

The new regulatory references regime in the UK

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The UK's Financial Conduct Authority and the Prudential Regulation Authority are introducing a new tool to enhance the accountability regime being rolled out in the financial services sector.

On 7 March 2017, the new rules on regulatory references to be provided to future employers will come into effect to coincide with the implementation of the full certification regime under the Senior Managers and Certification Regime ("**SM&CR**").

The new regulatory reference rules will require banks, certain dual regulated investment firms and insurers to seek references from previous employers of an individual applying for a regulated role under the SM&CR or the Senior Insurance Managers Regime ("**SIMR**"). Former employers that are also financial services firms will be obliged to provide a reference in a prescribed form, disclosing all information relevant to an individual's fitness and propriety dating back six years. Instances of serious misconduct must be disclosed even if they date back further than six years. References from non-financial services firms are likely to be general employment references.

The new rules also require former employers that are also financial services firms to update references should anything come to light after the reference has been given which would have changed the information that they would have included in the original reference. The result of this is that those employers will need to be able to track where a former employee is currently employed in order to be able to provide an update, if required to that new employer. This may not be straightforward and manual searches may have to be carried out. However, in quite a few cases the former employer will be aware of where that individual is currently employed, or can at least be located, as most senior bank employees will have deferred consideration which will continue to vest post employment with the original employer by virtue of the deferred compensation rules under the Capital Requirements Directive, where bonuses are subject to lengthy deferral periods and potential reclaim in the event of malus.

Any regulatory references given should be accurate, true, and fair, which will entail the employer carrying out checks in relation to allegations made before including them in a reference and allowing the employee an opportunity to comment on those allegations. This may be tricky to do in the case of former employees. If an employer gives a misleading or inaccurate reference, they could face tortious liability for negligent misstatement, defamation or malicious falsehood.

The new rules will pose substantial difficulties for those institutions employing individuals that have been embroiled in conduct that may lead to disciplinary investigations. Where employers and employees may ordinarily have sought to enter into settlement agreements in order to avoid airing dirty laundry, rather than go through a disciplinary process, the new rules stipulate that the employer and employee will be precluded from entering into any agreement that would limit the employer's ability to disclose information required under the

regulatory reference regime. It will therefore be difficult to include agreed references in a settlement agreement.

Since clean references are integral to securing employment in the financial services sector, the fact that the regulatory reference regime will require more full and frank disclosure of disciplinary action taken against an employee will mean that employees may have more to lose. It is anticipated that this will create a tension between negotiations centring on departure and the need to comply with the new regime. Individuals may not be able to secure another SM&CR/SIMR role with a qualified regulatory reference and so will run the risk of losing potential future livelihood in the financial services sector.

The potential reduction in the ability to negotiate settlements with employees will likely increase the number of disciplinary processes (and potentially dismissals) that a HR team will have to conduct.

The new regime is therefore likely to give rise to an increase in employees' appetite for litigation. Many individuals may prefer to go through the disciplinary procedure and pursue a claim for unfair dismissal rather than going quietly and receiving a bad regulatory reference. Litigation could offer employees the chance to secure vindication in the form of name-clearing and therefore the opportunity to obtain a role in the SM&CR/SIMR in the future.

Banks and insurers should be particularly astute when making dismissals in the wake of investigatory findings of a regulatory authority, which may put pressure on employers to make dismissals, and in some cases may seek to point the finger at specified individuals. Employers should be careful to observe a fair dismissal process in each individual case and ensure that the lines of responsibility within the bank/insurer are satisfactory. The responsibility maps that firms will have prepared as part of the general implementation of SMCR/SIMR will make this easier, as the specific areas of responsibility of individuals will be defined by both the maps and their individual terms of employment and thus it will be easier to say under whose watch a particular event occurred.

Employers should also be alive to the risk that employees who anticipate that they may be subjected to disciplinary procedures may seek alternative protection through pre-emptive whistleblowing (even when the whistleblowing employee is involved in the alleged misconduct).

Banks and insurers will need to make sure that they have adequate systems and controls in place to comply with the new rules in advance of 7 March 2017. They will have been running with the general provisions of SMCR and SIMR since March of last year and much of the updating company policies and procedures relating to references, revisiting the way that references are given in settlement agreements, and ensuring that HR staff have been sufficiently trained to deal with the new regime and have the requisite support from legal and compliance teams should be being dealt with as part of establishing SMCR/SIMR as "business as usual". If that has not been done, or remains to be validated, we would recommend that this is a matter for urgent attention.

The new rules can be found [here](#).

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