Is the regulatory references regime ripe for deceit and negligent misstatement claims?

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The regulatory references regime has wide-reaching implications for employers. They may unexpectedly find themselves in the civil courts for the torts of deceit and negligent misstatement in attempting to comply with the new rules.

Introduction

The regulatory references regime – set out in FCA PS16/22 and PRA PS27/16 – came into force on 7 March 2017. Under the new regime we can expect references to go from bland documents stating an individual's job title and dates of employment to including warning shots to employers ensuring that historical misconduct is referred to. This is designed to prevent the so-called 'rolling bad apple' effect – individuals with poor conduct moving from firm to firm. The new rules represent uncharted territory for banks and insurers, which will be left to grapple with the practicalities and potential unintended legal consequences.

This article explores the regime, before turning to the two most likely causes of action that may arise out of the former employers' continuing duty to inform current employers whether the candidate is fit and proper: claims in deceit and negligent misstatement. We envisage that other claims may well be pursued in the civil courts, including defamation, and in the employment tribunal, including victimisation and whistleblowing, but such claims are outside the scope of this article. Moreover, we envisage that problems are likely to arise when drafting settlement agreements or construing pre-existing settlement agreements.

The regime

The new rules apply to all firms covered by the Senior Manager and Certification Regime (SMCR) and the Senior Insurance Managers Regime (SIMR), namely banks (including branches of foreign banks operating in the UK), certain dual-regulated investment firms and insurers. The rules apply to applicants being recruited into regulated roles under the SMCR: individuals taking on senior insurance management; senior management; controlled functions; and/or significant harm functions.

Before this regime was introduced there was no duty on employers to give or seek references. It introduces an obligation on relevant firms to seek references covering the last six years of the relevant candidate's employment.

Regulated firms providing references are required to disclose *all* information considered to be relevant in determining whether a candidate is *fit and proper.* The reference must include details of any breach of the conduct rules where there has been disciplinary action. This will include:

- formal written warnings
- suspensions (excluding suspension pending an internal investigation)
- dismissals and
- any sanction involving a reduction in or recovery of remuneration.

The reference, which should be provided in a prescribed form (as set out in Annex 1 to SYSC 22 of the FCA Handbook) within six weeks of the request, should provide a factual description of the breach and its outcome. Notably, instances of serious misconduct committed more than six years ago also need to be disclosed.

Former employers that are financial services firms must update references given in the past six years if they become aware of information that would have caused them to draft the reference differently, where that difference is significant in terms of the individual's fitness and propriety. This will include any misconduct that subsequently comes to light after the individual has left the company.

The practical implications of the regime

The new obligations under the regime are likely to give rise to a plethora of problems in the employment realm, the most likely ramification being an increase in tortious claims of

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negligent misstatement being brought by employees.

From a practical perspective, former employers are under a common law duty to the employee and new employer to exercise due skill and care in providing a reference. Providing a true, fair and accurate reference may be particularly difficult in circumstances where an employee resigns during an investigation into alleged misconduct. The rules themselves do not specify that employees should have a right to reply to a regulatory reference, although they do provide that firms should 'usually' allow the employee the opportunity to comment on the allegations.

It is long established that fraudulent references can give rise to a tort of deceit (see *Foster*). This is a false and dishonest statement, which is intended to be relied upon. When it is relied upon, the deceived party may have an actionable claim in respect of any loss and damage. If former employers shy away from giving the new employer information relevant to whether a candidate is fit and proper, an omission alone *could* give rise to a claim from the new employer under the tort of deceit, as well as breaching the regulatory references statutory obligations. This is because there are now positive obligations conferred on employers under the regime.

Staying silent about any information that pertains to whether a candidate is fit and proper, by omission, positively affirms that there is no information that could bring into question whether the candidate is fit and proper. Thus, staying silent could be deemed fraudulent, given that the silence, in itself, could be deemed false and dishonest, leading to potential deceit cases being brought by new/prospective employers against former employers.

However, sending an update to the current employer can also bring about a whole raft of issues. As outlined in *McKie*, an ex-employee can bring a claim in negligence against a former employer for making negligent misstatements to his or her current employer, irrespective of whether those statements were made in a reference.

Where a party makes a statement that is reasonably relied upon by another party in the way intended by the maker of the statement, there may be an assumption of responsibility in a proximate relationship sufficient to give rise to liability for foreseeable economic loss flowing from the reliance. Therefore, the former employer is likely to owe a duty of care to both the employee and the new employer.

The new regulations create an onus on former employers to investigate properly and accurately issues that arise and report any findings to new employers when the employee moves on.

However, there will be instances where an employee leaves a firm part way through an investigation. It will not always be appropriate or possible to conclude the investigation, and indeed firms are not required to do so; however, the outgoing employer will need to decide how (or if) this is referred to in the regulatory reference. If the former employer does refer to the investigation, this could be taken to imply that it has concerns regarding that individual's fitness and propriety.

Unfortunately, this still could give rise to claims by former employees and even, potentially, new employers. The financial implications could be extensive; a loss of earnings claim is likely to be brought, but it is also not inconceivable that a claim for pain and suffering could be brought in circumstances where an employee has suffered psychologically due to the reputational damage caused by the negligent misstatement.

If the employer wishes to defend such a claim, the employer should attack the constituent parts of the claim. First, the employer should seek to show that the statement is accurate. Failing this, the employer could then attack the current employer's decision not to hire or to dismiss the employee. If a former employer can show that the statement was irrelevant to the current employer's decision-making, then that will defeat such a claim, as there plainly will not have been reasonable reliance on the statement.

Thus, if an offer of employment is withdrawn, or an employee is dismissed due to the information given, then, a claim may be brought against the former employer by the employee.

Given that under the new regime there is a continuing duty to bring any information relating to whether the candidate is fit and proper to the next employer's attention, the frequency of these sorts of claim is likely to increase.

The impact on settlement agreements

It is not uncommon for employees at authorised firms to be offered an amicable exit, via a settlement agreement, as an alternative to going through a disciplinary investigation that could result in their dismissal. This allows the individual to leave the business with their reputation intact, invariably with an agreed reference. From the firm's perspective, the errant

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individual is removed with minimal disruption to the business.

However, the new regime will prevent firms from entering into any arrangement or agreement with an employee that limits their ability to disclose relevant information about that person's conduct. This means that relevant employees will no longer have the comfort of knowing, with certainty, the form of reference that will be provided to a new employer.

Without a guarantee that they will walk away with their reputation intact, there may be little motivation for individuals to enter into a settlement agreement. Employees are likely to stay and exhaust internal procedures in an attempt to clear their name. If they do not achieve the desired outcome, they may choose to litigate. Individuals may demand higher settlement sums to compensate them for the uncertainty.

Consideration should also be had to how settlement agreements and COT3s are drafted, as ordinary clauses may not have any legal effect anymore. It is customary to have confidentiality and non-disparagement clauses within settlement agreements. Given that exclusions for confidentiality usually include where one is obliged in law to discuss the matter, the regime should not have an impact upon the ability to include a valid confidentiality clause, to the extent that the relevant clause is otherwise enforceable.

Conclusion

The regulatory reference regime will have far-reaching implications for firms and individuals performing regulated functions. Allegations of misconduct in a regulatory reference could cost an applicant a job offer, or result in an individual losing their existing job. It is possible that mere reference to an individual being involved in an investigation (whether or not that investigation was concluded) could call into question that person's fitness and propriety. As well as the financial consequences, in terms of loss of income, the contents of a reference could cause irreparable reputational harm. Given these high stakes, we may see a rise in tortious claims for negligent misstatement.

Former employers providing regulated references will have to tread with particular care. Failure to provide an accurate reference, or omission of information pertaining to an individual's fitness and propriety, would not only be in breach of their regulatory obligations but could result in negligence claims being brought by new employers. Parties within the relevant sector should be mindful of the way in which settlements are entered into, and those that have already entered into settlement agreements may find that part of the settlement agreement is void.

KEY:

Foster	*Foster v Charles* (1830) 6 Bing 396 (affd 7 Bing 105)
McKie	*McKie v Swindon College* [2011] EWHC 469 (QB); [2011] IRLR 575

Employment Law Clinic

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The Cardiff Employment Law pro bono clinic, which has been running in Cardiff since February 2015, is looking for some more volunteer employment solicitors to be added to the rota. Currently, we have nearly 40 solicitors from several firms in Cardiff and the surrounding area, and we hope members of ELA who are based in South Wales would like to get involved.

The clinic runs every other Wednesday, starting at 5.45pm and ending at 8pm. The solicitor will do a brief consultation, take notes and provide advice. Solicitor volunteers need to have 2 years' PQE and 2 years' experience in providing employment advice.

If any solicitors who are based in South Wales are interested, please send an email to info@cardifflawclinic.co.uk.