

Chairperson of the Board

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17 December 2014

Re: Themed Inspection of MiFID authorised Investment Firms regarding the Provision of Information to Clients in relation to Costs and Charges

Dear Sir/Madam

The Central Bank of Ireland (the Central Bank) recently completed a thematic review of investment firms subject to the requirements of the Markets in Financial Instruments Directive (MiFID) and, where relevant, the Consumer Protection Code (Code). This review examined the provision of information to clients on costs and charges. The purpose of this letter is to provide feedback in relation to the areas of concern identified by the Central Bank following this thematic review.

Consumer Protection Culture

A key focus of the Central Bank is to ensure that consumer protection and a customer focused culture is at the forefront of regulated entities' practices. The Board of Directors and those concerned in the direction and management of regulated entities must ensure that they embed a culture of treating customers fairly within their firm. A culture of treating customers fairly involves going beyond mere compliance with the letter of regulatory requirements. It requires that regulated entities act at all times in the best interests of their customers and in the spirit of ensuring that their customers are treated fairly.

The Central Bank expects the Board and senior management of regulated firms to take an active role in ensuring that their firms' practices regarding the disclosure and application of costs and charges

promote fairness and transparency. In this regard, the Central Bank expects regulated entities to aspire to the highest standards by:

- Disclosing information on costs and charges in a way that seeks to inform the customer;
- Putting in place appropriate governance and controls to ensure that such disclosure remains fair and transparent; and
- Undertaking consumer testing in relation to disclosure of costs and charges and consumers understanding of them and acting on the feedback received.

Provision of Information requirements

Generally MiFID requires that investment firms provide information to clients and potential clients on costs and charges in a durable medium or via a website that meets certain conditions, prior to the provision of services.

Information on costs and charges should be fair, clear and not misleading. It should also be provided in a comprehensible form so that the clients or potential clients are reasonably able to understand the nature and risk of the investment service and of the specific type of financial instrument that is being offered and, consequently, to take investment decisions on an informed basis. Any material changes to information on costs and charges should be notified in good time to clients. Clients should also receive post trade reports periodically on the costs and charges applied.

The Code, where applicable, also places similar disclosure requirements on MiFID firms to enable consumers to understand the costs and charges to be applied in relation to the provision of a service/product.

The aim of this thematic review was to assess and evaluate how MiFID investment firms provide information to clients on direct costs and charges applied by the firm. The thematic review was conducted in two parts. Part 1 consisted of a desk based review of 16 firms. As part of this review, the Central Bank also reviewed firms' client contracts in accordance with the European Communities (Unfair Terms in Consumer Contracts) Regulations, 1995 to identify any potentially unfair contract terms in relation to costs and charges and other general contract terms. Part 2 included onsite visits to 4 firms to examine a sample of client files in relation to disclosure of costs and charges both prior to provision of services/products and post-provision of services/products.

Review Findings

Overall, the findings of the thematic review raised concerns from a consumer protection perspective. In a number of the firms reviewed, the Central Bank identified areas for improvement in terms of compliance with both the letter and the spirit of the MiFID and Code requirements and the Unfair Contract Terms legislation examined. Please see the attached Schedule which sets out all of the issues identified from the thematic review and the steps to be taken by firms to address these issues. Some of the main issues identified include:

A. Provision of Information on Costs and Charges:

- Weaknesses in the presentation and content of information provided to clients on costs and charges prior to the provision of services.
- Failure to provide information prior to the provision of services, instead providing it after the provision of services.
- Failure to provide information in the format required such as a durable medium or a website, where allowable.

B. Unfair Contract Terms

The Central Bank identified a number of unfair contract terms where firms had unreasonably sought to limit their liability to clients. Firms have removed these terms following correspondence from the Central Bank.

Next Steps

All firms are now required to immediately review their systems and controls in light of the issues identified and take the appropriate steps identified in the Schedule. Firms must take all remedial action necessary to ensure that they are acting in the best interest of consumers.

Additionally, the Central Bank will engage in separate correspondence directly with those firms reviewed, where issues have arisen, and consider use of any regulatory power within its remit to address the issues identified.

The Central Bank will have regard to the contents of this letter, or any other guidance issued by the Central Bank in relation to the application of MiFID and/or the Code in assessing firms' future compliance with the provisions of MiFID and/or the Code.

Should you have any queries in relation to the contents of this letter, please contact Karen Cullen or Eoin Battigan at mifidconductofbusiness@centralbank.ie.

Yours sincerely

A handwritten signature in cursive script that reads "M Stewart".

Mick Stewart
Deputy Head of Consumer Protection

Schedule

The Central Bank identified areas for improvement in terms of compliance with both the letter and the spirit of the MiFID and Code requirements and the Unfair Contract Terms legislation examined. As a result, the Central Bank is now setting out in the shaded boxes in Part 1 of this Schedule the steps it expects firms to take in order to be able to demonstrate compliance with the applicable legislative requirements.

These issues and steps to be taken are divided into the following sections:

A. Provision of Information on Costs and Charges

This area contains the majority of issues identified and is, therefore, divided into a number of sub-sections.

B. Unfair Terms in Consumer Contracts

Additionally, the Central Bank identified a small number of firms that appeared to be in breach of some of the legal requirements under MiFID and the Code. Details of these issues are set out in Part 2 of this Schedule.

The main requirements of MiFID in relation to costs and charges are set out in the following sections of the EC (Market in Financial Instruments) Regulations, 2007:

Regulation 76;

Regulation 77;

Regulation 81;

Regulation 92;

Regulation 96; and

Regulation 101.

The categorisation of the client under MiFID is a relevant consideration in applying the above requirements.

The main requirements of the Code in relation to costs and charges are set out in:

Chapter 2 – General Principles;

Chapter 4 - Provision of Information; and

Chapter 6 – Post-sale Information Requirements

The content of this letter should be read in conjunction with the applicable MiFID and Code requirements concerning the disclosure and application of costs and charges in respect of the provision of products and services to clients. Firms must at all times comply with the legally binding requirements set out in MiFID and the Code.

PART 1

A. Provision of Information on Costs and Charges

1) Content of information provided to clients prior to the provision of services

(i) Presentation of information provided on costs and charges

Under MiFID, Regulation 76(2)(a) requires that information *“addressed by an investment firm to clients or potential clients is fair, clear and not misleading”*. Regulation 76 (2)(c)(iv) requires that information, including information about costs and associated charges, is provided in a *“comprehensible”* form to clients or potential clients. Regulation 92(1)(a) also sets out that firms shall provide its retail clients and potential retail clients with information on costs and associated charges that includes *‘the total price to be paid by the client in connection with the financial instrument or the investment service or ancillary service, including all related fees, commissions, charges and expenses, and all taxes payable via the investment firm or, if an exact price cannot be indicated, the basis for the calculation of the total price so that the client can verify it’*.

Similarly, Code Provision 4.1 requires that *‘A regulated entity must ensure that all information it provides to a consumer is clear, accurate, up to date, and written in plain English. Key information must be brought to the attention of the consumer. The method of presentation must not disguise, diminish or obscure important information.’*

Code Provision 4.56 also requires that *‘A regulated entity must display in its public offices, in a manner that is easily accessible to consumers, a schedule of fees and charges imposed by that regulated entity. If the regulated entity has a website, its schedule of fees and charges must also be made publicly available through placing this schedule on its website.’*

Supervisors found that a number of firms were presenting information on costs and charges to clients across a number of different documents, making it difficult for clients to clearly understand the total charges that the firm may apply to services and/or products provided by it. This practice may be misleading and/or unclear as in such cases clients must gather a number of documents in order to have a complete understanding of a firm’s costs and charges.

Supervisors are also concerned that some firms appeared to include generic and non-specific disclosures concerning the fees and charges applied by the firm itself. For example, there may be a general statement that other costs and charges may apply rather than providing specific details of the level of direct fees that may be applied by the firm and/or the precise basis upon which any such direct fees will be calculated. The requirements in relation to disclosure of third party charges are described separately under (ii) below.

It was also noted that some firms to whom the Code applied failed to have a schedule of costs and charges on their website as required by Code Provision 4.56.

Point 1:

Information provided to clients on costs and charges must be:

- a) Written in plain, easy to understand English;
- b) Easy to find - preferably available in the public domain such as on a firm's website and in a Terms of Business document;
- c) Inclusive of specific details of the level of all direct costs and charges applied by the firm itself or the precise basis for calculation of such charges; and
- d) Presented together as a schedule of costs and charges in one single document and/or webpage.

(ii) Failure to include information adequately or at all

- **Other Costs and Charges**

MiFID Regulation 92(1)(c) and Code provision 4.54, require that retail clients or potential retail clients and consumers respectively are notified of the possibility that other costs and charges, such as third party charges and taxes may arise as part of the service provided.

Supervisors found that, in a number of firms, disclosure of the possibility that other costs and charges may apply was inadequate. In some instances the notice of the possibility of other costs and charges applying was not included in the main section on costs and charges, while in other cases firms only referred to the possibility that taxes may apply without mentioning any other third party charges.

Point 2:

- a) Information provided to clients on costs and charges must clearly refer to the possibility that other costs and charges, such as third party charges and taxes may apply, if any such costs and charges may apply;
- b) Information provided to clients on such other costs and charges must be included in the same place as the information on direct costs and charges i.e. in the firm's schedule of costs and charges; and
- c) Information provided to clients on such other costs and charges should, to the fullest extent possible, be specific about the level of the other costs and charges that may be applied or the basis for their calculation.

- **Basis for calculation and arrangement for payment**

Where firms cannot identify the precise cost or charge payable, the basis for calculation of the relevant cost or charge must be clearly disclosed so that the client can verify it. The level of information provided to retail clients in this regard and the disclosure of arrangements for payment of costs and charges varied greatly between different firms inspected. This information is required to be provided in accordance with MiFID Regulation 92(1) (a) and (d).

Supervisors found that in a large number of firms reviewed, the information provided to clients on the basis for the calculation of charges and arrangements for payment appeared inadequate. These firms provided very limited information to enable clients to verify the price that they were charged and to understand how this charge was to be paid. Indeed, on one onsite inspection, this made it very difficult for supervisors to verify the charges applied to client accounts.

Below are some examples of adequate disclosure identified during the inspection:

- Annual Management Fee charged annually at the end of the year: *'The fee shall be calculated by applying the percentage Annual Management Fee specified to the value of the Portfolio at [DATE]. This fee will be deducted from the portfolio value annually in arrears on [DATE]'*.
- Assets under Instruction Fee charged monthly at the end of the month: *'The Assets under Instruction Fee is calculated and collected monthly in arrears by applying the percentage*

Assets under Instruction Fee specified to the value of the Portfolio at [DATE] and dividing by 12. This fee will be deducted from the portfolio value on [DATE]’.

Point 3:

- a) Information on the basis for the calculation of costs and charges and how these are to accrue and be paid must be included in the same place as all other costs and charges information;
- b) Where information is provided on the basis for calculation, this information must make clear to the client how and when the charge will be calculated e.g. if a management fee is based on the value of a client’s portfolio or assets under management, the percentage to be applied must be clearly provided and the dates upon which the fee will accrue and be calculated must be clearly disclosed; and
- c) Regarding information on arrangements for payment i.e. how charges are to be paid/collected, this information must make clear to the client how the firm will collect the charge from the client e.g. monthly/quarterly/annually, in arrears/advance, whether an invoice will be issued to the client for separate payment or whether any other collection arrangement applies.

2) Medium in which information on costs and charges is provided to clients

MiFID Regulation 81(6) allows information to be provided in a durable medium or via a website that meets the requirements of Regulation 77(2). Regulation 77(2)(e) requires that where a firm provides this information via a website *“the information must be accessible continuously by means of that website for such periods of time that the client may reasonably need to inspect it”*. The Code also allows for information to be provided in paper or a durable medium and as part of its definition of durable medium it requires that the information provided must be *“accessible for future reference for a period of time adequate for the purposes of the information”*.

Supervisors are concerned that where firms provide information on costs and charges at the outset of the business relationship and subsequently amend/update this information, it may become unclear to clients which costs and charges information they originally agreed to at the time of account opening. In addition, clients may be unclear as to the schedule of costs and charges that applied at any particular point in time over the course of an on-going business relationship.

Point 4:

- a) Information provided either in a durable medium or via a website on costs and charges, i.e. schedule of costs and charges, must be clearly dated as to the effective date of the costs and charges contained in the document;
- b) Firms must maintain a clear audit trail of all previous versions of the schedule of costs and charges and their effective date so that, if required, a client or the Central Bank can, upon request, easily ascertain the precise costs and charges that were payable by the client over the entire period of a client's relationship with the regulated entity.

3) Failure to provide adequate and/or timely notification to clients of material changes to the information on costs and charges

MiFID Regulation 81(8) requires that an investment firm shall notify a client in good time about any material change to the information provided on costs and charges. Code Provision 6.18 requires a regulated entity to *"notify affected consumers of increases in charges, specifying the old and new charge, or the introduction of any new charges, at least 30 days prior to the change taking effect"*.

A number of firms reviewed had made material changes to the information originally provided to clients concerning costs and charges. Supervisors noted that in some firms, it appeared that either no notification was provided to clients at all of changes to information on costs and charges or only those clients immediately affected by the change were notified. In another firm, notification of the change was provided only after it had occurred.

Supervisors also have concerns that some firms provide notifications of changes to costs and charges by simply updating the relevant webpage on their website. Some firms may also include notice of and/or seek consent from the client regarding the potential use of this practice in Terms of Business/contract documents issued to the client. The Central Bank does not consider this to be in line with best practice having regard to the requirements of MiFID and the Code. Such practices place an unreasonable burden on the client to continually check back to the firm's website in order to become aware of any changes to the costs and charges that they may have agreed to at the commencement of the business relationship.

Point 5:

- a) Notification to clients of changes to costs and charges must be clearly identified to clients after clients log in to a firm's website (where this medium was originally used) or otherwise a personal communication should be issued to a client advising them of the changes to costs and charges (e.g. an email/letter);
- b) The Code requires prior notification of all increased or new charges, while MiFID requires notification '*in good time*' of any material changes to information previously provided to the client on costs and charges. The Central Bank considers that all increases to or additional costs and charges must be notified in advance to clients; and
- c) Where the Code applies, at least 30 days' prior notice must be given before the increased charges/new charges take effect. The Central Bank considers that in providing notice of material changes to costs and charges '*in good time*' as required under MiFID, 30 days' prior notice must also be given in line with the industry standards set out in the Code.

4) Reporting to clients

(i) Inconsistent presentation of information

Supervisors noted in some firms reviewed, that there was inconsistent presentation of information on costs and charges across the reports provided by the relevant firms to clients. In one case identified, the firm had used different names for the same fee in periodic statements and contract notes issued to the same client.

In another firm, supervisors noted that the presentation and level of detail provided in the firm's invoices was not consistent across invoices issued to the same client. In this case, supervisors concluded that the client could not verify the accuracy of fees charged due to the inconsistent invoicing.

Point 6:

Firms must present all information on costs and charges, whether provided prior to, during or after the provision of a product or service, using consistent terminology and presentation.

(ii) Failure to ensure that reports provided by another person include the required information

MiFID Regulation 96 (2) and (9) allow for another person other than the firm carrying out the order or providing portfolio management services e.g. a third party firm, to provide contract notes and periodic statements to clients.

In a firm reviewed it was noted that another party, other than the firm, issued periodic reports to the firm's clients. It was also noted that the firm had not satisfied itself that these reports issued by that third party met the requirements of MiFID.

Point 7:

Where firms rely on reports provided by another person, they must satisfy themselves that these reports meet the relevant requirements.

(iii) Inadequate reporting to clients

Some firms charge a form of annual account management fee to clients who are provided with services other than portfolio management, i.e. execution-only clients and advisory clients. Supervisors noted that some firms may not provide any reports to clients regarding such charges as these clients are not portfolio management clients and are therefore not expressly required to be provided with periodic statements under Regulation 96.

However, MiFID requires firms to provide adequate reports to its clients on the transactions and services provided to them, including the costs associated with the transactions and services as set out in MiFID Regulation 101.

Point 8:

In order to provide adequate reports to clients in accordance with the requirements set out in MiFID Regulation 101, any management or other costs and charges must be reported to the client periodically and at a minimum, on an annual basis. Where contract notes or periodic statements require to be provided to clients under MiFID, these must be provided in the format and frequency set out in MiFID.

5) Monitoring and Controls

Regulation 34(3)(d) requires investment firms to *“establish, implement and maintain adequate policies and procedures designed to detect any risk of failure by the firm to comply with the provisions of these Regulations, as well as the associated risks”*.

Not all firms reported that they undertake monitoring of costs and charges applied to accounts post-trade to ensure that they are correct. In addition, the internal governance around amending or increasing costs and charges was not always clearly evident in the firms inspected.

Point 9:

- a) Where firms impose costs and charges on clients, regular monitoring of the accuracy of such costs and charges must take place. This process is important to ensure that the charges levied on clients are only those that have been clearly notified to clients prior to the provision of services. Firms must adopt appropriate policies and procedures to reflect this process.
- b) Firms must also have clear governance around any amendments to, or increases in costs and charges so that they are effected in accordance with MiFID, the Code and the guidance set out in this letter.

B. Unfair Terms in Consumer Contracts

As part of this thematic review, supervisors reviewed firms’ consumer contracts and/or Terms of Business documentation under the European Communities (Unfair Terms in Consumer Contracts) Regulations 1995 to identify any potentially unfair contract terms in relation to costs and charges and other general contract terms.

Additionally, where relevant, these documents were also reviewed for any breaches of Code Provision 3.8, which states that:

“ A regulated entity must not, in any communication or agreement with a consumer (except where permitted by applicable legislation), exclude or restrict, or seek to exclude or restrict:

(a) Any legal liability or duty of care to a consumer which it has under applicable law or under this Code.....”

Following the review, supervisors highlighted potential unfair terms in four firms' contracts. Each of the terms identified sought to limit the firm's financial liability to the client to no more than a multiple of fees/commissions paid for the provision of the service. The Central Bank considered the contractual terms in question to be unfair and/or contrary to the Code provision set out above. The Central Bank required the four firms involved to remove/amend the relevant consumer contracts.

Further information on the Unfair Contract Terms legislation is available on the Central Bank's website.

Point 10:

- a) Firms must carry out a review of their consumer contract documentation in accordance with the specific findings above and remove any terms which seek to limit the firm's financial liability to clients in a potentially unfair manner.
- b) Firms must carry out a review of their consumer contract documentation in accordance with the legislation above to ensure that the terms in all consumer contracts are fair.
- c) Firms must remain cognisant of the above legislation in redrafting or amending any such consumer contracts in the future.

PART 2

The Central Bank identified a small number of firms that appeared to be in breach of some of the MiFID and Code requirements. The Central Bank will engage in separate correspondence directly with those firms reviewed, where issues have arisen, and consider use of any regulatory power within its remit to address the concerns identified. The Central Bank expects firms to be aware of and adequately comply with the requirements of MiFID and the Code, where relevant. Based on the findings below, firms should immediately review their systems and controls and ensure that they are in compliance with the requirements of MiFID and the Code.

Suspected breaches identified included the following:

1) Timing of information disclosure

MiFID Regulation 81(4) requires an investment firm to provide information on costs and charges to retail clients or potential retail clients *'in good time before the provision to them of investment services or ancillary services'* subject to certain exemptions under MiFID Regulation 81(7). Code Provision 4.54 similarly requires that information is provided *'prior to providing a product or service to a consumer'*.

Supervisors suspected in some firms that the information was either provided to clients after the service had taken place or that the information had been provided verbally to the clients and not in a durable medium as required.

2) Information provided via a website

Where firms provide information on costs and charges via its website that does not meet the definition of a durable medium, and that information is not addressed personally to the client, certain conditions must be met. These conditions are set out in MiFID Regulation 77(2) as follows:

'(a) the provision of that information in that medium is appropriate to the context in which the business between the firm and the client is, or is to be, carried on;

(b) the client specifically consents to the provision of that information in that form;

(c) the client must be notified electronically of the address of the website, and the place on the website where the information may be accessed;

(d) the information must be up-to-date;

(e) the information must be accessible continuously by means of that website for such period of time that the client may reasonably need to inspect it.’.

Supervisors noted that a firm which provided information on costs and charges via its website did not appear to seek the specific consent of clients to the provision of this information via its website, which is required under MiFID Regulation 77(2)(b). The same firm also appeared to fail to notify clients electronically of the address of the website, and the place on the website where the information may be accessed in accordance with MiFID Regulation 77(2)(c).

3) Non-disclosure to Clients of Remuneration from Third Party Product Producers

MiFID Regulation 78 addresses, amongst other things, the issue of fees, commissions or other benefits paid or provided to investment firms by third party product producers which are categorised as inducements. Inducements of this nature are only allowable under certain conditions including where the fee, commission or benefit :

- (a) has been clearly disclosed in advance to the client; and
- (b) the payment is designed to enhance the quality of the relevant service to the client and does not impair compliance with the firm’s duty to act in the best interests of the client.

For further information on the inducements requirements under MiFID, see MiFID Regulation 78.

Code Provisions 4.57 - 4.59 require that certain information about remuneration received from third party producers must be disclosed to clients, prior to the provision of any service.

Specifically Code Provision 4.57 requires that:

“Prior to offering, recommending, arranging or providing a product or service a mortgage intermediary and a firm authorised under the Investment Intermediaries Act 1995 must disclose, on paper or on another durable medium, to a consumer the existence, nature and amount of any fee, commission or other remuneration received or to be received from a product producer in relation to that product or service. Where the amount cannot be ascertained, the method of calculating that amount must be disclosed. The disclosure must be in a manner that is comprehensive, accurate and understandable.

This provision does not apply where the product or service relates to an insurance policy.”

While not the focus of the thematic review, it was noted by supervisors that some firms, to which the Code applied, did not appear to be making adequate disclosures of the amount of any fee, commission or other remuneration received or the method of calculating that amount in accordance with Code provision 4.57.