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Central Bank's Expectation on Client Categorisation as a Result of Themed Inspection

Introduction

On 19 June 2015, the Central Bank of Ireland (the “**Central Bank**”) published the results of a recent themed inspection of client categorisation in investment firms (including stockbroking firms) authorised under the European Communities (Markets in Financial Instruments) Regulations 2007 (“**MiFID Regulations**”) and inward passporting MiFID branches. In the letter, the Central Bank also published expectations of actions to be taken by MiFID firms to address its findings.

The MiFID Regulations set out a three-tier categorisation classifying parties as (a) retail clients, (b) professional clients or (c) eligible counterparties, and attach different levels of regulatory protection and approaches to each party depending on their classification. The MiFID Regulations envisage some flexibility for clients to upgrade or downgrade between categories to obtain more or less regulatory protection. The thematic review focused on whether clients were correctly categorised, given that incorrect categorisation may lead to clients not being afforded the appropriate levels of investor protection and may impact on an individual's eligibility to access investor compensation.

Findings of Thematic Reviews

Opting up to Elective Professional

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Retail clients may be treated as professional on request and thereby waive some protections afforded under the MiFID conduct of business regime. In order to upgrade a retail client to elective professional, the investment firm must be able to show that the client possesses the market knowledge, expertise and experience to make investment decisions and understand the risks involved. In some instances the Central Bank found that the relevant investment firm had no documented information regarding their elective clients knowledge, expertise and experience.

The MiFID Regulations provide for a specific test to upgrade a retail client such that the client must meet **two** of the following three criteria. The client must have;

- (a) carried out an average of 10 relevant transactions per quarter over the previous four quarters;
- (b) a relevant portfolio exceeding €500,000; and
- (c) worked for at least one year in a relevant position in the financial sector.

The Central Bank found that firms did not apply the quantitative criteria set out above correctly. In addition, in relation to (a) above it is important to note that the transaction must be affected by the client to be counted – transactions effected at the discretion of an investment professional are ineligible.

In addition to the above assessment:

- (i) the client must state in writing that he/she wishes to be treated as a professional client;
- (ii) the firm must give a clear written warning of the protections the client may lose; and
- (iii) the client must state in writing that he/she is aware of the consequences of losing such protections.

The Central Bank found that some investment firms were unable to provide evidence that this correspondence was exchanged between the firm and the client. Investment firms are reminded that client categorisation records form part of the minimum records as per the List of Minimum Records¹.

Classification of Approved Retirement Funds (“ARFs”)

The review identified that in some instances ARFs had been categorised as per se professionals on the basis that they constitute a “pension fund” under the MiFID Regulations. The definition of pension fund requires such per se professionals to be “authorised or regulated to operate in the financial markets”. Personal pension structures and ARFs do not meet this requirement as they do not operate in the financial markets. In this context personal pension products must always be classified as retail in the first instance. Such structures may be

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).

permitted to opt-up to elective professional where the aforementioned beneficiary of the personal pension structure meets the criteria set out in the MiFID Regulations and chooses to opt up.

Credit Unions

The Registry of Credit Unions has indicated that whilst Credit Unions are automatically categorised as a Professional client under MiFID, firms should give careful consideration as to whether they should opt to be considered as Retail clients and to bear this in mind as Credit Union clients may request to opt-down in the future.

Next Steps

In its letter, the Central Bank states that it requires all MiFID firms to:

- ▣ review their client categorisation policies and procedures and, where necessary, amend these in light of the issues identified in this thematic review;
- ▣ take all necessary action required around the categorisation of their clients, in light of the content of the Central Bank's letter and review; and
- ▣ ensure that any subsequent actions are completed by the firm and then discussed and minuted by the board of the firm before 31 December 2015.

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