

October 31, 2014

Comments on the PRA and the FCA's Consultation Paper "Strengthening Accountability in Banking: A New Regulatory Framework for Individuals"

Japanese Bankers Association

We, the Japanese Bankers Association, would like to express our gratitude for this opportunity to comment on the consultation paper "Strengthening Accountability in Banking: a new regulatory framework for individuals" released on July 30, 2014 by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).

We hope that our comments below will be of assistance and offer an additional point of reference as you work towards finalising the rules.

[General Comment]

We understand that the financial crisis and repetitive conduct scandals by banks have prompted international discussions and national efforts to enhance professional standards, culture and corporate governance of the banking sector with a view to promoting banks to act with integrity and restoring trust in banking.

The necessity of strengthening regulation on the responsibility of individuals (e.g. executives) to such an end is understood. Nevertheless, given that the proposed framework addresses governance issues in the UK, we believe that it is not necessary to apply it to those individuals in foreign parent companies or headquarters provided that their subsidiaries and branches are appropriately governed by local management. Further, including individuals of foreign parent companies into the scope of application would result in extraterritorial application of the UK regulation, which may be inappropriate from the perspective of international cooperation.

The Consultation Paper (CP) mentions that whether to apply the proposed framework to UK branches of overseas banks will be consulted later. It is expected that the PRA and FCA will take into account our comment above and carefully discuss the issue.

[Specific Comments] (Our response to the questions in the CP)

Q1

[PRA] Does the proposed list of PRA Senior Management Functions capture the appropriate set of roles? If not,

- are there any other roles which the PRA should consider specifying as SMFs?
- are there any proposed SMFs which the PRA should consider excluding?

(Our response)

The proposed list is not considered as appropriate because individuals in non-UK parent companies should be excluded from the scope of application of the Senior Managers Regime (SMR). In addition, individuals who reside inside the UK but are responsible for the business outside the UK jurisdiction should be scoped out as well. Clear guidance, etc. should be provided to enable the determination of the scope of SMR application.

(Reason)

Inclusion of individuals in foreign parent companies in the definition of Senior Managers gives rise to a risk of regulating foreign entities beyond the UK jurisdiction. For example, if new remuneration rules currently proposed by the PRA and the FCA would be applied to senior managers outside the UK, this is likely to be deemed as application of rules beyond the UK jurisdiction. Therefore, individuals in non-UK parent companies should be scoped out of the SMR application.

Further, among those individuals in home jurisdictions who are positioned higher in a reporting line than a CEO in the UK under the same banking groups, individuals who might have high-level responsibility for merely overseeing (managing) the UK entity should be excluded from the scope of SMR application. This is because it is expected that there are cases, among others, where the UK CEO retains veto power over their headquarters or can escalate issues beyond his/her direct reporting line.

Even if an individual resides in the UK, this individual should be scoped out of the SMR application if he/she is responsible for the business outside the UK's jurisdiction.

Given a lack of explicit criteria related to the above, the criteria to determine the "Group Entity Senior Manager Function (SMF7)" should be clarified by, for example, explicitly stipulating in guidance, etc. that the criteria used to determine the "Shadow director position" under Article 251 of the Companies Act should be applied as the criteria to determine SMF7.

Q2

[PRA] Do you agree with the PRA's proposal that firms should not be required to have individuals approved to perform specific SMFs where these relate to committees or functions which they are not required to have and have elected not to have?

(Our response)

We strongly agree with the PRA's proposal.

(Reason)

Key is that the list of Senior Management Functions (SMF) should reflect the way that the firm governs itself and operates in practice. The principle of not requiring registration for functions that do not exist is important from a perspective of aligning the regulatory registration with accountability in practice. If this principle is not followed, the UK regulators will find it difficult to identify who is the responsible personnel (i.e., whether the Senior Manager registered with the regulators or other personnel actually performing the function in the firm's governance structure) and to take action against such responsible personnel.

Q3

[PRA] Do you agree with the PRA's proposed quantitative criteria to identify the Head of key business area function?

(Our response)

Entities should be required to satisfy both the proposed quantitative criteria, i.e., "gross total assets of £10bn or more" AND "20% or more of the firm's (or group's) gross revenue".

(Reason)

Note 17 to the CP stipulates that "An individual will require approval as a Head of key business area if they manage an area with gross total assets of £10bn or more which accounts for either 20% or more of the firm's or, where the firm is part of a group, 20% the group's gross revenue". Annex 7.2, on the other hand, stipulates in paragraph 3.6 that "The *Head of Key Business Area function* (SMF6) is the function of having responsibility, for management of a business area or division of a *firm*, where: (1) that business or division: (a) has gross total assets equal to or in excess of £10 billion; and /or (b) either...". It is therefore unclear whether it is required to satisfy both the quantitative criteria, i.e. "gross total assets £10bn or more" AND "20% or more of the firm's (or group's) gross revenue", or it is required only to satisfy either of the two criteria.

We believe that both of the quantitative criteria (i.e., “gross total assets of £10bn or more” and “20% or more of the firm’s (or group’s) gross revenue”) should be satisfied. Otherwise the PRA would capture for approval purposes many individuals who do not have the ability to impact the stability of the UK financial system.

Q4

[PRA] Do you agree with the PRA’s proposed list of Prescribed Responsibilities?

(Our response)

The proposed list of Prescribed Responsibilities cannot be supported.

(Reason)

Some responsibilities listed are held generally by the Board or a Sub-Committee of the Board (e.g., the development and maintenance of a firm's business model). Allocating such roles to a particular board member may not be appropriate given the governance structure of the firm, or the requirements placed on the Board of Directors by relevant regulations and/or Codes (e.g. UK Corporate Governance Code).

Further, some responsibilities may not be suitable for branches of non-UK banks (for example, the responsibilities No. 13, 16 and 20 set out in Figure 2). Therefore, the PRA should reconsider these responsibilities when applying this requirement to such third-country branches.

Q5

[PRA] Do you agree with the PRA’s proposed approach to the allocation of responsibilities?

(Our response)

While we agree with the allocation of responsibilities, the definition of responsibilities needs more clarification so as to avoid holding individual accountable based only on outcome. Further, elements to assess the responsibilities of individuals who share the same function should be clarified.

(Reason)

For example, it is requested to clarify the definition of the responsibilities No. 10 (“leading the development of the firm’s culture and standards...”) and No. 11 (“embedding the firm’s culture and standards...”) set forth in the list of PRA Prescribed Responsibilities in Figure 2. It is unclear what the PRA exactly expects from Senior Managers and what approaches should be taken and what criteria should be used to assess the fulfillment of these responsibilities by Senior Managers. In addition, deciding

“Credo” and “Principle of Ethics and Conduct” is defined as “function” for senior managers. This definition is not enough to clarify responsibilities and would entail a risk of pursuing responsibilities focusing only on outcome. In order to ensure effective operation of, and avoid arbitrary operation of, malus and clawback triggers for the enforcement of penalties should be clarified.

In cases where more than one employee performs the same SMF (under a job share arrangement), the CP requires each of the individuals to be accountable for all the responsibilities conferred by that SMF unless each shows that they have taken reasonable steps to prevent a breach from occurring or, if occurred, to take remedial action. This requirement is considered as lacking fairness given that firms generally assign more than one employee to server joint heads and there are some cases where it is not appropriate to hold all of them collectively responsible. Such cases include a case where one of the joint heads leads inappropriate conduct and it is difficult for other joint heads to take effective countermeasures, and a case where the responsibilities of joint heads within a division are segregated. Therefore, elements to assess the responsibilities of individuals who share the same function should be clarified.

Q6

[FCA] Does the proposed list of FCA SMFs capture the appropriate set of roles?

(Our response)

While the proposed list is considered to be appropriate, the definition of the term Significant Responsibility Senior Manager is complex and therefore potentially unclear. The FCA is requested to provide guidelines to address this point.

Q7

[FCA] Does the proposed list of Key Functions adequately cover those likely to be carried out by relevant firms? Which functions should be added or removed?

(Our response)

Paragraph 2.47 of the CP states that firms are not required to organise themselves in the manner set out in the list of Key Functions. As long as this flexibility is allowed, the list is considered to be appropriate.

Q 10

[PRA/FCA] Do you agree with the PRA’s and FCA’s proposals on Statements of Responsibilities?

(Our response)

We agree with the proposals on Statements of Responsibilities provided that additional

information required for application for approval does not impose an excess burden.

(Reason)

According to paragraph 2.66 of the CP, firms are required to include, depending on the needs of the regulators, a significant amount of additional information in their applications for approval to perform an SMF, including but not limited to CVs, job descriptions, organisational charts, Responsibilities Maps and learning and development plans. The PRA and FCA should only require additional information to the extent that will not impose an excess burden on firms.

Q 12

[PRA/FCA] Do you agree with the PRA's and FCA's proposed approach to handover arrangements?

(Our response)

The PRA's and FCA's proposed approach cannot be supported unless specific guidelines are provided.

(Reason)

It is unclear what kind of materials/information newly appointed Senior Managers would be reasonably expected to have. Given this, the PRA and FCA are requested to provide guidelines on how the handover process will work in practice and what type of records should be retained. Otherwise, it would be difficult to put the proposed approach into practice.

Q13

[PRA] Do you agree with the proposals set out in the PRA's proposed Statement of Policy on the 'Draft statement of the PRA's policy on conditions, time-limits and variations of approval?'

(Our response)

We agree with the proposals. Nevertheless, it is expected that time-limited approvals be kept to a minimum due to the potential for disrupting a firm's strategic and personnel development.

Q14

[FCA] Do you agree with the proposals set out in the FCA's proposed statements of policy contained in draft chapters SUP 10C and DEPP 8?

(Our response)

We basically agreed with the proposals, however are concerned that the use of own-initiative variation of approval power by the FCA may impose additional responsibilities.

(Reason)

If additional responsibilities are to be imposed on individuals, consent should be obtained from such individuals. If the individuals consent to such additional responsibilities, there should be no need to use the FCA's own-initiative variation of approval power to impose them. Further, it is not clear what will trigger the use of that power and whether there will be any opportunity for firms to provide further details/evidence before a conditional approval is granted.

Q15

[PRA] Do you agree with the PRA's proposed approach to defining certification functions?

Q16

[FCA] Do you agree with the FCA's proposed approach to defining certification functions?

(Our response)

The proposed approaches cannot be supported.

(Reason)

According to paragraph 3.18 of the CP, in exceptional circumstances where a role is being performed for less than two weeks to provide cover for a certified person whose absence was reasonably unforeseen, the firm will not need to issue a certificate. The period for allowing this exclusion for emergency appointments should be maintained at 12 weeks, which is prescribed by the current rules, instead of changing it to two weeks as proposed in the CP. The proposed emergency appointment period significantly enhance the current rules. In addition, it is difficult to determine in two weeks' time whether the absence of a certified person will extend for a long period of time. Even if it is determined so, a two-week period would not be enough for firms in practice to (i) identify a competent person, (ii) assess his/her fitness and propriety and (iii) grant a

certification.

Q18

[PRA] Do you agree with the PRA's proposed rules and supervisory statement on standards of fitness and propriety?

(Our response)

Please confirm whether the assessment of fitness and propriety is achievable through the existing annual personnel evaluation process.

(Reason)

For those banks assessing individual competencies and skills not only quantitatively but also qualitatively through annual personnel evaluations, the objectives of their personnel evaluation should include the assessment of fitness and propriety for the position based upon the appraisal of performance. Given that personnel evaluations also link to remuneration plans, it is considered that the personnel evaluation process satisfies the requirement to make the fitness and propriety assessment.

Q19

[PRA/FCA] Do you agree with the FCA and PRA proposed requirements on:

- a) criminal record checks, and
- b) the provision of references?

(Our response common to both a) and b))

The FCA and PRA should add a provision which allows UK subsidiaries/branches of foreign banks to rely on their parent company's references for the fitness and propriety of an expatriate from their parent company/headquarters (provided that the UK subsidiaries/branches conclude that their parent's employment process is in line with adequately high standards.)

(Reason)

Given that some senior managers seconded from the parent company to the UK have experience of working in various countries, it would not only impose excessive administrative burdens but also be time-consuming to undertake criminal record checks in all of those countries. Further, it is evident that such senior managers do not have a criminal record at the time of and after the employment by the parent company, and thus it is essentially unnecessary to require written evidence, including the parent's references and criminal records. Therefore, these senior managers seconded from the parent company/headquarters should not be subject to the requirement for criminal



record checks.

On the other hand, our response with regard to senior managers other than the above is as described below.

(Our response to a))

While we support the proposed requirement, it is also necessary to take steps to enhance the efficiency of the procedure.

(Reason)

Given that firms are already required in many countries to obtain criminal records to comply with the rule of fitness and propriety assessment, the proposed requirement is deemed as appropriate, except for those senior managers seconded from the parent company. However, since the procedure to obtain criminal records differs across jurisdictions, the FCA and PRA should take steps to enhance the effectiveness and efficiency of this procedure by, for example, unifying the form of such records and allowing reliance on mutual references between national authorities.

(Our response to b))

Firms should be given a certain period of time to comply with the requirement to provide references. The proposed requirement should be applied only when a breach is proved. In addition, further guidance should be provided.

(Reason)

A certain period of time is needed to appropriately achieve compliance with the proposed requirement on the provision of references. Further, firms should be required to report only when a breach has been proved, and not when relevant investigation is underway. Otherwise, this rule could be abused by the employer who is not content with the person in question. If a description of a breach, which is not required to be disclosed, needs to be included in references along with related disciplinary action under the proposed rule, this may compromise the firms' obligation to maintain confidential information. Therefore, further guidance on this issue is requested.

Q25

[FCA] Do you agree that these are the right additional FCA-specific rules?

(Our response)

Banks already have these rules incorporated into their customer protection policy.

Therefore, it is considered unnecessary to introduce these rules additionally to the Conduct Rules unless such policy has deficiencies in its element.

(Reason)

Rule 4 (related to TCF) and Rule 5 (related to market conduct) target divisions assuming customer-facing roles. It is unclear how training programs can be tailored for all non-customer-facing staff in relation to Rule 4. In addition, firms' existing Personal Account Dealing (PAD) policy already ensures what is required under Rule 5 by including breaches listed in Rule 5 as examples of breach of integrity.

Q26

[FCA] Does the guidance attached at Annex 6 give helpful clarity on the behaviours the FCA expects under each of the rules?

(Our response)

While the guidance is helpful, the regulators will need to take into account circumstances specific to each case when they examine.

Q 27

[PRA/FCA] Do you agree that individuals already performing the relevant controlled functions within their existing approvals should be grandfathered to the new SMF?

(Our response)

We agree.

(Reason)

This is important for firms to maintain smooth business operation, as well as for regulators to avoid being occupied with a number of applications which may impede their normal operations.

Q 28

[PRA/FCA] How much time do you think is necessary to implement the new SMR rules, including the preparations of Statements of Responsibilities and Responsibilities Maps? Please explain what activities would be required to prepare for implementation, and the time required for each activity.

(Our response)

We suggest that the new SMR rules should take effect from the later of one year after the release of the final rules or January 1, 2016 given activities that need to be undertaken by firms to satisfy the HR and governance-related requirements (e.g.

consequential discussions about job descriptions, Responsibility Maps, allocation of responsibilities to senior managers, remuneration and career development; renegotiation of employment contracts; consideration of systems and internal controls that are necessary to detect potential violation of employment-related laws and regulations; establishment of processes for annual appraisal of fitness and propriety of the approved (certified) person and changes to internal personnel evaluation system reflecting the new processes). This will enable firms to go through their HR/Board cycle taking into account HR and governance related requirements before the enforcement of the rules, and thus to achieve compliance with all necessary areas in a smooth and assured manner. In any event, the Certification Regime and SMR rules should be implemented at the same time in order to facilitate the transition and reduce confusion about regulatory responsibilities. It must be noted that our comment on the implementation timeline for branches will depend on the content of the upcoming PRA/FCA's consultation paper regarding the application of the regimes to branches of foreign banks.

Q29

[PRA/FCA] How much time do you think is necessary to implement the new Certification Regime? Please explain what activities would be required to prepare for implementation, and the time required for each activity.

(Our response)

Implementation of the Certification Regime will take at least 12 months to put develop new procedures and processes, including categorisation and tracking of staff. As mentioned in our comment to Q28, given the HR cycle, simultaneous implementation of the Certification Regime and the SMR rules would facilitate the transition and reduce confusion about regulatory responsibilities. Therefore, we suggest that the Certification Regime should also take effect from the later of one year after the release of the final rules or January 1, 2016. Similarly to Question 28, our comment on the implementation timeline for branches will depend on the content of the upcoming PRA/FCA's consultation paper regarding the application of the regimes to branches of foreign banks.

Q30

[PRA/FCA] In relation to the Conduct Rules, how much time do you think is necessary for implementation? Please explain what activities would be required to prepare for implementation, and the time required for each activity.

(Our response)

A period of 12 months is needed given time required for designing and rolling out

computer-based training programs for all employees. For the purpose of ensuring consistency, it is preferable to apply the Conduct Rules simultaneously to senior managers, employees within the scope of the Certification Regime and employees outside the scope of the Certification regime.