FINANCIAL REGULATOR
Rialtóir Airgeadais

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2 February 2010

Re: Suitability of Investment Products Sold to Older Consumers

Dear Sir/Madam

The Financial Regulator conducted an examination of selected credit institutions and life insurance firms which commenced in December 2008 and was conducted throughout 2009, specifically reviewing the suitability of investment products sold to older consumers. During 2009 it was decided to extend this examination to include investment and stockbroking firms ('firms') in order to get a comprehensive overview across the industry. As part of this four part examination, a mystery shopping exercise was also conducted to assess how credit institutions[1] are interacting with older customers regarding the sales process for investment products. The outcome of this exercise is the subject of a separate communication to credit institutions. The purpose of this letter is to provide firms with feedback in relation to the findings of the inspections conducted as part of this examination. A number of compliance issues were identified during the inspections and are being addressed specifically with the firms concerned. The Financial Regulator requests that you consider the issues raised below in the context of your firm and incorporate them into your firm's procedures as appropriate.

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1 Fourteen mystery shopping visits were carried out in a number of credit institutions in August 2009. These were undertaken by mystery shoppers aged over 71, seeking advice on a lump sum to invest, having no previous investment experience. The mystery shopping was carried out by a third party appointed by the Financial Regulator. The Financial Regulator has not carried out any testing of the research carried out by the appointed third party.

1. Definition of older client

The Consumer Director issued an industry letter on 18 June 2008 in relation to the mis-selling of investment products. This letter highlighted the need for firms to have a practical definition for older clients. The Financial Regulator suggested 60 as a useful benchmark. Despite this it was noted during the inspections that a number of firms still do not have a definition of an older client. The procedures used by firms when dealing with older clients should be updated where appropriate as the Financial Regulator expects firms to have robust and fair procedures for dealing with older clients.

2. Assessment of Suitability

The inspections discovered instances where firms did not gather the necessary information about a client prior to recommending an investment service or financial instrument. The MiFID Regulations[2] require firms, when providing investment advice or portfolio management services, to obtain the necessary information about a client to enable the firm to make an adequate and objective assessment of suitability. Where a client does not provide the required information, the firm shall not recommend investment services or financial instruments to that client.

A number of instances were noted where firms applied default risk ratings for clients that had failed to respond to correspondence or did not complete the 'Know Your Client' form in full. Furthermore, when new information is received in relation to the circumstances of a client the firm should update its systems to reflect this information as soon as possible. The Financial Regulator reminds firms that they must obtain all information as required by the MiFID Regulations to ensure suitability. In the particular instances where default risk ratings have been used or information on client files are not up to date, the Financial Regulator has commenced engagement with individual firms to ensure that customers have not incurred a financial loss where the firm failed to gather the required information.

3. Classification of investment risk

The inspections identified issues in relation to the terminology firms were using to classify investment risk. The Financial Regulator expects firms to consider how they classify investment risk. Firms must ensure that the client's attitude to risk corresponds with their individual profile and that clients are recommended a product that is in the appropriate risk category. Firms should ensure that terms for investment risk are well understood and are not subject to misinterpretation by either the firm's clients

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[2] European Communities (Markets in Financial Instruments) Regulations, 2007

or its employees. In particular, firms should be careful about the designation “low risk” as some clients may interpret this to mean “no risk”.

4. Level of Emergency Funds

The Financial Regulator recommends that firms refer to the need for an emergency fund in their dealing with clients, to ensure that clients have sufficient disposable funds in the event of an emergency. Clients who fall under the definition of older clients may have a specific need for access to an emergency fund that would cover any expenses that may occur such as medical and long term care. Firms should provide guidance to clients on the level of emergency funds that may be required, taking into consideration their age, other investments, assets and potential income streams. It is important that the client does not invest all their liquid assets in a product where they are unable to access their money for a fixed term or without incurring a financial penalty.

5. Retention of Records

The Financial Regulator reminds firms to maintain records to ensure compliance with the MiFID Regulations. Incomplete or inconsistent records cannot demonstrate compliance with the MiFID Regulations, and as a result, firms may find themselves subject to regulatory action. In particular, where investment advice is given, firms are required to record the fact that investment advice was rendered and the financial instrument that was recommended. Firms are also required to create this record upon providing the investment advice.

6. Third Party Presence at Meetings

The Financial Regulator recognises that some customers who fall within the definition of older clients are experienced investors and may not want or require a third party at the sales meeting. However, the Financial Regulator recommends that firms should always offer older clients the option of having a third party present at the sales meeting. This option would be particularly useful in cases where the client has no prior investment experience.

Should you have any queries in relation to the contents of this letter, please contact Patricia Fogarty at mifidconductofbusiness@financialregulator.ie.

Yours sincerely

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