

Central Bank Bill will impact on how boards and management work

Although generally a simplifying and harmonising Bill, the Central Bank (Supervision and Enforcement) Bill 2011, proposes to make reporting of breaches mandatory and punishable by fines of up to €1 million which will have considerable implications for boards and management at regulated firms writes KEVIN O'DOHERTY

The Minister for Finance announced the publication of the Central Bank (Supervision and Enforcement) Bill 2011 on 28th July 2011. The Bill will be introduced into the Dáil in the autumn session and presumably will quickly make its way onto the statute books. The Bill is commendably written in clear language and set out in a logical fashion. The Bill takes great effort to homogenise certain existing sectoral powers across financial services generally rather than introduce any radical new powers.

Skilled person reports

Part 2 of the Bill provides for the Bank to require the preparation of skilled person reports. While such reports have previously featured in regulatory directions, they are now being placed on a statutory footing. The firm can nominate the skilled person and the Central Bank has a right to overrule and impose its own expert if the firm's selection is unacceptable. The intention here is to improve efficiency by having a relevant expert prepare a report on a regulated firm for the Central Bank on some area of regulatory concern to it. The report is paid for by the regulated firm, but the Central Bank determines what work is to be done - it may specify the methodology to be used and whether recommendations are to form part of the report.

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The Bill specifically requires the Central Bank to consider the cost implications for the reviewed firm of commissioning the report and any likely benefits for that firm.

Another area of interest in Part 2 of the Bill for service providers is Section 14(2) which requires a person giving or who has provided services to a firm being reported

on to give 'all such assistance to a reviewer as he or she may reasonably require for the purposes of the preparation of the report'. The cost implications for auditors in particular in providing such assistance are obvious.



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Section 16 of the Bill provides that the Bank may use these reports 'in the performance of its functions under financial services legislation', which is presumably a reference to the Administrative Sanctions process and other enforcement responsibilities. This means a firm could well end up paying for an investigation by its own consultants and have this investigation report used as the basis for a prosecution against it.

The consultants writing such reports will in turn need to be sure of their facts and be careful about the conclusions that they draw, even in preliminary discussions, as the Bill provides for the Central Bank to have access to interim reports, documents and working papers.

Authorised officers

Part 3 of the Bill sets out a capability for Authorised Officers to enter premises, inspect, copy and seize documents. While similar regimes exist in a number of pieces of financial services legislation dating back to 1989, the Bill seeks to replace these differing capabilities with a single harmonised set of powers.

There are implications not just for regulated firms - inspection powers will also extend to 'any other person whom the Bank reasonably believes may possess information' which again brings auditors and professional advisors into scope. Authorised Officers may (among other powers) enter premises and retain documents.

Whistle-blower regime

Part 4 of the Bill introduces a whistle-blower regime by setting out protections

for persons reporting to the Central Bank reasonably-held beliefs that provisions of financial services legislation may be contravened or that evidence of same may be concealed or destroyed.

Section 33(2) of the Bill goes significantly further in making such disclosures mandatory for persons in any of the preapproval control functions introduced in the Central Bank Reform Act 2010. Such roles include all board directors and selected senior management roles.

This mandatory element, if unchanged during the passage of the Bill, is liable to have significant implications, as it represents a considerable increase in personal obligations and exposures for the

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directors and management involved. This mandatory provision could significantly undermine trust and relationships between boards and management given the significant personal financial penalties of up to €1 million proposed for breaches, by establishing clear incentives to conceal information from others or enter into a race to be first to disclose.

There is an exclusion from the mandatory obligation to make a protected disclosure where the person has a reasonable excuse. Reasonable excuses are not defined other than to specifically include avoiding self-incrimination as a reasonable excuse!

There are two major considerations with such a regime for a whistle-blower. The first is protection from other statutory and contractual confidentiality requirements.

The second is subsequent protection of the whistle-blower from reprisal action. Section 34 of the Bill provides for the first of these and requires that the Central Bank not disclose the identity of the whistle-blower without their consent. Section 35 contains extensive provisions for the second issue, however the prohibition of penal action against a whistle-blower does not prevent an employer 'ensuring that the business concerned is carried on in an efficient manner, or taking any action required for economic, technical or organisational reasons'. It remains to be seen how effective the protection provisions are in practice, given these broad but not unreasonable exemptions.

Power to issue directions

Part 5 of the Bill grants the Central Bank the power to give directions although these are powers already available to the Central Bank under various individual acts and regulations. As with Part 3 of the Bill, the objective

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appears to be to set out a common regime to codify and homogenise the precise powers in a clearly expressed manner. As such, Section 37 sets out the circumstances in which the Central Bank may give directions. Surprisingly, these grounds appear quite limited – when a firm is unable to meet its obligations to its creditors, when a firm is not maintaining regulatory capital minima, when a firm is failing to comply with financial services legislation, when a firm is likely to jeopardise client assets or where there are grounds for revoking a firm's authorisation. This appears a long way removed from Matthew Elderfield's public pronouncements in April 2010 that a more interventionist regulator would

'be prepared to insist on a course of action if we are unpersuaded by the plans of senior management'.

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Section 38 of the Bill provides that, where a direction is in place, no relevant court proceedings can be commenced or continued unless the High Court intervenes. Winding-up and receivership proceedings are specifically instanced as proceedings affected by this measure.

If unhappy with a direction issued against it, a regulated firm can apply to the High Court to have the direction set aside. This right is limited to the firm itself and is not available to customers, creditors or other group companies.

Power to make regulations

Section 40(1) grants the Central Bank the power 'to make regulations for the proper and effective regulation of regulated financial service providers'. This very broad grant of power is then narrowed by the following sub-section 40(2) which specifies the particular areas in which the Central Bank can issue its own Statutory Instruments, listing some 21 different headings.

Some of these headings are quite narrow, e.g. provisions restricting the making by regulated financial service providers of unsolicited phone calls or visits to customers, while some are quite broad e.g. provisions for identifying, monitoring and managing risk. Regulation in these areas under this section will potentially apply to all firms regardless of sector and not just to those under a particular Act or regulation as is the case currently. The Central Bank will have to take care when drafting such regulations to avoid conflicting with maximum harmonisation European Directives, such as MIFID.

The point has been made that these new powers are in areas where the Central Bank already has the power to issue binding codes of conduct, nonetheless the significant broadening of the power to issue its own Statutory Instruments first seen in the Central Bank Reform Act 2010 represents an elevation of the Central Bank as an integral part of the mechanism of government.

Enforcement

There are no significant new enforcement powers contained in the Bill, recent initiatives in relation to white collar crime having been included in the Criminal Justice Bill 2011. In a manner suitable for our times, the Bill stresses that persons convicted of an offence will be

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liable to reimburse the Central Bank for the costs of investigation and prosecution.

The Bill proposes to double the level of fines payable under the Administrative Sanctions Regime to €1 million for individuals and €10 million or 10 per cent of turnover for corporates. This was one of the key improvements sought by the Central Bank when it published its Enforcement Strategy Document in December 2010. This 10 per cent provision recognises that even the proposed sanction cap of €10 million may be an inadequate deterrent when dealing with some of the large international groups that have established Irish firms as their bridgehead into the European market. The 10 per cent provision will certainly ensure that the Central Bank's enforcement initiatives get onto the corporate radar at such firms, however having done so the Central Bank will have to be very careful to apply such powers transparently and proportionately as such firms will be very wary of any unpredictability in a materially important regulator.

The Bill itself will become a 'designated enactment' rendering any breach of it punishable under the Administrative Sanctions Regime. Lastly, the Bill provides a legal basis for the Central Bank to voluntarily co-operate with foreign regulators where not bound under EU law to do so, subject to cost recovery from the foreign agency.

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