WILLIAM FRY

// FINANCIAL REGULATION

Central Bank of Ireland's "Dear CEO Letter" on Supervisory Expectations for Payment Institutions and Electronic Money Institutions

December 2021

On 9 December 2021, the Central Bank of Ireland (the **Central Bank**) published a *"Dear CEO Letter"* on its supervisory expectations for payment institutions and electronic money institutions. This sector has seen substantial growth over the last number of years and these firms play an increasingly important role, both in the lives of consumers and in the broader financial system. The purpose of the *"Dear CEO Letter"* is to set out clearly the expectations the Central Bank has for all payment institutions and electronic money institutions and the actions expected of the board and senior management of these firms.

SUPERVISORY EXPECTATIONS

Short Overview of Supervisory Expectations

The Central Bank expects the following of all payment institutions and electronic money institutions:

- **Good governance and risk management -** firms should be well governed with appropriate cultures, effective risk management and control arrangements in place;
- **Sustainable business models -** firms should ensure they have sufficient financial resources, including under plausible but severe stress scenarios;
- **Operational resilience -** firms should be in a position to respond to, recover from and learn from operational disruptions. (The Central Bank recently published cross-industry guidelines for regulated financial service providers on operational resilience. See our briefing here);
- **Anti-money laundering and countering the financing of terrorism -** firms are expected to play their part in protecting the financial system against money laundering and terrorist financing.
- **Consumer protection -** the Central Bank emphasises its no tolerance approach to widespread consumer or investor harm. Firms are reminded that it is their responsibility to foster a consumer-focused culture within their businesses; and
- **Recovery and resolution -** where firms get into difficulty they should have the ability to recover and if they cannot recover they should be resolvable in an orderly manner.

Applicable Legislation

The Central Bank reminds firms that they are under an ongoing obligation to comply with all applicable legislation, codes, and guidelines. For payment institutions and electronic money institutions, this includes:

- the European Union (Payment Services) Regulations 2018 (as amended) (**PSR**) and/or the European Union (Electronic Money) Regulations 2011 (as amended) (**EMR**);
- the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 (as amended) (**CJA 2010**); and
- the Central Bank's Consumer Protection Code 2012 (as amended).

As well as complying with legislative and regulatory obligations, firms must at all times continue to comply with their conditions of authorisation issued by the Central Bank.

PRIORITY AREAS FOR THE CENTRAL BANK

The "Dear CEO Letter" highlights seven key areas which are supervisory priorities for the Central Bank.

1. Governance and Risk Management

Payment institutions and electronic money institutions are obliged to maintain governance and control arrangements which are proportionate and appropriate in accordance with the PSR and/or EMR.

Firms must have a functioning board which is responsible for the prudent and effective oversight of the firm. This includes responsibility for setting and overseeing the firm's strategy and for ensuring effective and adequate governance, risk management and internal control frameworks are in place to ensure ongoing compliance with legislative and regulatory obligations.

Firms are also reminded of the importance of the Central Bank's fitness and probity regime and in particular, the *"Dear CEO Letters"* of April 2019 and November 2020 (see our briefings here and here). All pre-approval control function (**PCF**) role holders and control function role holders are expected to be familiar with the contents of these "Dear CEO Letters".

In this regard, firms are further reminded that:

- a regulated firm must not offer to appoint a candidate as a PCF unless the Central Bank has approved such appointment in writing;
- firms must ensure those falling under the scope of the fitness and probity regime are fit and proper both at the time of appointment and on an ongoing basis thereafter;
- firms must conduct due diligence on candidates in advance of seeking Central Bank approval; and
- firms must ensure robust succession planning arrangements are in place to ensure the board and senior management composition remain commensurate with the nature, scale and complexity of the firm's operations.

2. Conduct and Culture

The Central Bank expects firms to embed a consumer-focused culture, demonstrated by:

- ensuring internal systems and controls, including well developed risk management frameworks, are in place;
- designing and selling products that are suitable to customers' needs, ensuring the firm can deliver promised benefits and disclosing all key risks associated with these products;
- examining the risks identified by the Central Bank in the Consumer Protection Outlook Report 2021 (available here) and taking all appropriate actions to protect consumers.

This must be reflected in all aspects of a firm's operations, including corporate governance, individual accountability, devising strategies, developing products, how the firm thinks about customers, risk management, people management, internal controls and whistleblowing.

3. Safeguarding

The Central Bank has identified safeguarding as a key supervisory priority due to the potential risks of consumer detriment if customer funds are not adequately safeguarded. Safeguarding arrangements should be reviewed regularly to ensure they remain compliant with regulatory requirements.

The board has an important role to play in relation to safeguarding:

- firms must have robust board-approved safeguarding risk frameworks in place which ensure that client funds are appropriately identified, managed, and protected on a day-to-day basis including clear segregation, designation, and reconciliation of client balances; and
- the board is expected to seek assurance on an ongoing basis that client funds are fully reconciled and matched with the designated safeguarding account.

The second (risk and compliance) and third line (internal audit) of defence also have an important role as they must provide independent oversight of the safeguarding risk framework to ensure it is operating as described.

4. Business Model and Financial Resilience

Payment institutions and electronic money institutions are expected to have capital accretive business models that are viable and sustainable. Firms must:

- have sufficient financial resources to support current and projected business plans with due regard given to potential firm specific and market-wide stress scenarios;
- understand and meet own funds requirements at all times; and
- ensure sufficient regulatory capital is available to absorb losses.

In addition to being financially resilient, the Central Bank expects the following of firms:

- *regulatory returns* - firms are reminded of their obligation to submit accurate and timely regulatory returns to the Central Bank and that miscalculation and misreporting of a firm's capital position, in particular, is not acceptable;
- *proactive approach to communication with the Central Bank* - the Central Bank expects to be

notified as soon as a firm becomes aware of any breach of a legal or prudential requirement or any other material adverse development which may impact the firm's business; and

- *material change of business model* - the Central Bank must be notified at the *'earliest possible opportunity'* where the firm expects a material change to its business model. Non-exhaustive examples of a material change of business model cited by the Central Bank include the firm seeking to make a substantive change to its service or product offering or materially change the way in which its service/product offerings are provided or the firm's business projections being forecast to be significantly in excess of that outlined in its authorisation. Notifications of a material change of business model must be in the Central Bank's required format and should be accompanied by a detailed risk assessment signed off by the board.

5. Operational Resilience

In its Strategic Plan 2019-2021, the Central Bank made a strategic commitment to *'strengthening resilience'* and it is focused on ensuring the financial system continues to address weaknesses and vulnerabilities and mitigates risks to better withstand shocks or crises. In this regard:

- firms are expected to respond to, recover from, and learn from operational disruptions;
- given the importance of operational continuity, firms should expect the Central Bank to scrutinise how they are ensuring risk and control frameworks operate effectively and how prepared they are for unforeseen operational disruptions;
- firms (including those which are part of a larger group) must operate sufficiently on a standalone basis to ensure the primacy of the legal entity authorised in Ireland; and
- firms must demonstrate they are in control of their own activities and material risks.

The board plays an important role in this area:

- the board and senior management are responsible for the activities of the regulated entity and in particular, the board bears ultimate responsibility for the firm's IT and cyber risk strategy and governance.
- this responsibility extends to outsourced activities, so board members must satisfy themselves that they have the necessary skills and knowledge to understand the risks facing the firm and the responsibilities they have.

6. Financial Crime

Payment institutions and electronic money institutions are *'designated persons'* for the purpose of the CJA 2010 and are subject to the obligations contained in the CJA 2010.

Firms are obliged to invest in and maintain strong anti-money laundering and countering the financing of terrorism (**AML/CFT**) control frameworks. These frameworks should be based on a firm-specific risk assessment, focussing on the particular AML/CFT risks arising from the firm's business model.

There should be robust controls in place to mitigate and manage risks identified and the Central Bank reminds firms to note that a 'tick the box' or 'rules based' approach to risk assessment does not meet the expectations of the Central Bank in this regard.

7. Resolution and Wind Up

The Central Bank expects firms to be able to recover should they get into difficulty and failing this, to be capable of being resolved in an orderly manner. Firms should ensure that:

- resolution should be possible without significant externalities;
- any insolvency process can be managed in an orderly fashion, without customer detriment;
- these principles are embedded within the firm's business model and operational strategy; and
- an exit/wind-up strategy is in place, which is linked to the business and operational model and includes provision for the return of customer funds at the earliest opportunity in an exit/wind-up scenario.

NEXT STEPS FOR THE CEOS AND BOARDS OF PAYMENT INSTITUTIONS AND ELECTRONIC MONEY INSTITUTIONS

The Central Bank expects each CEO of a payment institution/electronic money institution, together with the board, to carefully consider the contents of the *"Dear CEO Letter"* and to conduct a comprehensive assessment of the firm's compliance with:

- safeguarding obligations (under Regulation 17 of PSR or Regulations 29-31 of the EMR); and
- the conditions of authorisation of the firm.

The board is expected to oversee this review, consider the conclusions and take and remedial actions. If any issues are identified as part of this process, a remediation plan must be implemented which ensures timely resolution of the issues. This remediation plan must be approved by the board.

A board approved attestation confirming the completion and conclusion of this assessment must be provided to the Central Bank by 31 March 2022.

William Fry is available to assist payment institutions and electronic money institutions with their review and assessment of compliance of the firm with the Central Bank's supervisory expectations as set out in the *"Dear CEO Letter"*.

CONTACT US

For more information, please contact any of the below or your usual William Fry contact.

Shane Kelleher
PARTNER
Head of Financial Regulation
T: +353 1 639 5148
M: +353 87 617 7098
shane.kelleher@williamfry.com

Louise McNabola
PARTNER
Financial Regulation
T: +353 1 639 5196
M: +353 86 141 4693
louise.mcnabola@williamfry.com