches of the CBRA.

REMOVAL OF PCF 42 BRANCH MANAGERS WITHIN THE STATE

The new guidelines state that Fit and Proper standards do not apply to persons performing CFs on behalf of an RFSP authorized, licensed or registered by another EEA state and providing services on a cross border or branch basis. This means that branches of EEA authorised institutions operating in the State fall outside the scope of application of the standards. However, the legislation still provides for PCF 42 and while the guidelines disapply this, until legislation is updated there is an obvious disconnect between the Regulations and the finalised guidelines.

REFERENCES

The new guidelines provide that reasonable efforts must be undertaken to obtain references for new hires and all evidence of correspondence must be maintained. However, if an RFSP is unable to obtain a reference for whatever reason it must record the steps it has taken in order to obtain the reference. In the absence of a reference, the RFSP must demonstrate how it was satisfied that the person is competent to perform the CF. Another change is that references are not required for persons in situ as at 1st December 2011 where the person is in the same position for at least a year. This is of great relief to firms with longstanding employees for whom the exhumation of references from employers in the distant past would be challenging.

REMOVAL OF PCF 9 COMPANY SECRETARY

The Company Secretary function will be removed from the categories of PCF. However, where an individual in the position of Company Secretary exercises significant influence, they will continue to be captured under CF1. The legislation still provides for PCF 9 and while the guidelines disapply this, until the Statutory Instrument is updated there is an obvious disconnect between the Regulations and guidelines, as is also the case with PCF 42 as discussed above.

CONCLUSION

The Central Bank has made extensive changes to Fit and Proper guidelines. There are indeed many more exemptions and International groups and firms working in the funds industry in particular will welcome them. There is an obvious need to update the legislation to bring the Central Bank's thinking in line with the actual law. As part of this, the Central Bank has indicated that a revising Statutory Instrument bringing the Regulations into line with the guidance is imminent.

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