



REGULATORY UPDATE 04/2010 (04 February 2010)

Financial Regulator's inspection findings reveal weakness in, and concerns about, the sales processes for Older Customers at banks, insurers, investment firms and stockbrokers

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Financial Regulator's inspection findings reveal weakness in, and concerns about, the sales processes for Older Customers at banks, insurers, investment firms and stockbrokers

Compliance Ireland will examine this issue and more in its upcoming [Treating Customers Fairly and Complaints Handling course on Tuesday 16th February, 9.00am to 1.00pm](http://www.complianceireland.com/TCF.html)¹. Go to <http://www.complianceireland.com/TCF.html>.

The Financial Regulator has expressed concerns about weak sales processes at credit institutions, life insurance firms and investment and stockbroking firms. The regulator's findings are based upon a selection of sales and sales processes at these firms. The findings follow calls by the former Financial Services Ombudsman, Joe Meade, in July 2009 for a review of all investment products sold to elderly customers since 2006.

As recently as December 2009, Mr Meade announced that early intervention by his office resulted in €143,000 being paid to two elderly couples by a financial institution and a bank. In the same report the Ombudsman concluded on other cases involving the sale of products to elderly customers including a €175,000 award where an elderly couple suffered a €290,000 loss. In another matter a 80 year 'Granny' was advised to place €10,000 into an investment product by her bank despite the fact that an insurance company (which was a tied agent to the bank) understood her instructions to be for the money to be deposited into her current account. Neither the insurance company nor the bank submitted evidence to show that 'Granny' had any previous investment experience. Accordingly, the Ombudsman directed the insurance company to buy back the investment product for the original €10,000 and to pay that amount to her.

The release by the Financial Regulator makes a number of interesting findings including its belief that institutions should offer elderly customers the option to have a third party present where the customer has no prior investment experience. Concerns are also raised about: Fact Finds/Know Your Client documentation not including a 'default risk rating' (which would mean that a consumer could be

¹ <http://www.complianceireland.com/TCF.html>

allocated an incorrect risk profile); Suitability statements being of a generic nature (in breach of the Consumer Protection Code); and example of basic but important Fact Find information not being recorded (e.g. income, assets and liabilities). MiFID firms cannot disregard these findings as being of relevance only to banks, insurers and other retail firms. The Financial Regulator specifically states that it found evidence that some MiFID firms did not maintain on file all information to support their assessment of suitability of investments under the MiFID regulations.

Regulated persons need to be aware that these findings do not simply impact upon whether or not there was a regulatory infraction. The findings impact upon whether there may also be a breach of the statutory/regulatory duty of care owed to the client (whether retail/private or professional status). This is separate to whatever action the Financial Regulator and the Ombudsman may take. The breach by the regulated firm may be used as evidence by a client to sue the firm for direct and consequential loss. **Compliance Ireland** has advised lawyers and their clients involved in litigation about this route and we are aware of how this 'legal strategy' has helped resolve civil disputes more effectively and efficiently for all parties than might have otherwise resulted. As readers will appreciate, MiFID requires firms to obtain sufficient information about the client to enable them to make an adequate and objective assessment of an investment's suitability. The suitability of an investment must be based on the client's relevant experience, knowledge, financial situation and investment objectives. Where a potential client does not provide the required information the investment firm shall not recommend investment services or products to the client. The provision of other services (i.e. not investment advice or portfolio management) compels the firm to assess the appropriateness of its investment services and activities for the client. Investment firms are obliged to warn their client if it is concluded that a particular investment service or product is inappropriate. If the client does not provide the information to the firm, then the firm must warn the client that it cannot determine whether the service or product is appropriate. *[Editor – It is abundantly clear that these 'regulatory infractions' are ticking time-bombs in terms of investor compensation claims and law suits].*

Compliance Ireland has seen the recent letter (dated this month) sent to regulated firms on this issue which, whilst ominously stating that specific concerns are being addressed with specific firms, that others should incorporate the following headings into their sales and operational procedures: 1 Definition of Older Client; 2 Assessment of Suitability, 3 Classification of Investment Risk; 4 Level of Emergency Funds; 5 Retention of Records; and 6 Third Party Meeting.

Some of the above 6 points are dealt with in summary fashion in the Financial Regulator's open communication. However to understand the policy direction of the Financial Regulator one needs to read the communication sent to regulated firms. This type of clear signalling, especially as it is a repeat of previous guidance, is surely just a precursor to a more 'credible threat of enforcement action' promoted by Central Bank Governor Honohan and Chief Financial Regulator Matthew Elderfield (CEO, Financial Regulator). See Newsletters [11/2009](#)² and [12/2009](#)³ for more.

The core regulatory issue here involves the suitability of investment products sold to older consumers. The Financial Regulator's examination commenced in December 2008 and was conducted throughout 2009. A mystery shopping exercise was also carried out to assess how credit institutions interact with older customers regarding the sales process for investment products.

A number of issues of concern were identified during the examination and as noted above regulated firms are required to ensure that their sales processes for older people are robust to ensure only suitable products are sold. Separate letters were issued to the industry giving feedback on the findings (copies of which **Compliance Ireland** has seen) from the exercise. Firms are instructed to address the issues in their procedures. Certain non-compliance issues identified are already subject

² http://www.complianceireland.com/documents/CI_Newsletter_Dec09_11_web.pdf

³ http://www.complianceireland.com/documents/CI_Newsletter_Dec09_12_web.pdf

to separate engagement by the Financial Regulator with the individual firms concerned. We should therefore expect to see some announcements about administrative sanctions in the coming weeks.

A range of issues were identified during the course of the Financial Regulator's inspections and include the following:

- Despite previous guidance on the importance of a practical definition for older customers, some firms do not have a definition of an 'older customer', which the Financial Regulator advises is 60 years old (an appropriate benchmark).
- There were instances where basic client information such as income and assets/liabilities were not recorded on the fact finding documentation of firms. *[Editor – this is not good. This critical information is the foundation of suitable advice. Surely after all this time we are not still making the same basic error? Regulated firms are viewed by consumers and their lawyers as having deep pockets and, of course, insurance. In economic times like these, clients and their advisers will aggressively pursue others where they have incurred a loss. Recall the endowment mortgage, precipice bonds and PPI scandals in the UK]* .The Consumer Protection Code requires a regulated entity to gather and record sufficient information from the consumer to enable it to provide a recommendation or a product or service appropriate to that consumer before the service is provided. As noted above, the assessment of suitability of clients for investments provided by MiFID firms was of concern to the regulator.
- There were instances of firms selecting a default risk rating, which was not the lowest risk rating of the firm, for clients that had failed to complete a section of the Know Your Client documentation. This means that a consumer may have been allocated an inaccurate risk profile. *[Editor –this one speaks for itself in terms of liability of the regulated firm]*.
- There were instances of institutions not offering older customers the option of having a third party present at a sales meeting. The Financial Regulator believes that the option to have a third party present may be useful where the customer has no prior investment experience. *[Editor – let's call a spade a spade. Read this bullet point as being that the regulator 'requires the firm to make the offer and where it is not made or not accepted, the firm should record that fact on file']*
- There were instances of firms not giving customers any advice on the level of emergency funds that should be maintained to provide for medical or other long term care expenses. The Financial Regulator recommends that firms refer to the need for an emergency fund, to ensure that customers have access to sufficient disposable funds in the event of a requirement for future health care needs or other potential unforeseen events. *[Editor – Read this bullet point as requiring a firm to note this point on file (i.e. that the discussion was held with the client) and refer to those discussion in the letter of suitability]*.
- Some statements of suitability were generic in nature. The Consumer Protection Code requires that the written statement of suitability provided to a consumer sets out the reason why a product or service offered to a consumer is considered to be suitable to that consumer. *[Editor – More of the same stuff. Isn't the regulator simply stating that it has identified breaches of the Code but that it will action these on a case by case basis? Surely a generic statement is no statement at all under the wording of the Code and is therefore a breach for which administrative sanctions may apply or which may support a civil case for mis-selling??]*

The Mystery Shopping Exercise

The Mystery Shopping Exercise was conducted by an independent third party appointed by the Financial Regulator in selected banks and building societies. A number of matters were identified as part of the mystery shopping. Thirteen of the fourteen mystery shoppers with an age profile of 72 to 79 years of age were recommended deposits with terms less than three years. **However, in four cases, discussions took place regarding products that could not be accessed for up to six years which is the regulator states is of concern given the age profile.** *[Editor – Surely a clear signal to the Financial Regulator to look at the remuneration policy at these firms??]*

What is happening now?

The Financial Regulator states that it has already taken a number of steps in relation to the weaknesses identified as this examination continued, which include, requesting firms to conduct an independent assessment of certain files regarding products sold to older customers, engaging with all firms where there were findings as a result of inspections conducted and providing feedback on positive practices. It concludes its public release stating “Any breach of a legislative provision or regulatory requirement, such as the Consumer Protection Code, may be considered under the Administrative Sanctions Procedure”. We have commented upon this outcome above.

PS: No sooner have we finished this Newsletter, we see a letter to regulated firms reminding them about their obligations under the Minimum Competency Requirements (MCRs). Firms are reminded that they have less than one year to ensure that their relevant staff (and the firm) meets the requirements in respect of staff transitioning and having been grandfather properly under the MCRs. More on this latter!

Compliance Ireland will examine this issue, the MCR issue and more in its upcoming [Treating Customers Fairly and Complaints Handling](#) course on Tuesday 16th February, 9.00am to 1.00pm⁴ Go to <http://www.complianceireland.com/TCF.html>

Other training courses

Anti-Money Laundering & Counter-Financing of Terrorism for Financial Institutions

(Full Day - Dublin) [PTAML001] Dublin

- Dublin - Tues 26th January
- Dublin - Thurs 25th February
- Dublin - Tues 25th March
- <http://www.complianceireland.com/AMLDubFIs.html>

Seminar on MiFID - MiFID UPDATE - The Experience Of 2009 And The Challenges For 2010 (with Financial Regulator)

- Dublin - Thursday 18th February
- <http://www.complianceireland.com/MiFIDseminar2010.html>

Role of the Trustee for Collective Investment Funds

- (Half Day - Dublin) [PTTF001]
- Dublin - Tues 2nd February
- <http://www.complianceireland.com/Funds-Trustee.html>

⁴ <http://www.complianceireland.com/TCF.html>

How to Handle a Financial Regulator (IFSRA) Inspection

- (Half Day - Dublin) [PTFRI001]
- Dublin - Thurs 4th February
- <http://www.complianceireland.com/FRIInspections.html>

Introduction to Financial Services Regulation in Ireland

- (Half Day - Dublin) [PTFSR001]
- Dublin - Tues 9th February
- <http://www.complianceireland.com/FSRegulation.html>

Capital Requirements Directive for Investment Firms

- (Full Day - Dublin) [PTCRD001]
- Dublin - Thurs 11th February
- <http://www.complianceireland.com/CRD-Investment.html>

Complaints Handling & Treating Customers Fairly

- (Half Day - Dublin) [PTCH001]
- Dublin - Tues 16th February
- <http://www.complianceireland.com/TCF.html>

Directors Duties and Corporate Governance of Credit, Financial & Insurance Institutions Regulated in Ireland

- (Half Day - Dublin) [PTDDCG001]
- Dublin - Tues 23rd February
- <http://www.complianceireland.com/DirectorsCG.html>

Introduction to Solvency II

- (Half Day - Dublin) [PTIS001]
- Dublin - Tues 2nd March
- <http://www.complianceireland.com/SolvencyII.html>

Data Protection & How To Conduct A Data Protection Audit

- (Full Day - Dublin) [PTDP001]
- Financial Firms - Thurs 4th March
- Non-Financial Firms - Date TBA - [e-mail us](mailto:info@complianceireland.com) for details of next date.
- <http://www.complianceireland.com/DP&Audit.html>

Establishing the Internal Audit Function

- (Half Day - Dublin) [PTIAF001]
- Dublin - Tues 9th March
- <http://www.complianceireland.com/InternalAudit.html>

The Role of The Compliance Officer –Non-Insurance Industry (banks & investment firms)

- (Full Day - Dublin) [PTRCO002]
- Banking & Investment Firms version of this course for Compliance Officers
- Dublin - Thurs 11th March
- <http://www.complianceireland.com/ICONI&I.html>

MiFID - Understanding MiFID and its operational implications

- (Half Day - Dublin) [PTMiFID001]
- Dublin - Tues 16th March
- <http://www.complianceireland.com/MiFIDCI1.html>

Risk-based Compliance Monitoring for Financial Institutions

- (Half Day - Dublin) [PTRBCMP001]
- Dublin - Thurs 18th March
- <http://www.complianceireland.com/RBCMP.html>

The Role of the Compliance Officer – Insurance Firms

- (Full Day - Dublin) [PTRCO001]
- Dublin - Tues 23rd March
- <http://www.complianceireland.com/ICONI&I.html>

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