

GUIDANCE NOTE – RULE 8.14 – BREACHES OF REGULATORY REQUIREMENTS

Background

In issuing guidance on rule 8.14, it is appropriate to give guidance on the wider context of the Commission's approach to breaches of the regulatory requirements.

The use of "the regulatory requirements" in rule 8.14 is based on a defined term in rule 8.2.

During the Commission's discussions with practitioners in meetings with industry associations and on a one-to-one basis we have received a number of comments and queries about rule breaches. Examples of the issues raised have been:

- Whether the fact that a rule breach has been recorded means that the licenceholder would automatically face further disciplinary action?
- Could breaches be classified by the Commission according to severity (for example as material and not material)?
- How should a licenceholder approach the question of materiality under rule 8.14(1)?
- Why is every rule breach recorded in writing by the Commission?
- Are licenceholders being treated consistently?
- When a licenceholder has to report every recorded breach to the group compliance department (due to internal requirements), does the Commission really have to record them all?

This document has been prepared in response to the points raised. It is addressed primarily but not exclusively to the compliance officer. Licenceholders which have head offices or parent companies overseas might also wish to draw the guidance to the attention of group compliance and group internal audit.

This guidance covers:

1. Recording breaches;
2. Notifying the Commission of material breaches;
3. The consequences of breaches;
4. Examples of mitigating and aggravating factors; and,
5. Expectations of a licenceholder which has breached a rule.

Recording of breaches

Licenceholders are required by rule 8.14(3) to maintain a register of all breaches of the regulatory requirements.

The Commission has prepared a pro-forma register which is available for licenceholders either to adopt or to check against their existing register. It is not a statutory document and licenceholders are not obliged to use it. It can be found at:

- [Breaches](#)

The Commission records in writing the breaches of which it is aware. This may be in the form of a letter, a visit report or other written communication (for example a “shuttle” review of an annual compliance return).

The Commission records breaches in writing because:

- If a regulatory requirement is not being complied with, the situation should be addressed and if possible remedied;
- A written record of breaches provides clarity as to whether a breach has occurred and how it has been addressed by the licenceholder and the Commission;
- Recording a breach in writing assists the licenceholder to reply if it does not agree that there has been a breach (either on factual grounds or based on the interpretation of the rule);
- A record of all breaches promotes a consistent approach by Commission staff and confidence amongst licenceholders that consistency is being maintained;
- Recording all breaches avoids debates about whether a breach is or is not recordable;
- Recording breaches helps to keep a record of the circumstances, including mitigating and aggravating factors;
- By recording all breaches, it is possible to identify persistency (or a pattern) of breaches which might indicate poor controls in the licenceholder;
- If a number of licenceholders are not complying with a requirement it might be appropriate to issue guidance or amend a rule; and,
- Recording all breaches assists the Commission in assessing a licenceholder’s fitness and propriety on a cumulative basis.

Notifying the Commission of material breaches

Licenceholders are required by rule 8.14(1) to notify the Commission of material breaches of the regulatory requirements (emphasis added).

In considering whether a breach is “material” under rule 8.14(1) a licenceholder should apply its judgement.

Assessing materiality inevitably involves judgement and depends upon the particular circumstances of the licenceholder as well as the nature of the breach. Accordingly the Commission can give only limited advice. However, we would note that:

- A breach of a requirement to obtain consent from the Commission is always material; and,
- In the event of a breach of a requirement to give notification to the Commission, we would always expect the licenceholder to advise us, in order to rectify the situation.

The materiality of the breach is determined primarily by the nature of the regulatory requirement and the size, impact or extent of the breach. However, the circumstances and causes are also relevant to some extent in deciding whether a breach is material. It would be appropriate, for example, to take into account whether any of the aggravating factors in Table 1 are present (see “Further consequences of a breach” below).

Further consequences of a breach

The Commission's decision as to whether to take further action is based upon all of the circumstances, and aims to be proportionate to the breach and the circumstances.

The Commission has powers of investigation and enforcement which can be used following a breach or a pattern of breaches (for example, civil penalties, directions, or action over the fitness and propriety of the directors or key persons). The Commission uses these powers where appropriate. However, in practice many breaches are handled without the need to use such powers.

The Commission's decision may take into account the materiality and persistency of the breach and mitigating or aggravating factors, such as the examples in the list at table 1.

Table 1: Examples of mitigating and aggravating factors

Mitigating factors	Aggravating factors
Genuine error	Deliberate or negligent breach
Generally adequate procedures and controls, for example other similar matters handled correctly	Lacking or inadequate procedures or controls
Little or no impact on customers	Adverse impact upon customers, e.g. actual or potential financial loss
Force majeure - circumstances wholly or partly outside the control of the licenceholder.	Within the licenceholder's control – possibly senior staff involved
Little or no additional AML/CFT risk	Increased AML/CFT risk
Little or no financial crime risk	Increased risk of financial crime
Breach identified by licenceholder	Breach not identified by the licenceholder
Prompt and effective remedial action.	Slow and/or inadequate response to the problem
	Indications of lack of competence
	Increased risk of financial failure
	Repetition of the same breach
	Numerous breaches of different types, which could indicate weak controls or poor compliance.
	Possible damage to the reputation of the jurisdiction

(The list in Table 1 is illustrative and not exhaustive)

Commission expectations of a licenceholder that has breached a regulatory requirement

Breaches found by the licenceholder

The Commission would expect a licenceholder to take the following steps when it finds that it has breached a regulatory requirement:

1. Record the breach in the register maintained under rule 8.14(3);
2. Identify the causes;
3. Identify remedial action;
4. Notify the Commission under rule 8.14(1) if the breach is regarded as material; and,
5. Take prompt and effective remedial action.

If a potential breach is identified in advance, as might happen with the financial resources requirement for example, the licenceholder should seek to prevent the breach.

Notification to the Commission of a material breach under 8.14(1) should include:

- When the breach occurred;
- Description of the breach and the reasons why it occurred;
- What corrective action has been taken or will be taken (where the breach can be corrected);
- The timescale for the corrective action; and,
- What steps have been taken to prevent a repetition and what is the timescale for implementation?

Breaches found by the Commission

Where a previously unrecorded breach is identified by the Commission's officers, for example during a visit, the Commission would expect the licenceholder to:

1. Agree a realistic timetable for remedial action;
2. Start remedial action promptly – there is usually no need to await the final visit report;
3. If problems are encountered and a delay to completion is possible, notify the Commission and explain the circumstances, the action being taken and the expected revised completion date (the Commission however, reserves the right to regard missing the timetable as a compliance failure); and,
4. Confirm when the remedial action has been completed.