

## ASSET MANAGEMENT AND INVESTMENT FUNDS

# The Central Bank's Fitness and Probity Findings: Implications for Funds

November 2020

The Central Bank recently issued a 'Dear CEO' industry letter (the "**2020 Letter**") following its thematic inspections of compliance by the insurance and banking sectors with their obligations under the Fitness and Probity ("**F&P**") Regime.

The Central Bank believes that the findings and observations from the inspections along with its expectations need to be brought to the attention of the wider financial services industry. Fund management companies, SMICs and externally managed funds, as well as other regulated fund service providers, need to review the 2020 Letter to assess their compliance with the findings and observations identified by the Central Bank.

It is notable that the 2020 Letter has been issued in advance of the anticipated introduction of a Senior Executive Accountability Regime ("**SEAR**") which is aimed at improving transparency and accountability in the financial sector. SEAR will introduce a range of new measures including enhancements to the F&P Regime, as well as the Administrative Sanctions Regime and will give the Central Bank greater powers to hold individuals and firms to account where compliance with requirements are not met. (For more information on SEAR, please see our [briefing here](#)).

The [2020 Letter](#) details the Central Bank's findings and expectations and all firms should review these findings and, where necessary, take steps to remediate any identified issues or weaknesses in their compliance with F&P requirements. The Central Bank expects firms to be able to

evidence the appropriate actions taken to address the issues raised in the industry letter, if requested.

## BACKGROUND

The F&P Regime was introduced by the Central Bank under the Central Bank Reform Act 2010 (the "**2010 Act**"). The key objective of the F&P Regime is to ensure that regulated firms and individuals who work in these firms are committed to high standards of competence, integrity and honesty, and are held to account when they fall below these standards.

In April 2019, the Central Bank issued a 'Dear CEO' letter (the "**2019 Letter**") to all firms, which highlighted the importance of compliance with the F&P Regime, the F&P Standards and relevant guidance documents. The 2019 Letter identified a number of areas where compliance was found to be lacking (please see our previous [briefing](#), for more information). The Central Bank subsequently undertook thematic onsite inspections across a sample of the firms in the insurance and banking sectors, the findings of which are set out in the 2020 Letter.

## FINDINGS

The onsite inspections did not examine the fitness and probity of particular individuals, but evaluated the processes in place to manage compliance with the requirements of the F&P Regime. The inspections focused on the following areas:

- awareness and understanding within firms of their compliance obligations;
- initial and ongoing due diligence processes;
- oversight and control where Pre-Approval Controlled Function ("**PCF**") roles or Controlled Function ("**CF**") roles have been outsourced;
- processes and channels for effective engagement with the Central Bank; and
- role of the Compliance Function with regard to the F&P Regime.

The 2020 Letter notes that the inspections highlighted a number of common issues and shortcomings across the firms inspected and sets out these findings (as well as good practices identified) in an Appendix to the 2020 Letter noting that these should be reviewed and assessed by firms in the context of their own systems and processes.

The Central Bank's key findings identified are as follows:

**Levels of awareness and understanding of the F&P Regime**

**Issues Identified**

- Poor awareness by Board members of their F&P obligations, particularly in relation to the process for appointing members to the Board.
- Board appointments were generally not subject to the same level of scrutiny or formality as other PCF/CF appointments (including a lack of documentation in relation to the discussions or decisions relating to such appointments and lack of use of succession plans).
- In a number of instances there was no evidence of Board approval of a PCF appointment, Board approval took place after approval by the Central Bank or there was no evidence of discussion or challenge by the Board of the proposed appointment.
- There were a number of instances of the CEO screening potential Board candidates which is inappropriate given the conflict of interest.
- The quality of succession plans for the Board and executive team did not meet expectations.
- Management of the F&P process varied significantly across the firms as well as the quality of policies and procedures in relation to F&P.
- There were instances where no register of employees performing PCF or CF roles was maintained.
- The process of regular review of individuals whose roles changed resulting in their coming within the remit of the F&P Regime was lacking.

**Recommended Actions**

- Firms should ensure that Board members are reminded of the importance of the F&P framework and apply the same high standards to board appointments as to those elsewhere within a firm.
- Firms should ensure that they have in place appropriate procedures to ensure all appointments are conducted according to the F&P requirements, including the requirements set out in the 2019 Letter and the 2020 Letter.

**Conducting Due Diligence**

The Central Bank found that this was the area which was most consistently weak across the majority of firms.

**Issues Identified**

- The initial and ongoing due diligence undertaken by firms was not sufficiently

robust to evidence compliance with the requirements of the F&P Standards.

- On initial due diligence, there was a lack of evidence of qualifications, reference checks, suitability searches, interview notes, judgment searches, directorship searches and adverse media searches.
- On ongoing due diligence, firms have an obligation under Section 21 of the 2010 Act to conduct ongoing due diligence to ensure that employees performing CFs continue to comply with the F&P Standards.

**Recommended Actions**

- Firms should have defined processes in place for conducting initial due diligence, including documented policies and procedures, an understanding of the allocation of responsibilities among the various functions (e.g. human resources, compliance function and company secretary).
- Due diligence searches should be carried out and interviews should be conducted and interview notes retained.
- Firms should disclose all information in the PCF application Individual Questionnaires ("IQs") that is relevant and potentially relevant to the Central Bank's assessment of a proposed appointee's F&P. Full and frank disclosure is required. Adverse information in relation to the candidate should be brought to the attention of the Central Bank and the firm should explain why this does not affect the individual's suitability for the role proposed. Where a firm has a doubt as to the materiality of a piece of information in this regard, this should be disclosed and explained.
- An annual self-declaration by PCF and CF role holders of their compliance with the F&P Standards is the minimum standard expected.
- Firms should proactively conduct ongoing due diligence screenings of staff to ensure there has been no change in circumstances that may affect the F&P of the individual.
- Where a firm becomes aware that there may be concerns regarding the F&P of a person performing a CF role, the Central Bank expects the firm to investigate such concerns and take action as appropriate without delay.

**Outsourcing of Roles subject to the F&P Regime**

**Issues Identified**

In appointing unregulated outsourced service providers ("OSPs") to PCF or CF

roles, most firms had not obtained the required documentation or made any inquiries as to the OSP's process for assessing F&P. In addition, firms did not have a process whereby outsourcing arrangements were analysed to verify whether PCF or CF roles were being performed.

**Recommended Actions**

Firms should have appropriate processes and procedures to ensure compliance with respect to F&P irrespective of whether the PCF or CF role is performed within the firm or outsourced to an unregulated OSP.

**Engagement with the Central Bank**

**Issues Identified**

- Many firms did not have adequately developed, documented or embedded processes relating to engagement with the Central Bank on F&P issues, including the various stages of the IQ submission process. In addition, there was a lack of clarity in firms in relation to what would constitute a material fact for inclusion in the IQ.
- Many firms did not have robust processes in place to identify, escalate and notify the Central Bank in a timely manner of potential concerns regarding the F&P of a CF or PCF holder. In addition, the Central Bank found that there was a distinct lack of policies and procedures to support these escalations.

**Recommended Actions**

Firms should be proactive in identifying F&P issues as part of its ongoing due diligence and in reporting as appropriate to the Central Bank without delay.

**Role of the Compliance Function**

**Issues Identified**

- Many firms were not undertaking robust compliance testing of their F&P processes and procedures.
- It was noted that in some cases the Central Bank found that there was an over reliance placed on the Compliance Function thereby creating potential key person risk.

**Recommended Actions**

Firms should ensure that the F&P process is subject to comprehensive oversight by the Compliance Function and periodic independent review by the Internal Audit Function to ensure it is fit for purpose.

**CONCLUSION**

The Central Bank concludes that the F&P Regime is a cornerstone of the regulatory framework in Ireland applicable not only to individuals but also to regulated firms. It reminds firms that failure to comply with their ongoing obligations can result in an investigation under the Central Bank's Administrative Sanctions Procedure leading to potential sanctions for firms and individuals. The Central Bank notes that the range of findings from the thematic onsite inspections indicated that many firms did not have

due regard to their obligations under the F&P Regime in particular following the 2019 letter which emphasised the importance of compliance by firms with their requirements.

The Central Bank added that it is a matter of concern that a number of firms did not take any action on being prompted by the 2019 Letter to perform a formal "gap analysis" of their policies, processes and procedures, noting that: *"it is wholly unacceptable that such shortcomings continue to exist in circumstances where the F&P Regime was introduced almost 10 years*

*ago"*. The Central Bank's expectation is that all firms take appropriate action to address the significant issues outlined in the 2020 Letter and can evidence such action to the Central Bank if requested. The 2020 Letter therefore should be read in conjunction with the 2019 Letter, the F&P Standards and the associated F&P guidance.

If you would like to discuss the foregoing, or require any assistance in assessing your requirements please do not hesitate to contact a member of our team.

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