

Settlement Agreement between the Central Bank of Ireland

and

Kinsale Capital Management Limited

The Central Bank of Ireland imposes a fine of €275,000 on Kinsale Capital Management Limited for client categorisation failings

The Central Bank of Ireland (the “**Central Bank**”) has fined Kinsale Capital Management Limited (the “**Firm**” or “**Kinsale**”) €275,000 and reprimanded it for breaches of the European Communities (Markets in Financial Instruments) Regulations 2007 (the “**MiFID Regulations**”). The breaches have been admitted by the Firm.

The breaches in this case relate to:

- The Firm’s failure to carry out adequate assessments of certain clients who elected to be treated as professional clients between 7 June 2011 and 31 July 2015;
- The Firm’s failure to implement appropriate policies and procedures for client categorisation between 6 April 2010 and March 2015; and
- The Firm providing investment services to three retail clients in breach of the terms of its authorisation between 14 December 2011 and 31 July 2015.

The Central Bank’s Director of Enforcement, Derville Rowland, has commented as follows:

“The protection of financial services consumers is one of the Central Bank’s key objectives. The regulatory framework puts in place stringent requirements to ensure that firms uphold their duty of care to clients and place their interests at the forefront of everything they do. It is critically important

that investment firms ensure that the clients who request to be treated as professional investors are afforded all the protections to which they are entitled and that those protections are not permitted to be waived unless the firm has followed the strict client categorisation requirements set out in the MiFID Regulations.

The level of investor protection that firms are required to afford to each client depends on that client's categorisation - retail clients being afforded the highest level of protection. Failures in that categorisation process, such as the miscategorisation of retail clients as professional clients, can have very serious impacts, including a client being exposed to elevated levels of investment risk and a loss of eligibility to investor compensation.

Kinsale is not authorised to provide investment services to retail clients. Therefore, it is especially concerning that the Firm did not put in place and adhere to robust procedures to appropriately assess and categorise prospective clients requesting to be treated as professionals so as to ensure that the Firm did not provide investment services to retail clients.

As the consequences of miscategorisation are very serious for clients, the Central Bank expects investment firms to give high priority to compliance with client categorisation requirements. Failure to do so will result in vigorous investigation and enforcement action by the Central Bank."

BACKGROUND

Between 1 November 2007 and 2 September 2016, the Firm was authorised as an investment firm under the MiFID Regulations. The Firm was authorised to receive and transmit orders and to provide portfolio management and investment advice (the "**Investment Services**") to eligible counterparties and professional clients.

Since 2 September 2016, the Firm is authorised as an Alternative Investment Fund Manager under the European Union (Alternative Investment Fund Managers) Regulations 2013. It remains authorised to provide the Investment Services but, as under its MiFID authorisation, only to eligible counterparties and professional clients, not to retail clients.

In October 2014, the Central Bank conducted an on-site inspection of the Firm's client categorisation procedures as part of a thematic review. The focus of the review was on the Firm's assessment of clients who elected to be treated as professional clients at the point in time when they were taken on by the Firm. This inspection and the subsequent follow up steps by the Central Bank identified a

number of issues in respect of the Firm's compliance with the MiFID Regulations, prompting an Enforcement investigation into those issues.

Kinsale is a low impact firm under PRISM (Central Bank's risk based supervisory framework). The Central Bank does not have an active supervisory relationship with lower impact rated entities. Under PRISM, low impact firms are supervised reactively or through thematic assessments. Enforcement is therefore a key support for the effective supervision of these entities.

PRESCRIBED CONTRAVENTIONS

The investigation was conducted on a sample of elective professional clients of the Firm. The investigation identified four breaches of the MiFID Regulations, namely:

Failure to carry out an adequate assessment of the expertise, experience and knowledge of the clients it treated as professional

Schedule 2 paragraph 3(3) of the MiFID Regulations requires the Firm, before it determines that a client could be categorised as professional, to conduct an assessment of the client's expertise, experience and knowledge to ensure that the client is capable of making his/her own investment decisions and understands the risks involved.

Following the Central Bank's investigation, it was established that, in respect of eight of the sample elective professional clients, the assessments of expertise, experience and knowledge conducted by the Firm at the point the clients were taken on were not performed to an adequate standard. The Firm failed to gather sufficient documentary evidence of the assessments it had conducted, as required under the MiFID Regulations. The Firm did not conduct the required objective assessments on the individual clients to establish whether those persons could qualify as professional clients.

Failure to take all reasonable steps to ensure that elective professional clients met the quantitative test set out in the MiFID Regulations

Schedule 2 paragraph 3(7) of the MiFID Regulations requires investment firms to take all reasonable steps to ensure that a client who requests to be treated as an elective professional satisfies at least two of the following three quantitative criteria (pursuant to Schedule 2 paragraph 3(5)):

- (a) The client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters;

- (b) The size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments, exceeds €500,000;
- (c) The client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged.

Following the Central Bank's investigation, it was established that, in respect of eight of the sample clients, the Firm failed to take reasonable steps to ensure that the clients met at least two of the criteria set out above. In particular, the Firm categorised clients by reference to criterion (a) but failed to ensure that transactions it considered eligible to satisfy the test were conducted at the discretion of the client, and not an investment firm. Transactions conducted at the discretion of an investment firm do not demonstrate any market expertise or knowledge on the part of a client.

In July 2015, as part of the remediation exercise imposed by the Central Bank, four of the eight clients evidencing this breach were re-categorised by the Firm under different criteria in accordance with paragraph 3(5) of the MiFID Regulations. Three of the four remaining clients form the basis of an additional breach detailed below.

Breach of authorisation

Regulation 72(1) of the MiFID Regulation requires an authorised investment firm to comply at all times with the conditions and requirements of its authorisation.

The Firm's authorisation states that *"the Firm will provide investment and ancillary services to eligible counterparties and professional clients only"*. The Firm's authorisation does not permit it to provide Investment Services to retail clients.

As a result of the Firm's failures to conduct adequate assessments, three of the sample elective professional clients were incorrectly categorised as professional clients, accordingly they defaulted to retail client categorisation. The provision of Investment Services by the Firm to these three retail clients was a breach of its authorisation.

Failure to implement appropriate written policies and procedures to categorise professional clients

Schedule 2, Paragraph 3(9) of the MiFID Regulations requires firms to implement appropriate written internal policies and procedures to categorise clients.

The Central Bank's investigation established that the Firm's documented client categorisation policies were deficient for the following reasons:

- They failed to outline how the Firm would carry out an adequate assessment of the expertise, experience and knowledge of clients;
- They failed to address the reasonable steps that the Firm are required to take before categorising elective professional clients;
- They failed to specify the documentary evidence which the Firm requires from clients prior to categorising them as elective professional clients; and
- They failed to specify the type of investment account and/or the degree of client discretion which would be required in order for transactions to be eligible for the purposes of the criterion set out in Schedule 2 paragraph 3(5)(a) of the MiFID Regulations.

Effect of the breaches

The Firm is authorised to provide Investment Services to eligible counterparties and professional clients only and is not authorised to provide services to retail clients. As a result of the Firm's breaches, certain clients were not afforded the level of investor protection appropriate to their status as retail clients.

The Implications of Classification as a Professional Client

The investor protections that investment firms are required to afford to retail and professional clients differ considerably, as outlined below:

- Compensation: Retail clients are eligible for compensation under the Investor Compensation Act, 1998, professional clients are not;
- Disclosures: Retail clients are entitled to more disclosure prior to the provision of service than professional clients in respect of an investment firm's services, commissions, fees and charges, the safeguarding of client assets and best execution policy;
- Reporting: The ongoing client reporting obligations are higher for retail clients. For example, contract notes/periodic statements have increased frequency and contain prescriptive content;
- Best Execution: The best execution obligations on an investment firm are higher when executing retail client orders than those for a professional client;
- Suitability: Professional clients can be given access to more complex products by virtue of their client category, due to their knowledge, experience and expertise. Therefore, if retail clients are miscategorised, there is a risk of investment in products unsuitable to their status.

Rectification

The Firm has taken all necessary steps to rectify the breaches identified in the Central Bank investigation and updated policies and procedures have been put in place in respect of client categorisation. As part of that process, the Firm performed a full reassessment of all of its elective professional clients to ensure that each was appropriately categorised. As a result, the Firm recategorised certain professional clients as qualifying under different quantitative criteria set out in Schedule 2 paragraph 3(5) of the MiFID Regulations. In addition, the three client accounts that defaulted to retail categorisation were closed.

PENALTY DECISION FACTORS

In deciding the appropriate penalty to impose, the Central Bank considered the following matters:

- The extended period of time over which the breaches occurred;
- The seriousness of the breaches – client categorisation failings and breach of authorisation;
- The Firm initially did not take adequate remediation steps, necessitating further engagement with the Central Bank before full remediation was completed;
- The co-operation of the Firm during the investigation and in settling at an early stage in the Central Bank's Administrative Sanction Procedure; and
- The previous compliance record of the Firm.

The Central Bank confirms its investigation into the Firm in respect of this matter is closed.

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NOTES TO EDITORS

1. The Firm was first authorised as an investment business firm under the Investment Intermediaries Act, 1995. That authorisation was transposed to an authorisation under the MiFID Regulations on the coming into effect of those regulations on 1 November 2007.
2. The European Communities (Markets in Financial Instruments) Regulations 2007 (S.I. No. 60 of 2007) are available to download [here](#).
3. The fine imposed by the Central Bank was imposed under Section 33AQ of the Central Bank Act 1942. The maximum penalty available under that Act is €10,000,000.
4. The fine reflects the application of the maximum percentage settlement discount of 30%, as per the Early Discount Scheme set out in the Central Bank's "Outline of the Administrative Sanctions Procedure" which is [here](#).
5. On 25 February 2014, the Central Bank of Ireland published its Programme of Themed Reviews and Inspections for 2014 (available [here](#)), which included a thematic review on firms' arrangements in relation to satisfying MiFID client categorisation and suitability requirements. On 19 June 2015, following the conclusion of the Thematic Inspection, a Dear CEO letter was issued highlighting the main issues that arose from the review. The Dear CEO letter on Client Categorisation under MiFID Themed Inspection of Investment Firms is available [here](#).