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// FINANCIAL REGULATION

Whodunnit? – Central Bank of Ireland proposes greater accountability of senior individuals in banks, insurance firms and MiFID investment firms

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A new framework to promote greater individual accountability within banks and certain other regulated firms is a key proposal of the recently published Central Bank's 'Behaviour and Culture in Irish Retail Banks' report.

Since the financial crisis there have been concerns that when something goes badly wrong in a bank some individuals rely on what one UK regulator termed the 'Murder on the Orient Express defence' of "it wasn't me, it could have been any one of us".

The Central Bank 'Behaviour and Culture in Irish Retail Banks' report of 24 July 2018 proposes a new individual accountability framework with four pillars:

Conduct standards providing greater clarity about the behaviour expected by regulators for regulated financial services providers and the individuals working in them

a **Senior Executive Accountability Regime**, applicable only to banks and certain insurance firms and investment firms in the first instance, requiring firms to allocate individual responsibility for different areas within the firm, leaving no gaps

a **streamlined enforcement process** removing certain barriers to regulatory enforcement action against individuals

stronger requirements for regulated firms to assess the fitness and probity of senior managers on an ongoing basis

CONDUCT STANDARDS

There are obvious merits not only for the regulator, but also for regulated firms and the public, in having a clearer and more structured system for identifying required behavioural standards and mapping which senior individual is responsible for what. When considering whether to introduce such reforms legislators may draw from lessons learned from recent UK reforms promoting individual accountability in banks.

The Central Bank's proposals bear many similarities to the UK's Senior Managers Regime which has applied to UK banks since 2016. The UK regime requires banks to allocate particular responsibilities to individual senior managers, to prepare statements of responsibility for each individual senior manager, to arrange appropriate handover of responsibilities between senior managers and to prepare a "management responsibilities" map to identify which senior individual is responsible for any given matter at any given time.

SENIOR EXECUTIVE ACCOUNTABILITY REGIME

Should we expect a sudden sharp increase in regulatory enforcement action against senior individuals after the introduction of a regime akin to that proposed by the Central Bank? Based on the UK's experience to date the short answer is "no" or at least "not immediately". However, the point of such a regime is not simply to lead to a greater number of enforcement actions against senior individuals - the mere prospect of career-ending, severely stressful enforcement action against individuals is itself designed to encourage responsible conduct from senior individuals in banks and other regulated firms.

With such a regime in place, would some talented individuals think twice about becoming a non-executive director of an Irish bank? "Bankers jostle to be junior as accountability rules kick in" blared one headline when the UK regime was being introduced - to derision from some quarters. A non-executive director is paid less than senior executives and has less control over day-to-day management of a bank but the proposed regime may lead to heightened exposure to individual accountability. At the very least we should expect an increased focus on the precise description of an individual's responsibilities, the demarcation of responsibilities of others, some defensive escalation of concerns to senior individuals and the seeking of independent legal advice at the bank or regulated firm's cost by senior individuals to protect their position when material issues arise.

In a regulatory landscape in which there must be no gaps in responsibility, practical challenges may arise where there is a change in the senior manager who is responsible for a particular area. Where a senior manager is leaving a bank in difficult circumstances or at short notice he or she may be unwilling to cooperate fully with the handover process to a replacement including describing issues which have arisen under his or her watch within the area for which he or she is responsible. Some UK banks have dealt with these challenges by making completion of handovers a contractual requirement or a factor determining the release of deferred remuneration. In any event, detailed succession planning is reframed from a business to a regulatory imperative.

STREAMLINED ENFORCEMENT PROCESS

In its report, the Central Bank states that "it is…critical to break the link between the conduct of an individual and a firm's wrongdoing (referred to as 'participation'). This hurdle of participation significantly complicates enforcement action". The Central Bank recommends that the "hurdle" of participation be removed to allow the Central Bank to pursue individuals directly for their own misconduct rather than only where they are proven to have participated in a regulated firm's wrongdoing. Enforcement actions against individuals are typically bitterly-fought and costly for the Central Bank to pursue. It is likely therefore that any attempts to simplify regulatory enforcement action against individuals will be resisted by some.

Controversy arose in the UK in the lead up to the introduction of the Senior Managers Regime regarding requirements for enforcement action against individuals. The UK regulator originally proposed a "presumption of responsibility" which would have reversed the burden of proof in enforcement cases against senior managers. However before the new regime entered into force the "presumption of responsibility" was abandoned, leaving the burden of proof with the regulator, as before.

STRENGTHENED FITNESS AND PROBITY REQUIREMENTS

The Central Bank proposes introducing a certification regime which would impose a positive obligation on firms to certify on an annual basis that the individuals in question are fit and proper to carry out their functions. The current regime merely requires firms, on an annual basis, to ask persons performing a controlled function to confirm their compliance with the CBI's fitness and probity standards so this would place a greater responsibility on firms.

The Central Bank also recommends that certain previous Central Bank proposals for reforms to the fitness and probity regime (including the power to publish refusals of appointment to pre-approval controlled function roles and to investigate those who performed such roles in the past) be adopted.

VALUABLE LESSONS FROM OTHER JURISDICTIONS

No doubt "the devil will be in the detail" but there are valuable lessons to be learned from the UK and other jurisdictions. The Central Bank's report is likely to shape the agenda of individual accountability in Irish banks and regulated entities for years to come. There is widespread acceptance that it is no longer a question of if - but rather when - measures to strengthen individual accountability will become law. In that context, it would be wise for senior managers in banks and other regulated firms to start thinking now about how such a framework might be implemented in practice.

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