

FCA issues new guidance on fitness and propriety assessments in the financial services sector

7 October 2020

The Financial Conduct Authority (“FCA”) has recently [provided information](#) to their regulated firms as to good and bad practice relating to, amongst other things, the carrying out of fitness and propriety (“F&P”) assessments. In this blog, Nick Ralph and Jill Lorimer explain what the new guidance is and consider the implications.

Background

The regulation of most firms in the financial services sector (so called “solo regulated firms”) is undergoing significant change following the introduction of the Senior Managers & Certification Regime (“SM&CR”) to them with effect from 9 December 2019. The big banks, also regulated by the PRA, and so not “solo regulated”, have been subject to the SM&CR since March 2016.

One aspect of the SM&CR is the effective shifting of responsibility, from the FCA to regulated firms themselves, in relation to assessment and maintenance of the fitness and propriety of many of their staff – both senior managers and so called “certification staff” (i.e. not purely ancillary staff).

A major feature of this Certification Regime is that regulated firms must assess and certify to the FCA, at least annually, that staff who are subject to the SM&CR are fit and proper to perform their roles, in addition to assessing F&P on an on-going basis.

Originally, firms had been due to conduct such assessments and report on this to the FCA by the first anniversary of the introduction of the SM&CR to them i.e. by 9 December 2020. However, in June 2020, HM Treasury agreed to delay the deadline until 31 March 2021 for regulated firms to undertake the first assessment of the F&P of their certification staff [in the light of the COVID-19 pandemic](#).

The new guidance

It is clear that the FCA expects the annual assessment to be a robust process. If any firms thought that their pre-SM&CR Annual Appraisals would be sufficient to allow them to “tick the box”, the FCA is seeking to dispel that notion.

The FCA’s approach is to identify positive and negative indicators as to whether firms can demonstrate that they are making regular, thorough and consistent assessments of the fitness and propriety of their senior managers and certification staff. A few of these indicators are:

Positive indicators	Negative indicators
F&P checks identify new issues with staff – some fail.	F&P checks identify nothing new; a ‘rubber stamp’ exercise.
Relevant senior managers actively oversee the F&P process and ensure appropriate reporting.	Relevant SMFs have delegated the F&P process (e.g. to HR).
Competence assessment demonstrates that thought has been given to each specific role (including managers).	Competence assessment is perfunctory and/or cannot be evidenced as being objective.
Managers are adequately trained in the firm’s approach to F&P and understand what is expected of them.	Managers are poorly trained and/or have inadequate guidance as to what is expected of them in terms of F&P.
A detailed F&P process has been introduced and integrated into existing HR/performance management processes (it covers what happens if someone fails F&P).	F&P is considered (without review) to already be covered by pre-existing HR/performance management processes and/or there is no process for dealing with someone who fails F&P.
F&P panels – which include senior managers - are convened to consider marginal cases.	Process for considering marginal F&P cases either does not exist or is rarely convened.

Taking the first of these, it is interesting to note that the FCA appears to be encouraging firms to implement testing regimes, with pass or fail outcomes, with some expectation that there could be failure. The thought occurs as to whether some firms might use such test results to “weed out” staff who are felt to be underperforming (perhaps an alternative or additional approach to the historical practice of awarding lower bonuses to staff who are perceived to be less high achievers).

What is meant by fitness and propriety

The FCA has produced detailed guidance regarding the meaning of F&P, which is contained in its [Sourcebook – FIT1](#).

In outline, the most important considerations will be the person's:

- Honesty, integrity and reputation.
- Competence and capability.
- Financial soundness.

In practice, were there to be issues relating to honesty and integrity, these will likely have been identified and addressed as part of the on-going assessment of F&P (and probably by means of disciplinary action) as and when they arise, and will not wait to be considered as part of the process leading to the annual certification of F&P to the FCA.

The annual certification assessment may therefore need to focus more on the competence and capability of individuals for their roles.

Legal considerations

If a member of certification staff is considered to lack F&P, this may well have serious consequences for them. At one end of the scale, the process may lead to a warning, the individual being taken away from his/her certification function, and being required to undertake some training. At the other end of the scale, a decision that a person is not fit and proper may lead to a termination of employment. Further, this reason will need to be disclosed to future employers of the individual under the regime of regulatory references which requires regulated firms to provide [detailed information](#) (and not simply dates of employment and positions held, which is more common practice in other sectors). One of the questions which a regulated firm is required to answer is whether they are aware of any information that they reasonably consider is relevant to an assessment of whether the individual is fit and proper.

It is very important that employers are fair and consistent in their approach to the assessment of F&P. Employees can potentially challenge decisions on a number of grounds:

- An inconsistent approach may amount to a breach of the implied duty of trust and confidence, which exists in every employment relationship, potentially allowing the employee to resign on the basis of constructive dismissal and sue for unfair dismissal.
- Employees may raise formal grievances, which can be time-consuming for management and may further damage relations between management and the individual concerned.
- Management must not allow any judgements to be influenced (whether consciously or unconsciously) by considerations regarding protected characteristics (sex, race, disability, sexual orientation, religion or belief etc.) as this could form the basis of a claim for unlawful discrimination.
- In order to gather information regarding a decision on their F&P, employees may submit Data Subject Access Requests in order to obtain relevant personal data. DSARs can be time consuming for management and can reveal that a process for assessing F&P has not been fair and consistent.
- If the decision regarding F&P leads to a dismissal, the individual concerned may bring proceedings for unfair dismissal. The approach of an Employment Tribunal to such a claim may be similar to the approach adopted in cases relating to capability.

Of course, the above matters must be considered in the context that the whole SM&CR is designed to improve standards in the financial services sector so as to improve the service to consumers and reduce the risk of a crash like that of 2008. It is to be hoped that the regime of annual assessments does serve to achieve this goal, and does not result in either unfair treatment of less-favoured staff nor provide a stick with which vexatious employees can seek to beat employers trying to do the right thing.