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Re: Client Categorisation under MiFID Themed Inspection of Investment Firms

Dear CEO,

The Central Bank of Ireland (the “Central Bank”) recently carried out a themed inspection to examine client categorisation in investment firms, including stockbroking firms (“firms”), authorised under the European Communities (Markets in Financial Instruments) Regulations, 2007 (“MiFID Regulations”) and MiFID branches passporting inwards. This letter provides feedback on the findings and highlights a number of aspects you should consider as they relate to your firm. The recent inspection identified varying levels of compliance with client categorisation requirements.

The proper categorisation of clients is an important step in the take-on of clients and allows firms to ensure that the appropriate services and products are offered to clients. The ability to opt-up to a Professional client should not be widely available and firms are responsible for ensuring that this option is only offered to clients who meet the criteria.

Incorrect client categorisation will lead to clients not being afforded the appropriate levels of investor protection and eligibility to access investor compensation. As Retail clients are afforded the highest level of investor protection, the thematic review focussed on whether Professional clients were correctly categorised as such.

Opting up to Elective Professional

There are strict requirements where Retail clients are opting up to Elective Professional. Fundamentally, all firms must ensure that only clients which meet the Elective Professional client requirements as outlined in MiFID Schedule 2, are categorised as such. The thematic inspection raised concerns around the application of these requirements in particular:

1. The requirement to carry out a qualitative assessment under Schedule 2, (3)(3) was not consistently complied with or evidenced by a number of firms. This requirement states that an opt-up from Retail to Elective Professional is only valid where an assessment of the expertise, experience and knowledge is carried out. In some instances, firms had no

documented information on record regarding their Elective clients' expertise, experience and knowledge, as per the MiFID Minimum books and records requirement.

2. The quantitative criteria of Schedule 2, (3)(5) & (7) were, in some instances not correctly applied. Some firms did not take "reasonable steps" or did not evidence having taken "reasonable steps" to ensure that a proposed opt-up client meets the quantitative criteria. Firms are reminded that for a transaction to be eligible and to be included in the number of transaction criteria (Schedule 2, (3)(5)(a)), the transactions must be effected by the client, i.e. at the client's discretion. Transactions effected at the discretion of an investment professional are not eligible.
3. The opt-up process requires under Schedule 2, (3)(6) that three separate specific pieces of correspondence are exchanged between the client and the firm ((i) a request from the client, (ii) a disclosure by the firm of the protections lost, and (iii) an acknowledgement by the client of the protections lost). Many firms were unable to evidence that the requirements of Schedule 2, (3)(6) had been complied with.

Firms are reminded that client categorisation records form part of the minimum required records as per the List of Minimum Records¹.

Other Client Classification Concerns

The on-site reviews identified that in some instances Approved Retirement Funds ("ARFs") had been categorised as Per Se Professionals, on the basis that they constitute a "pension fund" under Schedule 2. The Central Bank would like to clarify that the "pension fund" heading under Schedule 2, does not apply to personal pension structures. This definition of pension funds requires such Per Se Professionals to be "authorised or regulated to operate in the financial markets". Personal pension structures and ARFs in particular, do not meet this requirement as they do not operate in the financial markets. Furthermore, in most instances, the funds in a personal pension fund remain the property of the individual, who is the beneficial owner. In this context personal pension products must always be classified as Retail in the first instance. It should be noted that such structures would be permitted to opt-up to Elective Professional where the aforementioned beneficiary of the personal pension structure meets the criteria and chooses to opt-up.

Finally, the Registry of Credit Unions has indicated in the Central Bank "Credit Union News" (issued January 2015), that whilst Credit Unions are automatically categorised as Professional clients under MiFID, they should give careful consideration to whether they should opt to be treated as Retail clients. Investment firms are therefore encouraged to remain mindful of the fact that their Credit Union clients may request to opt-down to Retail status.

¹ List of Minimum Records as required by Article 51(3) of EC Directive 2006/73/EC and Regulation 40(5) of the European Communities (Markets in Financial Instruments) Regulations 2007 (S.I. 60 of 2007)

Action

The Central Bank requires your firm to:

1. Review client categorisation policies and procedures to ensure they meet the requirements set out in MiFID; and
2. Take all necessary action required around the categorisation of their clients, in light of the content of this letter.

This review and any subsequent actions are to be completed by the firm and then discussed and minuted by the Board before 31 December 2015.

Furthermore, please note that a review of client categorisation and the issues raised in this letter may form part of any future Full Risk Assessment carried out by the Central Bank.

Should you have any queries in relation to the contents of this letter, please contact iffs.mifid.conduct@centralbank.ie.

Yours sincerely



Denise Murray
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