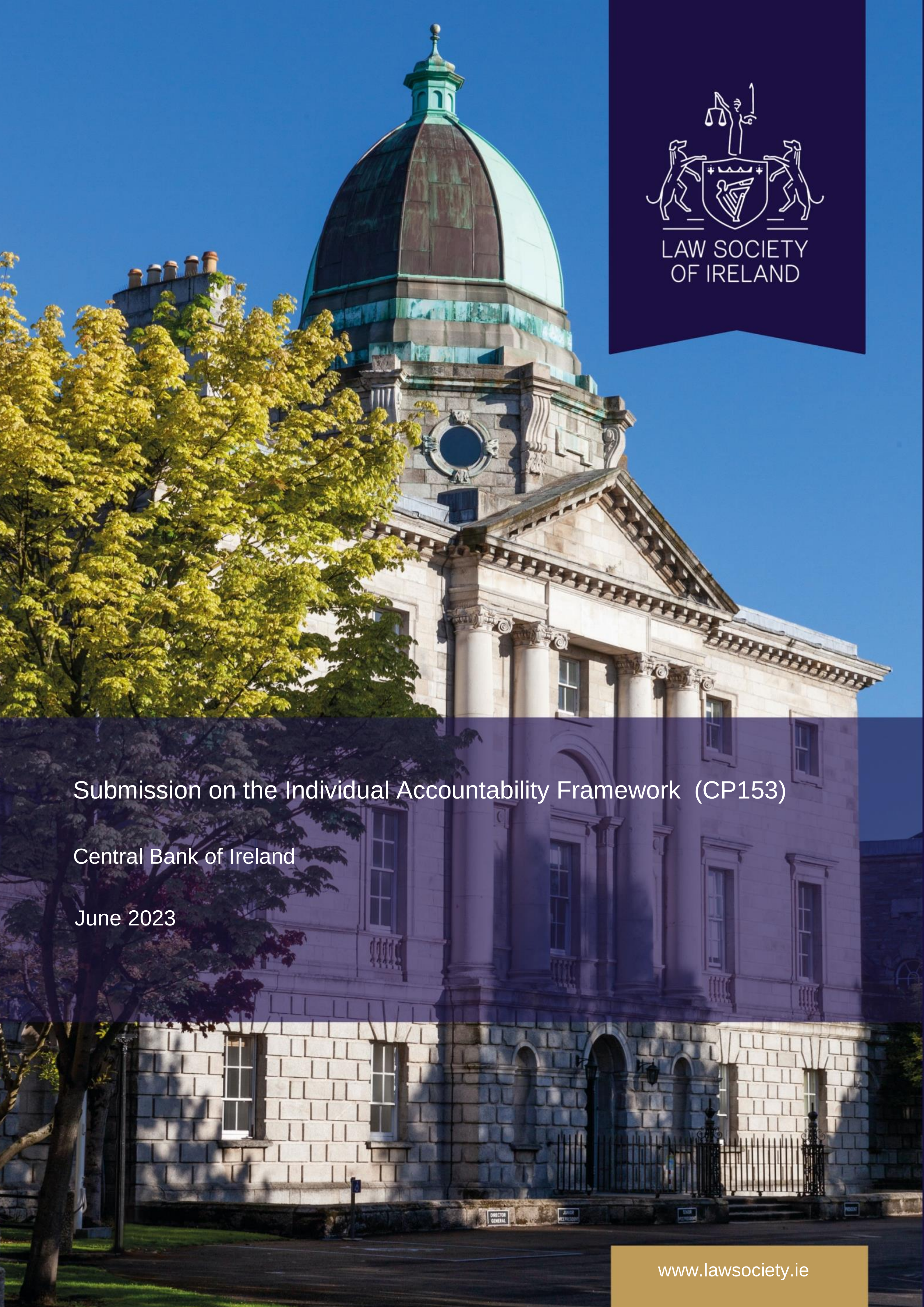

LAW SOCIETY OF IRELAND

# Submission on the Individual Accountability Framework (CP153)

Central Bank of Ireland

June 2023

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## 1. Introduction

This submission is provided in response to Consultation Paper 153 (**CP 153**) published by the Central Bank of Ireland (the "**Central Bank**") in March 2023.

Noting that a primary aim of the Individual Accountability Framework (**IAF**) is to ensure the personal accountability of executives responsible for wrongdoing, the Law Society of Ireland (the "**Society**") supports the Central Bank's work in driving and maintaining good governance practices, clarifying the responsibilities of regulated firms and enhancing individual accountability and conduct standards across impacted regulated firms.

We note that amendments to the Central Bank's Fitness & Probity (F & P) Investigative Process (which requires changes to the F&P Investigations Regulations and Guidance) are not part of this consultation process.

As those changes will be critical to ensuring fair procedures and due process for executives under investigation by the Central Bank, we would welcome an opportunity to comment on those measures at an appropriate time.

## 2. Law Society Recommendations

In this submission, we make the following recommendations for consideration:

**Recommendation 1**

Align the implementation timeline for the SEAR regime, the Conduct Standards and the changes to the F & P Regime (e.g. all to commence on 1 July 2024).

(Otherwise, it will be necessary for MRMs to be substantively progressed (if not completed) by 31 December 2023 given the link between the MRM, the Conduct Standards and the changes to the F & P Regime.

If In-Scope Firms wait until January 2024 to consider their MRMs and Statements of Responsibilities, that will likely create practical difficulties and a duplication of efforts in order to ensure alignment and compliance with Conduct Standards and the F & P Regime.)

**Recommendation 2**

The obligation to report disciplinary action should be triggered either when the final internal appeal process has concluded or the deadline by which the right to exercise the appeal has expired, whichever is the earlier.

## 3. "Equality-of-Arms" Concerns

As noted in CP153, the Central Bank is a leading international regulator in a globally successful financial services jurisdiction which, according to its Annual Report 2021 (page 170), spends over €200 million annually on financial regulation activities.

Its enforcement record is reflected in the number and size of fines it has imposed on major Irish and international institutions – more than €400 million since the introduction of the fines procedure in 2006.

To our knowledge, all such fines have been agreed as settlements suggesting that, faced with Central Bank enforcement action, major Irish banks and other high profile institutions (which value their brand reputation and integrity), admit liability, agree to a fine, and allow the Central Bank to publish the settlement terms (which include the amount of the fine).

That the Central Bank has succeeded in establishing such a strong enforcement record is a tribute to the Administrative Sanctions Procedure and the calibre of the Central Bank's Enforcement Division.[1]

Success in achieving these results with major businesses, by settlement in lieu of further enforcement action, may also illustrate how powerful a counter-party the Central Bank is and how much negotiating strength it commands, in enforcement actions.

Under the IAF, Central Bank enforcement action will be taken against people, not businesses.[2] Even if exclusively focused on executives and board members of major institutions, the Central Bank will make, interpret and enforce the rules, adjudicating on any alleged rule-breaking. As such, it may be seen to enjoy an even more commanding negotiating position.

This is particularly so where the proposed "participation link" break, whereby the business for which a defendant executive works may have no enforcement jeopardy. In such circumstances, the employer too may wish to see the matter promptly settled, increasing pressure on the defendant employee.

This inequality of arms, and the potential for unlawful "conviction by settlement", has a number of important implications which include the following:

1. Enforcement via settlement - because it bears a real risk of undermining the due process and defence rights which are inherent in public hearings, it should be the absolute exception when taking enforcement action against individual defendants.

   To press executives to agree to settle without a public hearing, where the outcome could well harm their reputation and livelihood, risks legal challenge. Given the extent

[1] We understand that an "early settlement discount scheme" in the Central Bank's ASP enforcement regime, whereby a defendant that admits wrong-doing early in the investigation receives a 30% discount on fines, has been important to this success.

[2] We note that a number of Central Bank Settlement Agreements involving individuals have previously been reached, including one against a former INBS Head of Commercial Lending (UK), in which the individual agreed to a fine of €200,000 and was disqualified from a management role in a financial services entity for 15 years. Fines in two other individual settlements relating to INBS were €20,000 for a non-executive Chair of the INBS Board and disqualification for 3 years, and a senior manager of Commercial Lending ROI, who was fined €250,000 (reduced to €23,000 on the basis that the full fine would result in the individual's bankruptcy) and 18 years disqualification (in, respectively February and December 2018). Similarly, in May 2015, Bloxham's former Head of Finance and Compliance entered into a settlement which disqualified him from management in a financial services firm for 10 years.

In September 2020, individual settlements were also made with Kevin Lunney and Liam McCaffrey in respect of their roles in Quinn Insurance Limited, the terms of which were not made public due to "*the circumstances arising … at the time [the CBI] reached the settlement, which were unrelated to the Central Bank's Inquiry*." In June 2020, an individual settlement was also reached against a former CF and Executive Director of RSA Ireland Insurance, in which the executive agreed to a disqualification period of 8 years 4 months and a fine of €70,000. Much more limited settlement agreements have been imposed on sole trader insurance brokers (e.g. €1,470 on Albert Reilly t/a Albert Reilly Insurance and Financial Consultants in December 2017). That the Central Bank previously reached Settlement Agreements of this kind with individuals on an *ad hoc* basis prior to the entry into force of the IAF should not be considered to justify codifying such a practice in respect of the new, significantly more widely applicable framework.

of sanction proposed (up to €1 million and/or permanent/temporary work exclusion), this would be tantamount to conviction by settlement.

In any attempt to reach a settlement in an investigation, employees should not be required to make self-accusatory statements or expected to confess to wrongdoing which has not been formally adjudicated on, either by the Central Bank or by a court.

2. For the same reasons, the Central Bank should ensure that its enforcement practices and procedures respect the higher protections of fundamental Constitutional rights e.g. the right to earn a livelihood and to a good name.[3]

   An enforcement outcome which is likely to materially impact an individual's constitutionally protected rights demands that fair procedures be followed. Investigation letters, for instance, should be sent to the individual under investigation, not the business/regulated entity where they work. In no case should an individual under investigation be disadvantaged, disfavoured or otherwise considered uncooperative merely because they assert their civil rights, including the right to legal representation, during a Central Bank investigation.

   Consistent with established EU law on the rights of defence in regulatory investigations, the Central Bank must keep effective notes of interviews and conference calls during an investigation. It should also diligently and rigorously assess defence arguments and counter any such arguments with detailed reasons, where relevant.

   More generally, as an organ of the State, the Central Bank must also perform its functions in a manner that is compatible with the State's obligations under the European Convention on Human Rights.

3. Given that the IAF provides for executives at different levels within an organisation to be liable for the same wrong-doing (e.g. CEO and CIO where an IT breach is alleged), complex legal questions regarding the reliability and use of leniency and whistle-blower testimony by one executive against another will no doubt arise. In such circumstances, the Central Bank will need to rigorously defend fairness and the protection of the fundamental rights of the accused.

4. Given the risk of conflict, executives under investigation may need (and it would likely be advisable for them to take) legal advice, independent of their employer's legal advisors. Again, given the nature of the sanctions involved (e.g. large financial fines, restrictions on future work), individuals should be supported in ensuring that they are adequately represented throughout the process.

   Again, given the negative implications for an individual of an adverse outcome to enforcement proceedings, an individual should never be criticised for fully asserting their rights of defence and/or for not providing "the expected level of co-operation".[4]

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[3] We note that a Settlement Agreement forms "*part of the regulated entity's compliance record*" (Draft Guidance, at para. 4.8.1). A prior Settlement Agreement may also be considered by the Central Bank "*in assessing a subsequent application by that person to perform a pre-approval controlled function under the Fitness and Probity regime*" (para. 4.8.3). A Settlement Agreement may also "*be taken into account in determining appropriate sanctions…if subsequent prescribed contraventions are committed*" (para. 4.8.4).

[4] The Central Bank's *Outline of the Administrative Sanctions Procedure* explicitly states that the level of cooperation with an investigation is a factor the Central Bank takes into account in deciding whether to discontinue an investigation (para. 3.7.3), to issue a Supervisory Warning (para. 3.7.7), to reach a

## 4. Corporate Governance Concerns

“***Directors have but one master, the company***.”

- Lord Cullen, *Dawson v Coats* [1989] BCLC 243

According to Keane on Company Law (*5th* Ed.) “*directors occupy a fiduciary position towards the company. This means they must always act in good faith in the interest of the company as a whole*” (at para. 27.85).

The Draft Guidance states that the new IAF “*complements the statutory and fiduciary duties of directors, as set out in the Companies Act 2014*” (para. 2.4.11).

In certain respects, new director obligations in the IAF appear to conflict partly, if not fully, with long-establish company law duties of directors (including executive directors and senior management).[5]

Under the IAF, executives and directors will effectively have duties to the Central Bank, as well as the company. Further, the Central Bank will assess *post facto* the lawfulness of management conduct by reference to a much broader test than the shareholder value test, including an ill-defined “consumer interest” test.

Irish company law is widely considered to endorse a “shareholder value” test (see e.g. Keane on Company Law, 5th) in determining whether director and executive duties to the company have been observed. An important question in this regard is whether the IAF cuts across this bedrock principle?

This is not a theoretical question - if a financial service provider delays or decides against passing a cost decrease through to customers immediately (e.g. if it is a prescribed contravention), while that decision may enhance the business and improve shareholder value, but is it consistent with an executive’s new consumer interest obligation?

## 5. Legal Certainty/Opacity Concerns

### *(i) What is a “Prescribed Contravention”?*

According to the Central Bank’s Outline of Administrative Sanctions Procedure “*there are many instances where the Central Bank issues statutory instruments, or imposes conditions, directions or requirements, pursuant to a designated enactment or statutory instrument*” (at para. 2.3.2).

Accordingly, the same document declines to provide a definitive list of the legal provisions which may give rise to a prescribed contravention and further states that “[*s*]*ome obligations, in the form of conditions, directions or requirements, are imposed on a*

settlement (para. 4.2.1.), and the level of sanction imposed (para. 6.3.1(2)(b)). Whether the conduct is admitted or denied is also a factor (para. 6.3.1(2)(e)). Indeed, the timeliness of responses to the Central Bank “*may be a factor taken into account in determining any sanction imposed*” (para. 2.4.2).

[5] Section 224 of the Companies Act 2014, repeating provisions of section 52 of the Companies Act 1990, imposes a duty on the directors to have regard to the interest of the company’s employees in general, as well as the interests of the members. According to Keane on Company Law, this provision suffers from an “*inescapable defect … [t]here is no guidance as to how the board are to resolve the conflict which may rise between those interests and the interests of the shareholders which they may also protect … Moreover, since the section expressly states that the duty is owed to the company., it would seem the employees have no means of enforcing the obligation it creates*” (at para. 27.91).

*bilateral basis. These obligations will be known only to the Central Bank and the regulated entity involved*" (*ibid*).

There is, in other words, no definitive list of rules violation which amount to sanctionable breaches. At the same time, an attempt to commit a prescribed contravention constitutes a prescribed contravention, as does aiding, abetting, procuring, inducing or attempting to induce, or conspiring to commit a contravention – all of which are also sanctionable violations (at para. 2.3.3).

Further, failure to report information giving rise to a suspicion of a prescribed contravention is, of itself, a prescribed contravention.
If the enforcement agency is not in a position to provide a definitive list of prescribed contraventions and wrong-doing, can it reasonably expect executives to be sufficiently aware of the potential for wrong-doing?[6]

Lack of clarity around what constitutes a prescribed contravention, makes it close to impossible to ensure compliance. It also undermines legal certainty in a manner that is unfair to those affected, creating greater jeopardy for executives.

Similar concerns regarding a lack of certainty apply to the approach in the Draft Guidance as regards "conduct standards" which "*impose positive, enforceable legal obligations on individuals*" (at 4.13). Further, the legal obligations are "*to act in accordance with a single set of standards of expected behaviour*".

A breach of conduct standard is a prescribed contravention which means that an executive "*may be subject to enforcement action in respect of any such breach*" (at 4.37).[7]

It is concerning, therefore, that the Draft Guidance does not provide specific clarity on each standard of behaviour listed in section 53E of the 2010 Act as amended by the IAF Act. Rather, it states that "*each of the listed behaviours … are generally self-explanatory and should be readily understood by those to whom they apply*".

In law, however, the listed conduct rules include complex and contestable state-of-mind legal standards such as honest, integrity, due skill, care and diligence, and acting in good faith.

Similar legal certainty concerns arise in respect of the Central Bank's broad instruction that "*any matter otherwise adversely affecting the activities or interest of customers, the regulated financial service providers, its related undertakings, or the financial system in the State*" must be reported to the Central Bank (at, 5.2.2.).

***(ii) Who is Liable?***

Its website confirms that the Central Bank regulates more than 10,000 firms which provide financial services in Ireland and overseas. This includes 52 credit institutions, 206 insurance and re-insurance firms, 37 payment and e-money firms, 2462 retail intermediaries.

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[6] We note that The European Central Bank has stated that "[w]ithout a consolidated legislation, the legal structure of the Irish central bank is lacking in transparency" (2010 ECB Opinion).
[7] The seriousness of this matter for executives is reflected in the statement that "*a past breach of a Conduct Standard may be relevant to their ongoing suitability for a role*." The bank must report disciplinary actions arising from the breaches of the Conduct Standards to the Central Bank.

CP 153 confirms that the SEAR regime will initially apply to "*approximately 150 firms*" (at page 17) but no estimate is around how many business people it will apply to.

Schedule 1 of the Draft Regulations identifies 24 roles within credit institutions, 23 roles within investment firms, and 23 roles in insurance companies which include the Chair of the Board, the CEO, CFO, Head of Retail, COO and CIO. Given the breadth of roles covered in Schedule 1, over 1,000 business people could be subject to the new rules.

However, there is a lack of clarity around precisely who the new conduct rules will apply to. The Draft Guidance states (at 4.3) that these rules "*will apply to relevant individuals in all firms, irrespective of the sector*" (a footnote further confirms that executives at certain unregulated financial service providers will not be covered). Further, many of these new rules will apply to "*CFs (which include all PCFs as a subset of CFs)"* while others will apply to "…*individuals performing PCF roles and other individuals who may exercise significant influence on the conduct of a firms [sic] affairs (CF1 roles)*".

For reasons of legal certainty and fairness, and to ensure adequate respect for (and protection of) the rights of defence, a clear and reliable plain-English explanation of who will be subject to enforcement action for conduct rule breach must be provided.

A concern also arises around the liabilities of executives in the case of overlapping responsibilities. Schedule 1 provides that a CEO has "[o]*verall responsibility for managing and steering the business activities of the firm*" and the CIO has "[o]*verall responsibility for managing the firm's information and use of technology*" but which of the two will be answerable in the event of an IT issue?[8]

The Draft Guidance states "[*i*]*t is possible that more than one [executive] will be responsible under SEAR for an aspect of the firm's affairs. As such, it is possible that more than one [executive] will have contravened the Duty where each of them fails to take reasonable steps to avoid the firm contravening its obligation in relation to that aspect*" (at para. 2.8.10).

Without further clarification as to liability, the Draft Guidance states that "[*i*]*n such circumstances, the Central Bank will consider whether it is appropriate to take enforcement action … against one, some or all such individuals*." (at 2.8.14). Among other concerns, this ambiguity could seriously prejudice executives' rights of defence where the Central Bank uses leniency enticements to pit executives at different levels of the organisation, perhaps with overlapping liabilities, against each other.

We note that a CEO has responsibility (which includes responsibility to the Central Bank) for "*managing and steering the business activities of the firm*" (Draft Regulation, Schedule 1). In effect, this means that a CEO may always have liability to the Central Bank for a prescribed contravention by the business, irrespective of where fault within the organisation for that contravention may lie.

We note that the Management Responsibilities Maps and Statements of Responsibility "*will be relevant in determining*" responsibility (or liability) of executives (Draft Guidance, at 2.8.9). However, the Draft Guidance notes that the Central Bank may "*look beyond these documents where circumstances require it*" (ibid).

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[8] We take this example because, in December 2021, the Central Bank fined Bank of Ireland €24.5 million for "*breaches pertaining to its IT service continuity framework*" (see The Governor and Company of the Bank of Ireland fined €24,500,000 and reprimanded by the Central Bank of Ireland for breaches pertaining to its IT service continuity framework and related internal controls failings).

According to the Draft Guidance, "*other sources of information such as organisational charts, minutes of meetings, emails, regulatory interviews and telephone recordings*" may also be relevant in determining executive liability.

This seems likely to increase uncertainty in respect of executive liability.

## 6. Concerns on Reversal of the Burden of Proof and Consistency with the Common Law

In company law, the test in respect of whether a director acted in good faith in the interest of the company as a whole is subjective. According to Keane on Company Law:

"*If the directors genuinely believe that what they are doing is in the interests of the company as a whole, the court will not interfere with their decisions even though they might appear objectively to be detrimental to the company"* (at 27.84).[9]

The common law standard of skill and care does not therefore expect infallibility from directors and, if a director makes a decision which they genuinely believe to be the best interests of the company, the fact that it subsequently proves to be mistaken (frequently with the benefit of hindsight) will not - of itself - be a ground for setting it aside.[10]

According to the Draft Guidance, section 53B of the 2010 Act (as amended by the IAF Act) "*imposes an enforceable legal duty*" on executives which is to take "any steps," reasonable in the circumstances, to prevent a violation by the business. Effectively, this appears to result in an outright reversal of the Common Law rule on burden of proof.

Use in the statute of the word "*any*" before "*steps*," in conjunction with "*reasonable in the circumstances for the person to take*" opens the possibility of enforcement action and sanction, even where executives took active steps to prevent a violation.

Worryingly, it introduces an extremely high burden of proof that may be close to impossible to meet. Under the SEAR, a senior executive is made personally liable for rule violations by the business unless they can persuade the Central Bank *post facto* that any other step to prevent a contravention would have been unreasonable. Again, executives will be liable to fines of up to €1 million and/or long-term disqualification from working in a similar role.

What constitutes a reasonable step for this purpose is, according to the Draft Guidance "*any steps that the Central Bank considers that an individual, in that position, could reasonably have been expected to take*" (at 2.8.11). Further, the Draft Guidance states that executive failure to take steps that the Central Bank subsequently considers the executive should have taken to prevent a violation by the business is, in itself, a breach.

In this regard, the Draft Guidance states that the Central Bank "*will consider what steps an individual, in that position, could reasonably have been expected to take at that point in time*" and look to the overall circumstances and environment "*as they existed at the time rather than applying standards retrospectively or with the benefit of hindsight*" and that "[*i*]*t is acknowledged that human error can occur and that perfection is not the required standard*" and that "[t]*he Central Bank also recognises the role of judgement exercised by those in senior roles in discharging their responsibilities*" (at 3.5).

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[9] Keane on Company Law cites as authority for this rule *Bloxham (in liquidation) v Irish Stock Exchange Ltd* [2014] IEHC 93.
[10] *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425, at 437.

At the same time, however, the Draft Guidance states that "*while that judgement may have turned out to be wrong in a given circumstance, with the benefit of hindsight, it is clearly possible for that individual to demonstrate how that judgment may have been reasonable at the time*."

## 7. Concerns about "Breaking the Participation Link"

The participation requirement, by which a business person is exposed to enforcement action solely if they participated in wrong-doing by the business, dates from the Central Bank Act, 1942.

The current proposal to break this participation link gives rise to serious legal concerns.

The European Central Bank has noted that "[*t*]*he effect … is that the CBI can pursue individuals directly for their misconduct rather than only where they have participated in a firm's wrongdoing*" (ECB Opinion on the IAF at 1.6). If the business is not in breach, what wrongdoing can an executive be guilty of?

Executives will be liable to Central Bank enforcement action and, ultimately, sanction, even if the business they manage has not breached any law or rule. That no evidence or experience is provided to justify what is a radical departure is concerning and it seems clear that a break of the participation link significantly increases executive jeopardy.

In *Fingleton v Central Bank* 2018 [IECA] 105, a former INBS executive challenged the Central Bank's right to pursue an individual ASP case against him following a Central Bank settlement with the INBS. Ms Justice Irvine considered it relevant that the Central Bank process against the Applicant would determine whether INBS committed the suspected prescribed contraventions *and* whether the individuals participated in the commission by INBS of the prescribed contravention, noting that this was of particular relevance to the appeal (at para. 9).

It is clear from her judgment that the Central Bank "*must prove that INBS committed the alleged prescribed contraventions before any finding as to [the individual's] participation in them might be made*" (at para. 50).

Breaking the participation link will also mean that the business for which an executive works may have no concurrent enforcement risk or jeopardy. In these circumstances, the employer may also wish to see the matter settled promptly, which is likely to increase pressure on the employee.

## 8. Further Reponses

See below responses to specific questions:

***Q1. What are your views and comments on the draft SEAR Regulations and related draft guidance?***
***Q6. Do you agree with our proposed approach to the Statements of Responsibilities?***
***Q7. Do you agree with our proposed approach to the Management Responsibilities Map?***

(a) We note that CP 153 proposes that the SEAR will initially apply to a defined range of regulated firms, namely:

- Credit institutions (noting that the CBI excludes applications of SEAR to credit unions);
- Insurance undertakings (excluding reinsurance undertakings, captive (re)insurance undertakings and Insurance Special Purpose Vehicles);
- Investment firms which underwrite on a firm commitment basis and/or deal on their own account and/or are permitted to hold client assets; and
- Incoming third country branches of the above are also within scope (i.e. "In-Scope Firms").

(b) On the timeline for proposed implementation, CP 153 proposes that the Conduct Standards (including accountability of senior individuals for running their parts of the business effectively) will apply from 31 December 2023, with the Regulations prescribing that the responsibilities of different roles and the requirements on firms to clearly set out the allocation of those responsibilities and decisions within Management Responsibilities Maps (**MRM**) and Statements of Responsibilities to apply (to In-Scope Firms) from 1 July 2024.

**Recommendation 1**

**Align the implementation timeline for the SEAR regime, the Conduct Standards and the changes to the F & P Regime (e.g. all to commence on 1 July 2024).**

Otherwise, it will be necessary for MRMs to be substantively progressed (if not completed) by 31 December 2023 given the link between the MRM, the Conduct Standards and the changes to the F & P Regime.

If In-Scope Firms wait until January 2024 to consider their MRMs and Statements of Responsibilities, that will likely create practical difficulties and a duplication of efforts in order to ensure alignment and compliance with Conduct Standards and the F & P Regime.

**Q17. Do you agree with our proposed approach to reporting of disciplinary actions?**

Yes, subject to the following suggested modification.

The legal obligation on firms in relation to the Conduct Standards (including the obligation to report disciplinary actions arising from breaches of the Conduct Standards to the Central Bank) should apply to the relevant firm at the conclusion of the internal disciplinary procedure i.e. after – not before - any appeal process has concluded.

An employee has a fundamental right to appeal any disciplinary sanction as well as a right to a fair and impartial adjudication of their appeal.

A possible outcome of a successful appeal is that a disciplinary sanction which was imposed previously is revoked and purged from the record. As such, an employee could argue that such a report could prejudice or damage their reputation before the CBI where a report is made regarding a disciplinary sanction which is subsequently revoked.

**Recommendation 2**

The obligation to report disciplinary action should be triggered either when the final internal appeal process has concluded or the deadline by which the right to exercise the appeal has expired, whichever is the earlier.

## Conclusion

We hope that these observations and recommendations will assist in your consideration of these issues and would welcome the opportunity to engage further if that would be helpful.

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