29 May 2024

Re: Thematic Review of Compliance with the Minimum Competency Code and Consumer Protection Code

Dear Director, Partner, Principal,

The Central Bank of Ireland ("Central Bank") recently conducted a thematic review ("Review") which examined Retail Intermediaries' compliance with the Minimum Competency Code ("MCC"), Knowing the Consumer (also referred to as Knowing Your Consumer or "KYC") and Suitability requirements set out in the Consumer Protection Code ("Code").

The Central Bank's Regulatory and Supervisory Outlook Report 2024 sets out our view on the key trends and risks facing the regulated financial sector. One of the risks identified is the risk of inappropriate practices and behaviours that do not serve consumers' or investors' interests, an issue that has been observed from our day-to-day supervision of the Retail Intermediary sector, particularly in smaller firms. Professionalism in the financial services industry encompasses a range of characteristics and behaviours that are essential for building trust and managing risk. These characteristics include, *inter alia*, ethical behaviour, competence (e.g. MCC), and a client-focused approach (e.g. KYC and Suitability requirements). When availing of the services of Retail Intermediary firms, consumers need to have confidence that their Retail Intermediary is competent, professional, and will act in their best interests. In this regard, the Central Bank considers compliance with MCC, KYC, and the Suitability Provisions of the Code to be integral in order for the Retail Intermediary Sector to serve consumers' best interests. The purpose of this letter is to provide feedback to industry on the findings of the Review and to outline the Central Bank's expectations in relation to adherence to the Provisions of the MCC and the KYC/Suitability requirements as laid out in the Code.

The Review covered a number of firms of different sizes, ranging from sole traders up to larger Retail Intermediaries with hundreds of thousands of consumers. The sample of firms reviewed provide financial services to approximately 25 percent of the total retail consumers serviced by Retail Intermediary firms in Ireland. The Review focussed on Insurance and Investment Intermediaries, in particular Retail Intermediaries selling products where poor standards of compliance could result in significant consumer detriment, such as Life and Investment products.

<u>Findings</u>

The Review identified that compliance levels are related to the size and scale of the Retail Intermediary, with good practices more evident in larger firms. The Central Bank understands that Retail Intermediaries differ greatly in terms of size, and the nature, scale and complexity of their product offering, and this was taken into account when conducting this Review. However, every Retail Intermediary should be able to demonstrate a minimum standard of compliance in terms of MCC and KYC/Suitability.

1. ***Compliance levels are related to the size and scale of the Retail Intermediary***
Although findings were identified in the majority of firms inspected, the volume and severity of the risks and breaches identified were far greater in smaller, independent Retail Intermediaries[1]. The Review identified a number of significant weakness, poor practices, and instances of non-compliance across each of the topics under review. In several cases, Retail Intermediaries were unable to provide adequate evidence and/or documentation to demonstrate compliance with MCC and KYC/Suitability requirements. It is apparent that these weaknesses arose due to inadequate or ineffective internal processes and controls, and general poor record keeping and file management. This overarching finding is underpinned by the specific weaknesses outlined below. **Schedule 1** details our key findings and expectations in greater detail.

2. ***KYC and Suitability Weaknesses***
The Review identified a number of instances of KYC customer fact-finds that were not sufficiently detailed (in particular for subsequent products/services). In addition, there were instances of inadequate Statements of Suitability, including generic Statement of Suitability templates used.

3. ***Minimum Competency Gaps***
The Review identified varying standards and frequencies of review of the Accredited Persons Register, and some Retail Intermediaries did not adhere to the requirements as set out in the Minimum Competency Regulations 2017[2]. In certain cases, registers fell short of the requirements in terms of format, clarity and detail, and it was not clear they had been adequately updated or maintained.

4. ***Variable Remuneration Policies***
The Central Bank implements a proportionate approach regarding Variable Remuneration Policies[3] for Retail Intermediaries, and where appropriate (based on their nature, scale and complexity) Retail Intermediaries should implement a comprehensive policy. A number of firms reviewed in the on-site inspections were deemed to be of such a size and scale that a Variable Remuneration Policy should be in place. Half of these firms either did not have a policy in place, or their policy did not meet Central Bank expectations.

5. ***Vulnerable Consumers***
All Retail Intermediaries included in on-site inspections showed awareness and knowledge of how to identify vulnerable consumers and had processes in place to make accommodations once such consumers were identified. However, in a small number of Retail Intermediaries, the onus was placed on the client to opt to be treated as a vulnerable consumer.

[1] Independent refers to Retail Intermediaries not tied to a single product provider and operating on a fair analysis of the market basis.
[2] Regulation 7. Obligation to establish and maintain register of accredited persons.
[3] A Variable Remuneration Policy should encourage the right culture and behaviours in sales staff; ensuring there is a focus on suitability in sales, i.e. quality over quantity.

The Review also identified good practices, including Statements of Suitability that included all relevant information for the consumer in a single, easy-to-read document, and regular scheduled reviews of the MCC registers. Details of all good practices identified are included in **Schedule 1**.

Actions Required:

The Central Bank has issued Risk Mitigation Programmes to individual firms requiring them to take specific actions on foot of our findings. Where appropriate, we will utilise other supervisory tools available to us, up to and including taking enforcement action. It is the responsibility of every firm to ensure that robust business practices are in place to ensure that the firm is in a position to demonstrate its compliance with all relevant regulatory requirements on a continuous basis. In light of the findings, the Central Bank requests all Retail Intermediaries to:

1. Review their business practices and compliance arrangements against the findings, expectations and good practices set out above and in **Schedule 1**. This review and its outcomes must be documented. This should include details of actions taken and / or planned to address findings, with reference to updated procedures, processes, controls, registers, templates and training, as well as timelines for implementation. This review should be completed, and an action plan discussed, approved and evidenced by the firm's management team **by 31 August 2024**[4]. The Central Bank expects that this document will be available for review during future engagements with any Retail Intermediary.

2. On completion of the review referenced in point 1, the Central Bank expects that Retail Intermediaries will apply their improved KYC/Suitability arrangements in subsequent engagements with all consumers. Where gaps are identified in KYC/Suitability files and documents for existing consumers, Retail Intermediaries must be proactive and use the next engagement/meeting with their customer to update the relevant KYC fact-find and other related documents.

The findings set out in this letter are not exhaustive and the Central Bank reminds Retail Intermediaries of their obligations to comply with all relevant requirements of the MCC and the Code. The Central Bank expects firms to adopt a more proactive approach to the continuous evaluation of the effectiveness of all of their arrangements and practices, to ensure that they are meeting the highest standards of consumer protection and delivering fair outcomes that put consumers' interests first.

In circumstances of non-compliance by a firm with any regulatory requirements relevant to the matters raised in this letter, the Central Bank may, in the course of future supervisory engagement, or when exercising its supervisory and/or enforcement powers in respect of such non-compliance, have regard to the consideration given by a firm to the matters raised in this letter.

Should you have any queries regarding the content of this letter please contact brokers@centralbank.ie

[4] For clarity, the 31 August is the date by which the review is to be completed and an action plan documented and agreed by senior management. Implementation of the action plan can take place post-31 August as per a reasonable timeline set by each firm.

Yours sincerely

Des Ritchie
Head of Division
Consumer Protection – Investment Firms, Intermediaries & Client Assets Division

Schedule 1 – Findings and Expectations

2. Knowing the Consumer (KYC) & Statement of Suitability

It is critical that product recommendations are based on a thorough fact-find and assessment of a consumer's personal circumstances. A failure to properly gather and document KYC information poses a significant risk that key information is missed and/or not updated. There is a risk that recommendations are based on inaccurate, incomplete or out-of-date information. As a result, a consumer may purchase a product unsuitable to their current needs and situation (for example, a product that is too risky or is unsuitable for their financial situation), leading to financial loss, poor value for money, or other detriment.

Poorly formatted, generic Statements of Suitability may not clearly convey to the consumer how and why a product is considered suitable for their specific needs and objectives. It may also mean that the consumer is not provided with clear and transparent information to enable them to make an informed financial decision. Effective disclosure is a critical element in identifying the suitability of financial products for consumers. The information provided through the Statement of Suitability should seek to provide a concise summary of relevant material information to consumers in one standalone document.

Overview:	Chapters 2 and 5 of the Code set out a number of principles and regulations that Retail Intermediaries must apply when dealing with KYC and Suitability requirements. Provision 4.58 sets out requirements when firms receive on-going remuneration.
Findings:	• Poor record keeping for KYC documentation, for example firms were unable to retrieve specific documentation in a timely manner; • Reliance on out of date or insufficiently detailed KYC information; • Lack of updated KYC particularly in subsequent product cases; • Lack of signatures and dates on the KYC and Suitability document; • Statements of Suitability that did not reflect current circumstances ; • Firms not encouraging customers to review policies on an ongoing basis; and • Firms placing the onus on customers to contact the firm for reviews.
Good Practices Identified:	• Statements of Suitability that went beyond recommending a suitable product by including detailed descriptions of the products and consumer profiles; • Firms taking an informative approach regarding complex products, where the Statements of Suitability reflected the complexities associated with the product; • Detailed analysis of the customer's needs and objectives; • Statements of Suitability that encouraged consumers to regularly review the ongoing suitability of their products; • Firms clearly noting the remuneration they would receive from the Product Producer over the lifetime of the product in the Statement of Suitability; • Internal checklists used by firms to ensure all necessary steps taken accompanied with a sign-off by a second person; and • Ongoing service propositions included in the documentation to encourage customers to review their products on an ongoing basis.
Central Bank Requirements:	The Code requires that all Retail Intermediaries act honestly, fairly and professionally in the best interests of their consumers and the integrity of the market. This includes but is not limited to: • Gathering and recording sufficient information from the consumer prior to offering a product or service; • Ensuring that for any subsequent products that the KYC is updated to reflect any material changes to a consumers circumstances; • Assessing whether the product and term offered is suitable for the consumer's current circumstances; • Preparing a detailed, personalised Statement of Suitability and providing this to the consumer to ensure transparency; • Undertaking of ongoing reviews of any products with the consumer; and • Disclosure to the consumer in relation to the services offered on an ongoing basis in respect of the remuneration received.

Example:	In one example, a firm sold a Section 72 policy[5] to a customer; however, there was insufficient information gathered relevant to the nature of the product. The fact-find recorded the customer's income but failed to document details of any assets, savings, debts or financial commitments; with some relevant sections in the fact-find marked as "did not discuss". Without this information, it is not clear how the Retail Intermediary was able to determine that the customer could afford the monthly premium, which appeared to be significant in comparison to the customer's stated income. Further, there were no details recorded of the value of the assets to be covered by the policy, leading to a risk to the customer that the level of cover may be insufficient to provide for the inheritance tax bill.

[5] A Section 72 Policy (Section 72 of the Capital Acquisition Tax Consolidation Act 2003) is a Whole of Life insurance plan, providing a lump sum benefit upon the death of the life/lives assured. These plans are primarily used for inheritance tax planning.

3. Minimum Competency Code (MCC)

Professionalism in the financial services industry encompasses a range of characteristics and behaviours that are essential for building trust, managing risk, and promoting ethical behaviour. These characteristics include ethical behaviour, competency, and a client-focused approach. Failure to fully comply with MCC puts consumers at risk of being advised by and / or buying products from staff that do not have the minimum acceptable level of competence or experience in the provision of advice and information in connection with retail financial products. Poor MCC compliance is one example of inappropriate / poor business practices that increase the risk that consumers' needs may not be adequately met.

Overview:	The MCC sets out minimum professional standards for persons providing certain financial services in Ireland.
Findings:	• Poor file management and record-keeping for key MCC documentation, for example, no single location to maintain such records; • Inadequate understanding of Grandfathering requirements; • Lack of up to date reports; • No follow up with staff members to ensure completion of relevant annual requirements; and • Accredited Person Register not in the prescribed format as laid out in section 7 (1) (a-e) of the Minimum Competency Regulations 2017.
Good Practices Identified:	• Centralised folder that contains all required MCC documentation for staff; • Dedicated staff member with responsibility for ensuring staff are up to date on their registration and relevant annual requirements; and • Regular scheduled reviews of the register.
Central Bank Requirements:	Firms are required to ensure that any individual dealing with customers in relation to retail financial products has the necessary qualifications and maintains their qualifications on an annual basis. Firms are also required to have an up to date Accredited Person Register of all staff that aligns with requirements in the MCC. In addition, the Central Bank expects that Retail Intermediaries have procedures in place to ensure that their staff meet the qualifications and maintain these qualifications on an annual basis.

4. Variable Remuneration

Failure to have and adhere to a robust Variable Remuneration Policy risks creating a culture among staff of selling higher-commission products (to drive higher revenue) instead of the most appropriate products suited to their customers' needs. Strong controls and frameworks around the payment of variable remuneration are essential in ensuring staff are not incentivised to make poor quality sales and / or act in an unprofessional manner. Remuneration arrangements should focus on encouraging the right culture and behaviours in sales staff, while actively discouraging poor practices.

Overview:	The Central Bank published its Guidelines on Variable Remuneration Arrangements for Sales Staff in 2014. The Guidelines place an emphasis on encouraging the right culture and behaviours in sales staff, while actively discouraging poor practices.
Findings:	• Firms had no policy in place; • Policies did not have clear objectives in place; • Policies that didn't take into account the quality of service given and compliance with relevant requirements; and • Failures to deter incentivised payments.
Good Practices Identified:	• Robust controls and frameworks for payments of variable remuneration; • Policies clearly setting out the remuneration process which were easily understandable by staff; • Policies that placed a significantly high weighting on key quality objectives such as overall performance scores; and • Metrics used to determine the remuneration were clearly set out in the policy (for example factors such as file review results, number of complaints upheld and instances of administrative breaches).
Central Bank Requirements:	The Central Bank expects Retail Intermediaries to ensure that sufficient weighting is given to quality assurance factors in order to prioritise good behaviours. Firms should utilise deterrents against poor sales-related behaviours. The Central Bank expects at a minimum 50% of the factors linked to unlocking variable remuneration to be qualitative metrics.
Example:	In one firm, it had a Remuneration Policy which included generic details on variable remuneration. The policy included statements that staff must act in the best interest of clients and that the policy was designed in a way to avoid creating conflicts of interest. However, there was no specific, measurable metrics included in the policy that definitively linked staff behaviours to their variable remuneration, for example, number of complaints by advisor, etc. Without these in place, staff may make poor quality sales without any impact on the variable remuneration they receive.

5. Vulnerable Consumers

Firms must be aware that consumers may not identify themselves as vulnerable due to the personal nature of the underlying matter. Where firms rely on the consumer to self-identify as a vulnerable consumer, they increase the risk that a vulnerable consumer may not be identified, and in turn may not receive a sufficient level of support from the firm. Where firms are of the view a consumer is vulnerable they must ensure they continue to act with the appropriate levels of care and not place the onus on consumers to seek an accommodation or arrangement.

Overview:	Consumers who may be in vulnerable circumstances require additional support when engaging with financial services. The Code outlines the requirements applicable to all regulated entities with regard to vulnerable consumers. Where a regulated entity has identified a vulnerable consumer they must ensure that the consumer is provided with reasonable arrangements and/or assistance to facilitate him or her in his or her dealings with the regulated entity. It places an obligation on regulated entities to take reasonable steps to identify and make the necessary arrangements for any dealings with consumers deemed to be vulnerable.
Findings:	• Instances observed whereby firms were placing the onus on customers to “opt in” to be treated as vulnerable.
Good Practices Identified:	• Firms have a specific vulnerable customer policy in place which is regularly updated; and • Internal procedures that clearly set out the role of the Firm and its staff members when liaising with vulnerable customers.
Central Bank Requirements:	Firms need to understand vulnerability, and to ensure that their culture, policies and processes take account of the needs of consumers in vulnerable circumstances so that they are reasonably protected from poor outcomes. The Central Bank expects that all Retail Intermediaries take reasonable steps to identify vulnerable consumers, and have processes in place to provide the necessary supports for vulnerable consumers identified.