

ATEB consulting Newsletter 22 - February 2004

1. Stop press - ATEB consulting launches I.T Support Service
2. Professional Indemnity Insurance – FSA feedback from CP193
3. Pension Unlocking
4. Introducing – Will you have permission wef January 2005?
5. Exclusion: article 72C (Provision of information on an incidental basis)
6. Custody and client money
7. Variation of Permissions (VOP) - problems
8. MCCB Fees significantly reduced during final renewal period

Ladies & Gentlemen

Please find enclosed the latest compliance and industry news.

As usual, site back and enjoy!

Kind Regards

ATEB Consultants

Which article applies to me?

Please use the following table to decide which article applies to you, if any:

Investment (IFA)	1	2	3	4	5	6	7	8
Directors/Partners	✓	✓	✓	✓	✓	✓	✓	✓
Compliance / A&O Function	✓	✓	✓	✓	✓	✓	✓	✓
Money Laundering Officer								
Advisers & Trainees				✓				
T&C Supervisor				✓				
Pensions Transfer Specialist				✓				
Back Office								
*Mortgage (inc. IFAs)	1	2	3	4	5	6	7	8
Director/Partner	✓	✓		✓	✓			
Compliance / A&O Function	✓	✓		✓	✓			✓
Sales Advisor								
T&C Supervisor								
Back Office								
General Insurance	1	2	3	4	5	6	7	8
Director/Partner	✓	✓		✓	✓			
Compliance / A&O Function	✓	✓		✓	✓			✓
Sales Advisor								
T&C Supervisor								
Back Office								

*Includes Mortgage arms of IFA and APF firms

1. Stop press - ATEB consulting launches I.T Support Service

David Anderson graduated last year from Durham University with an honours degree in computer science. For a number of years, he has provided IT support to ATEB, including computer build, network installation, web development and maintenance. More recently, he has been providing support to one of our long standing clients, who use the 1st Computer system running a Microsoft 2000 network and including a Virtual Private Network (i.e. remote access).

One interesting thing about David is that he has financial services knowledge and is not simply, to use a colloquialism, an 'anorak'. He has a good understanding of systems like 1st and Fairs, but also knows how an IFA operates. This, we believe, makes this offer unique. How many other IT providers do you know who understands FSA reporting requirements or what KPIs are?

Here is a brief summary of what the ATEB IT service can provide:

System Audit	<ul style="list-style-type: none">• Audit of current IT infrastructure, identifying potential weaknesses
Installation	<ul style="list-style-type: none">• New network systems• New software deployment• Broadband internet• Secure wireless network solutions
Upgrading	<ul style="list-style-type: none">• Expanding networks• Installing new PCs• Software upgrades
Problem solving	<ul style="list-style-type: none">• Internet connectivity problems• Network fault finding• Desktop PC problems
Web and e-commerce	<ul style="list-style-type: none">• Development and maintenance
Disaster recovery	<ul style="list-style-type: none">• Protection using Firewalls/Antivirus Software• Controlled backup systems & procedures
Administration	<ul style="list-style-type: none">• Regular administration of networks and servers
Financial Services	<ul style="list-style-type: none">• Automated integration between product providers and client databases• Knowledge of IFA specific software eg. 1st/Fairs

ATEB view:

We pride ourselves on the quality of our service. As such, we would not recommend any service or anyone without satisfying ourselves that the offer is an excellent one. David has been providing backup for ATEB for a couple of years now and we have every confidence in promoting his services to a wider audience.

Action required by you:

Make an appointment to meet David and hear more about the service!!

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2. Professional Indemnity Insurance – FSA feedback from CP193

The FSA has published its feedback to CP193 (new Professional Indemnity rules). The key points to note are as follows:

1. All firms must have cover, which complies with the IMD requirements by 15th January 2005. i.e. minimum cover of EUR1,000,000 for a single claim and aggregate cover of EUR1,500,000.
2. All business activities, whether regulated or not, must be covered. Obtaining separate policies to cover, for example, mortgage advice or protection business is acceptable
3. Incidental costs such as legal defence costs should not be included in the IMD level. (Many current policies are all inclusive.) FSA wants firms to be aware that legal defence costs can be significant and senior management are expected to assess what their potential exposure might be and obtain additional cover accordingly. This could be included in the PI policy or by a separate policy.
4. Policies must have retrospective cover i.e. previous business, including cover for Ombudsman awards and legal defence costs.
5. There are no minimum or maximum excess levels, but an excess over £5K on any class of business will necessitate additional financial resources. The current table used for this purpose is unaltered. Senior management must decide on a level, which they feel is appropriate.
6. Exclusions (i.e. categories of business not covered) will be permitted provided firms hold additional funds to cover the excluded business. However, exclusions should not unreasonably limit cover IPRU (INV) 13.1.4 (8) R. Again, senior management must assess their potential exposure and reserve funds accordingly. FSA will be issuing case studies.

ATEB view:

- The PII market is still very difficult. FSA has granted over 100 waivers to date and will continue to consider applications. But **waivers will only apply until 14 January 2005** and firms with waivers need to think carefully about this issue.
- The FSA has been reluctant to take enforcement action against firms who have no cover. But there are a significant number who have been operating without cover for a considerable time now and FSA will be focusing more attention on these firms. Any members in this position should seriously consider their options and keep trying the market.
- The new rules do allow more flexibility but the IMD minimum requirements mean small firms will have to hold a higher amount of cover than under the old rules.
- ATEB is working with insurers to try to put in place some form of group cover available for our clients. This is proving difficult, but progress is being made.
- We are seeing the underwriter's criteria changing and moving from a factual basis (e.g. how many endowments do you have) to a risk based assessment (e.g. what systems do you have in place).

Action required by you:

Plan your PI carefully and discuss issues with us. All firms currently operating under waivers please note that these will cease in Jan 2005.

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3. Pension Unlocking

Do you remember the Berkeley Jacobs television adverts in which they freely promoted how they could unlock pensions? At the time, I recall thinking – “how the heck do they get away with that?” and “are the regulators watching this?” Well, as it turns out they didn't and the regulators were watching. Now, there is one thing in having poor compliance in place, but to advertise this fact on national television, not a wise move!

The firm was recently fined £175,000 by the Financial Services Authority (FSA) for misleading advertising and serious failings in the advice it gave to consumers to release cash early from their pensions. i.e. transfers to Personal Pensions.

What can we learn?

This is not an exhaustive list, but it summarises and recaps the key issues which the FSA focused on during their assessment of the problem. Now apply this to your situation:

Have you?

- Ensured that adverts and promotions have gone through a rigorous process of approval.
- Given consideration to the drop in pension income or the inability to make up for that loss where the customer is close to retirement.
- Identified and quantified (monetary) the clients needs in retirement?
- Balanced the above precisely with what the client currently has?
- Considered the annuity option that will give the customers the best income?
- Carried out a comparison of the options available to customers, such as whether a loan or re-mortgage would be more cost effective?
- Accurately and precisely, assessed customers' attitude to risk?
- Drawn attention to the 'critical yield' on transfers from occupational pension schemes?
- Prioritised the competing objectives of "cash now" or "income in retirement"?
- Assessed the effect on DWP / DSS benefits?
- Issued a suitability report / letter which gives customers adequate and fair information and includes downsides to the advice as well as risk warnings in context?

Most important: don't forget if its not written down it hasn't happened!

ATEB view:

This was probably an extreme situation. Most firms will be adopting a more disciplined approach than was the case here; however there will still be room for improvement. Why not use this article as a starter to enhance your firm's own internal procedures? In relation to adverts in particular, anyone could be 'out there' reading an advert and that person could report you. Ask yourself - do you want to attract this sort of attention?

Action required by you:

Ensure that you have adequate new business procedures

In place to deal with the above and make sure that all staff in particular advisers are clear in their understanding of the requirements.

4. Introducing – Will you have permission wef January 2005?

You may or may not be aware that your 'scopes of permission notice' defines what your firm can and cannot do within the boundaries of FSA regulation. The FSA 'permissions' are derived from the Regulated Activities Order (RAO). The RAO broadly defines what activities need authorisation.

One of the permissions which most IFA firms have is '**Making arrangements with a view to transactions in investments**'. This permission permits firms to help potential policyholders fill in or check application forms. Another example of its use would be to permit an IFA firm to introduce customers to a Pension Specialist Firm for advice or to help arrange a pension policy. The introduction might be oral or written.

Also, contained within the RAO are 'exclusions'. Historically, these have been used by unauthorised firms (e.g. Mortgage and general brokers) to 'by-pass' the need to have permission provided certain criteria are met. Currently, one particular exclusion, (article 33 - Introducing) excludes some arrangements, which would otherwise be '**Making arrangements with a view to transactions in investments**'. An example of how the exclusion could apply would be where a general broker has referred a client to an IFA for advice or to help arrange an investment bond.

From the 14th January this important exclusion along with a number of others will be restricted. If the referral **specifically** involves contracts of insurance (i.e. general insurance, term assurance, investment bonds etc) then it will no longer be available.

What are the implications wef January 2005?

Where IFAs, Mortgage Brokers, General Brokers (or indeed any unauthorised person) do not receive or expect remuneration from any referral and the referral is for **general independent advice**, then this would not require authorisation and/or the scope of permission that includes '**making arrangements etc....**'

Where an introduction is made by an unauthorised person and involves remuneration to the introducer and the referral is **specific** to a contract of insurance, then this would require (not withstanding the availability of other exclusions) authorisation of the introducer. In the case of an authorised person (for example an IFA), it is likely to trigger a potential variation to his scope of permission.

ATEB view:

We have only 'scratched the surface' in this short article. Of course, there are other issues that you may need to consider, if you would like to discuss further please call.

Action required by you:

Most IFA firms are currently applying to vary their permissions so this should cater for the changes, although those firms which have chosen not to vary, may need to reconsider their position. More Information can be found at http://www.fsa.gov.uk/handbook/legal_instruments/2004/2004_01.pdf 2004 in particular 5.15.4 G

5. Exclusion: article 72C (Provision of information on an incidental basis)

In contrast to the above item, the FSA considers that a mere passive display of literature advertising insurance (for example, leaving leaflets advertising insurance in a dentist's or vet's waiting room and doing no more) would not require the permission of 'Making arrangements with a view to transactions in investments'.

Introducers whose introductions relate directly or indirectly to contracts of insurance may be able to use the exclusion in article 72C of the Regulated Activities Order for **merely passing information**. However, the exclusion only exists for persons whose principal business is other than insurance mediation activities. (Insurance mediation activities are broadly speaking advising and/or arranging general and life insurance for potential clients).

In broad terms, article 72C of the Regulated Activities Order excludes from the activities of 'Making arrangements with a view to transactions in investments'.

- activities which consist of the provision of information to the policyholder or potential

- policyholder;
- by a person carrying on any profession or business which does not otherwise consist of regulated activities;
- if the provision of information may reasonably be regarded as being incidental to that profession or business.

Who can rely on the exclusion wef January 2005?

The exclusion may be of relevance to exempt professional firms (for example Solicitors and accountants that are not FSA authorised). Doctors, vets and dentists as well as many businesses in the non-financial sector might also, for example, rely it on. This is assuming that their activities for which they are seeking to use the exclusion in article 72C are limited to providing information in a way which is incidental to their main profession or business. The exclusion only extends to information given to the policyholder or potential policyholder and not to the Product Provider. An intermediary who forwards a proposal form to a Product Provider would not be able to take the benefit of the exclusion. Similarly, where a person does more than provide information (for example, by helping a potential policyholder fill in an application form), he cannot take the benefit of this exclusion.

ATEB view:

Whatever the source of your introductions ensure that where appropriate you or the introducer has the correct permissions and or ensure that you are making correct use of any exclusions.

Action required by you:

If you would like to discuss further please call, alternatively more information is located in the Insurance Mediation and Mortgage Mediation lending and administration (Prudential Provisions) instrument 2004 in particular 5.15.4G - another riveting read!!
http://www.fsa.gov.uk/handbook/legal_instruments/2004/2004_01.pdf

 [Return to Features List](#) or  [Contact Us](#)

6. Custody and client money

Many small and medium sized firms are not allowed to hold client money and custody assets, although there could be situations where they could sail close to the wind by inadvertently holding client money and custody assets. You may wish to think about the following two situations.

Custody Investments

The FSA rules state that generally, when an IFA firm temporarily holds an investment (policy document) belonging to a client it is exempt from the custody rules if it takes certain steps. These steps would be as follows:

- The firm must keep it secure, record it as belonging to that client, and forward it to the client or in accordance with the client's instructions, as soon as practicable after receiving it;
- The firm must retain the designated investment for no longer than the firm has taken reasonable steps to determine is necessary to check for errors and to receive the final document in connection with any series of transactions to which the documents relate; and
- The firm must make a record, which must then be retained for a period of 3 years after the record is made.

You should not rely on this rule as a matter of course, and should only retain a designated investment for as long as is strictly necessary. Note that most IFA firms will not be 'temporarily holding' client assets because the policy documents will usually be sent out to clients the day they are received. More Information in the Client Assets Sourcebook (CASS) 2.1.9 (3) R

Client money

There is no equivalent exemption for client money. An example of where a firm may need to act to avoid holding client money is where a customer sends a cheque intended for the purchase of a product made payable to the firm rather than the product provider. In this case firms should not cash the cheque if they want to avoid holding client money – instead they should return the cheque to the client with a request for an amended cheque. ATEB supply a proforma to record this.

A further potential client money issue is that of rebated commission. Technically, as soon as a

firm agrees that a part of its commission will belong to the client, then on receipt it will be part client money and part firm money and the client money rules may need to be applied.

A potential solution to avoid the client money rules would be for a firm to set out clearly in its agreement with the client that any commission remains the firm's until actually paid into the account of the client. More Information in CASS 4.1.22 R

ATEB view:

It could be fairly easy to breach these rules if the firms do not have the right systems and controls in place to prevent it from happening.

Action required by you:

Confirm with your staff that your process and documentation deals with the above adequately.

[Return to Features List](#) or [Contact Us](#)

7. Variation of Permissions (VOP) - problems

This month, many firms have been completing on line applications to vary their permissions. However, there have been a few teething problems:

Some of the VOP questions really require a 'not applicable' but the option has not been included. ATEB have spoken with the FSA on a couple of occasions to clarify the situation. Questions 16, 17,18,19 are relevant only to Authorised Professional Firms (these are generally solicitors or accountants who are authorised through the FSA). Firms need to input the 'No' option because when you 'validate and save' it does not allow you to leave unanswered. We have been assured by the FSA that you should input 'no' even though it doesn't make sense. The problem still impacts on Authorised Professional Firms because where the form explains you should jump a question you still have to make a physical input before you can submit.

IT gremlins in the system have prevented some firms from making changes to earlier saved versions. These have been ongoing for some weeks but we believe these will be rectified soon.

ATEB view:

None, for information only

Action required by you:

None, for information only

[Return to Features List](#) or [Contact Us](#)

8. MCCB Fees significantly reduced during final renewal period

MCCB's Board have now agreed the registration fees for the final renewal period

1 May - 31 October 2004. For intermediary firms there will be no firm registration fee and the sales staff fee will be at a rate of less than 50% of the fee payable in 2003/4.

MCCB will be mailing all registered intermediary firms in late February to invite them to renew their registration for the period **1 May – 31 October 2004**. MCCB will require one simplified form to be completed and returned with a cheque for the appropriate fee. MCCB recognises that firms' current registration does not expire until 30 April 2004.

However, due to the large volume of forms to be processed they are asking firms to return their renewal forms **no later than 31 March 2004** to guarantee that their details are included on the first lender disk of the new registration year, issued at the beginning of May.

In addition and very significantly, the FSA has confirmed that to benefit for due credit firms must maintain their MCCB registration until 'Mortgage Day' (31 October 2004); firms, which resign their registration, will be subject to additional scrutiny.

Firms who miss the final deadline of 30 April 2004 will have to apply for **new** registration, which will incur the additional Fitness & Propriety fee of £117 (incl. VAT) and involve the issue of a new registration number. In addition, there is a risk that they will not be entitled to the benefit of 'due credit' status with the FSA by allowing a break in registration to occur.

If you have any queries on completing the application form when received, please email enquiries@mortgagecode.org.uk or contact the Help line on 01785 218200 between 9.00am and 5.00pm, Monday to Friday.

ATEB view:

None, for information only

Action required by you:

Don't miss these important deadlines.

 [Return to Features List](#) or  [Contact Us](#)

Important Note:

The ATEB Newsletter is intended to provide general guidance on areas of compliance and T&C; however it is not a replacement for the main Rules and Guidance contained within the FSA Handbook.

We welcome all feedback. If you have any feedback or questions relating to any articles then please direct them to your local ATEB consultant or the newsletter editor Steve Bailey email steve@atebconsulting.co.uk

Unless you have consulted specifically (as part of a regular visit) with ATEB on a particular issue then ATEB Consulting accept no liability for any actions taken based on the information contained solely within the newsletter.

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