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Central Bank of Ireland

Eurosystem

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Re: Thematic Inspections of Compliance by Regulated Financial Service Providers (“Firms”) with their Obligations under the Fitness and Probity Regime

Dear CEO,

The Fitness & Probity (“**F&P**”) Regime was introduced by the Central Bank of Ireland (the “**Central Bank**”) under the Central Bank Reform Act 2010 (the “**2010 Act**”). The key objective of the F&P Regime is 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 to all firms, which highlighted the importance of compliance with the F&P Regime, the F&P Standards and relevant guidance documents. This letter identified a number of areas where compliance was found to be lacking.

Subsequently, the Central Bank undertook thematic onsite inspections across a sample of firms in the insurance and banking sectors in order to assess the level of compliance with the F&P requirements. The inspections did not examine the fitness and probity of particular individuals, but rather 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.

These inspections highlighted a number of common issues and shortcomings. This letter sets out key findings and observations from the inspections together with the expectations of the Central Bank, which we believe need to be brought to the attention of the wider financial services industry. It is acknowledged that examples of good practices were implemented in a number of firms which are identified in Appendix 1.

Overarching Findings and Observations

The inspections found a wide divergence of standards in the implementation of the F&P Regime. A significant number of findings were identified in relation to the role of the Board, the conduct of due diligence and the outsourcing of CF roles.

Details of the findings and observations are set out in Appendix 1, which should be reviewed and assessed by firms in the context of potential issues with their own systems and processes. While not all of the issues outlined in this letter arose in each firm inspected, they are representative of the findings across the sample of firms. Key points to note include:

a) Role of the Board in the Fitness and Probity Process

In many of the firms, the level of awareness by Board members of their fitness and probity obligations was poor. This was evident 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. For example, there was a notable lack of interview notes and suitability assessments available to support Board appointments, and succession plans generally did not meet expectations and were not used in practice. It was also



notable that in a number of cases there was no evidence of Board approval, discussion or challenge of proposed PCF appointments.

In addition, instances of the CEO screening potential Board candidates was observed in some firms. It is inappropriate for a CEO to carry out such a role given the conflict of interest between the respective responsibilities of directors and the executive.

It is essential that Board members recognise the importance of the fitness and probity framework and their responsibilities within it, not only for the firm, but also for the Board itself. The Central Bank expects that the same high standards and rigour be observed and applied to board appointments as to those elsewhere within a firm.

b) Conducting Due Diligence

The area which was most consistently weak across the majority of firms was due diligence. The initial and ongoing due diligence undertaken was not sufficiently robust to evidence compliance with the requirements of the F&P Standards. Issues identified included a lack of evidence of qualifications, reference checks and suitability searches. While there were shortcomings in both the initial and ongoing due diligence processes, the latter was particularly poor and often limited to an annual self-declaration with no ongoing due diligence screening to check if a change in circumstances had impacted an individual's fitness and probity.

In the context of initial due diligence, PCF application Individual Questionnaires ("IQs") are ultimately endorsed and submitted to the Central Bank by the firm, which must declare in the IQ that it has carried out all necessary due diligence enquiries. At this point the firm should disclose all information relevant and potentially relevant to the Central Bank's assessment of a proposed appointee's fitness and probity. 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. The Central Bank takes non-disclosure seriously, especially where there



is an apparent attempt to mislead. This may call into question not only the individual's suitability but also the firm's decision to propose the individual in question.

As regards ongoing due diligence, firms have ongoing obligations under Section 21 of the 2010 Act¹ to ensure that they do not allow a person to perform a CF role unless they are "satisfied on reasonable grounds" that the person: (i) complies with the applicable standards of fitness and probity; and (ii) has agreed to abide by those standards. An annual self-declaration by PCF and CF role holders is the minimum expected. Where a firm becomes aware that there may be concerns regarding the fitness and probity of a person performing a CF role, the Central Bank expects the firm to investigate such concerns and take action as appropriate without delay.

c) Outsourcing of Roles subject to the F&P Regime

Where PCF or CF roles are outsourced to unregulated Outsource Service Providers ("OSPs"), the majority of firms had not, as part of their due diligence in appointing CF role holders, obtained the required documentation nor made any inquiries as to the OSP's process for assessing fitness and probity. In addition, firms did not have a process whereby outsourcing arrangements were analysed to verify whether PCF or CF roles were being performed.

Firms' obligations with respect to fitness and probity apply irrespective of whether the PCF or CF role is performed within the firm or outsourced to an unregulated OSP. Firms are required to have appropriate processes and procedures to ensure compliance in both scenarios.

d) Engagement with the Central Bank

In the majority of firms the processes related to engagement with the Central Bank on fitness and probity issues, including the IQ submission process, have not been adequately developed, documented or embedded. Many firms did not have robust processes in place to identify, escalate

¹ Under the SSM legal regime, the ECB is responsible for taking decisions on the approval of certain pre-approval controlled functions within credit institutions deemed by the ECB to be a 'significant institution' ("SI"). Additionally, the ECB is responsible for supervising SI's compliance obligations under the Fitness and Probity Regime, as provided for within the 2010 Act. For further detail regarding the ECB's responsibilities in this regard, please refer to the: [ECB authorisations webpage](#). Detail regarding the ECB's harmonised approach to fit and proper assessments is set out within the [ECB's Guide to F&P Assessments](#).



and notify the Central Bank in a timely manner of potential concerns regarding the fitness and probity of a CF or PCF holder.

The lack of engagement with the Central Bank is also a reflection of the passive approach taken by firms to their ongoing due diligence requirements. The Central Bank expects firms to be proactive in identifying fitness and probity issues as part of its ongoing due diligence and in reporting as appropriate to the Central Bank without delay.

e) Role of the Compliance Function

While the majority of firms had compliance frameworks, policies and procedures in place, given the findings of the thematic inspections, it is clear that many firms are not undertaking robust compliance testing of their fitness and probity processes and procedures. The fitness and probity process should be 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 F&P Regime is a cornerstone of the regulatory framework in Ireland. It applies not only to individuals; firms are also subject to significant requirements under the regime to ensure that any individual who is engaged to carry out a CF role has the requisite fitness and probity to do so.

Failure by a firm to comply with its 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's Dear CEO letter of April 2019 emphasised the importance of compliance by firms and identified areas where compliance was inadequate. The range of findings from the subsequent thematic onsite inspections indicates that many firms do not have due regard to their obligations under the F&P Regime. It is also a matter of concern that a number of firms did not take action, on being prompted by our April 2019 letter, to perform a formal 'gap analysis' of their



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policies, processes and procedures. It is wholly unacceptable that such shortcomings continue to exist in circumstances where the F&P Regime was introduced almost ten years ago.

The Central Bank expects that all firms take appropriate action to address the significant issues outlined in this letter and can evidence this to the Central Bank, if requested. This letter should be read in conjunction with the April 2019 letter, the F&P Standards and the associated fitness and probity guidance.

The Central Bank will continue to engage with firms to assess the robustness of their application of the F&P Regime and will initiate necessary supervisory responses to any weaknesses identified.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Derville Rowland'.

Derville Rowland
Director General Financial Conduct

A handwritten signature in blue ink, appearing to read 'Ed Sibley'.

Ed Sibley
Deputy Governor Prudential Regulation



Appendix 1: Key Findings Identified by the Thematic Inspections

a) Levels of awareness and understanding of the F&P Regime

Role of the Board / Nomination Committee (“NomCo”) in Fitness and Probity Process²

1. The level of awareness of fitness and probity obligations was weak throughout many of the firms, with Board awareness of its obligations particularly poor.
2. Board appointment procedures were generally not subject to the same level of scrutiny or formality as other CF and PCF appointments. In most cases, there was a lack of interview notes or suitability assessments available to support Board appointments.
3. In a number of instances there was no evidence of Board approval of the PCF appointment, Board approval of the appointment took place after approval by the Central Bank and/or there was no evidence of discussion or challenge by Board members of the proposed appointment.
4. Instances of the Chief Executive Officer (“CEO”) screening potential Board candidates were noted in a small number of firms. This is inappropriate given the conflict of interests that arise as between the respective responsibilities of directors and the executive.
5. The quality of succession plans for the Board and executive team generally did not meet expectations. A number of these succession plans did not set out the skills, competencies and experience required for the various roles and/or how the proposed successor would demonstrate/acquire those. However, some firms had developed their own Board Skills Matrix, which set out the key areas of experience required. This matrix was used to identify gaps in the combined experience of the Board.

² Includes appointment of board members and senior management, and succession planning.



Functional Responsibility for the F&P Regime

6. Management of the fitness and probity process varied significantly across the firms. Where there were clear, prescribed roles and responsibilities along with appropriate segregation of duties, the due diligence conducted in these firms was of a higher standard than those without clearly articulated and assigned responsibilities.
7. The quality of policies and procedures in relation to fitness and probity varied from firm to firm. Elements of good practice were observed in the form of 'How To' guides, establishment of Fitness & Probity Steering Committees, checklists, and clearly documented roles and responsibilities in relation to the fitness and probity process in the firm. However, good practice was not evident in most firms; the majority had disjointed processes that did not clearly outline the roles and responsibilities of the various functions performing fitness and probity related tasks.

Analysis and Mapping of Roles

8. There were instances where no register of employees performing PCF or CF roles was maintained. In addition, the process of regular review of individuals whose role changed, resulting in their coming within the remit of the F&P Regime, was lacking. Good practices identified included a documented requirement to review the job description when a vacancy arises to determine if the role is CF or PCF in nature, and guidelines setting out the key principles and rationale for the general interpretation of the CFs across the firm.

b) Conducting Due Diligence

Initial Due Diligence

9. In the majority of the firms inspected, the initial due diligence undertaken was not sufficiently robust to evidence compliance with the requirements of the F&P Standards. Issues highlighted by the inspections included: a lack of evidence of academic qualifications; lack of references from previous employers; a notable absence of interview notes across the



majority of firms inspected; and no evidence of a documented assessment as to the suitability of the candidate.

10. Issues were also identified in a number of instances with a lack of judgement searches, regulatory searches, directorship searches and adverse media searches, including adverse media searches regarding previous employers that could assist with identifying potential fitness and probity concerns to be examined further.
11. Firms assessed as performing better had 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, Company Secretary and Compliance Function); performed due diligence searches and conducted and retained interview notes.

Ongoing Due Diligence

12. Under Section 21 of the 2010 Act, firms are required to conduct due diligence on an ongoing basis to ensure that employees performing CFs continue to comply with the F&P Standards.
13. All firms had in place a requirement for each PCF and CF role holder to annually certify their compliance with the F&P Standards and their agreement to abide by the F&P Standards. An annual self-declaration by PCF and CF role holders is the minimum expected by the Central Bank.
14. However, the ongoing due diligence process in most firms is limited to the annual self-declaration. Firms should proactively conduct ongoing due diligence screening of staff to ensure there has been no change in circumstance that may affect the fitness or probity of the individual. In one firm they conducted ongoing due diligence searches on an annual basis for all PCF role holders and on a sample basis for CFs.



c) Outsourcing of Roles subject to the F&P Regime

15. Where CF roles are outsourced to unregulated OSPs, the majority of firms had not, as part of their due diligence in appointing CF role holders, obtained the required documentation nor made any inquiries as to the OSP's process for assessing fitness and probity.
16. Firms did not have a process whereby outsourcing arrangements were analysed to verify whether PCF or CF roles were being performed. This gives rise to the risk that relevant individuals at OSPs may not be identified and subjected to the F&P Standards.
17. In addition to obligations under the Central Bank's F&P Regime, the Solvency II Regulations impose requirements on insurance firms with respect to the outsourcing of critical or important functions. Under these Regulations, firms are obliged to verify that all staff of the service provider who will be involved in providing the outsourced functions or activities are sufficiently qualified and reliable. There was generally a low awareness of Solvency II obligations in this regard and these had not been included in applicable policies and procedures.

d) Engagement with the Central Bank

18. Firms did not have clearly defined procedures covering the various stages of the IQ process including initiation, compilation, completion, review, approval and submission of the IQ application. In addition, there was a lack of clarity in relation to what could be regarded as a material fact for inclusion in the IQ.
19. Firms did not have robust processes in place to identify, escalate and notify an appropriate individual or function, within the firm in a timely manner, of potential concerns regarding the fitness and probity of a CF or PCF holder. Additionally, there was a distinct lack of policies or procedures to support these escalations (i.e. investigation of concerns and the taking of timely action as appropriate) or to ensure timely notification of actions taken to the Central Bank.



20. Overall, the processes related to engagement with the Central Bank on fitness and probity issues, including IQ submission process, have not been adequately developed, documented or embedded.

e) Role of the Compliance Function

21. The majority of firms had compliance frameworks, policies and procedures in place. There was a good understanding of fitness and probity obligations by the Compliance Function in a number of the firms inspected. However, in some cases there was an over reliance placed on the Compliance Function, thereby creating potential key person risk.

22. Many firms are not undertaking robust compliance testing of their fitness and probity processes and procedures. The fitness and probity process should be subject to periodic independent review by the third line of defence.