

ATEB consulting Newsletter 25 - May 2004

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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	9	10
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	9	10
Director/Partner	✓	✓					✓		✓	✓
Compliance / A&O Function		✓		✓			✓	✓		
Sales Advisor										
T&C Supervisor										
Back Office										
General Insurance	1	2	3	4	5	6	7	8	9	10
Director/Partner	✓	✓					✓		✓	✓
Compliance / A&O Function		✓		✓			✓	✓		
Sales Advisor										
T&C Supervisor										
Back Office										

*Includes Mortgage arms of IFA and APF firms

1. Mortgage and General Insurance key deadlines for authorisation

	Mortgage & General		
	Mortgages	(Includes Variation of permission)	General Only
First deadline			
31 March 2004	Apply by the 31 March 2004 to qualify for an early application fee discount	Apply by the 31 March 2004 to qualify for an early application fee discount	
	-	-	
Second deadline			
30 April 2004	This is the deadline for submitting applications if you want to be certain that the FSA will process it for 31 October 2004 start date*	This is the deadline for submitting applications if you want to be certain that the FSA will process it for 31 October 2004 start date*	
		-	
First deadline			
31 May 2004			Apply by the 31 May 2004 to qualify for an early application fee discount
Second deadline			
13 July 2004			This is the deadline for submitting applications if you want to be certain that the FSA will process it for 14 January 2005 start date*

ATEB view:
 Don't miss the deadlines
Action required by you:
 Don't miss the deadlines!

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2. PII & EU Legislation - A single set of European regulations?

The following article is aimed at clarifying and explaining the situation surrounding PII cover and how European Legislation will impact on it. There are two key directives with PII requirements, the Insurance Mediation Directive (IMD) and the Markets in Financial Instruments Directive (MiFID).

What is the IMD?

The Insurance Mediation Directive has been introduced to tackle the 'inability of insurance

intermediaries to operate freely throughout the (European) Community'. It aims to create a single market in insurance across Europe. It was approved by the European Parliament on 30 September 2002 and published in the EU Official Journal on 15 January 2003 – giving Member States two years from that date to implement the Directive.

What is the MIFI?


The European financial services industry arguably stands at the threshold of a new era of regulation. The European Commission (the Commission) has been pushing ahead with the Financial Services Action Plan. The Markets in Financial Instruments Directive (MIFI) is one of its flagship measures. MIFI will replace the existing Investment Services Directive, which was implemented in 1995. The UK will need to implement this Directive by 1 May 2006.

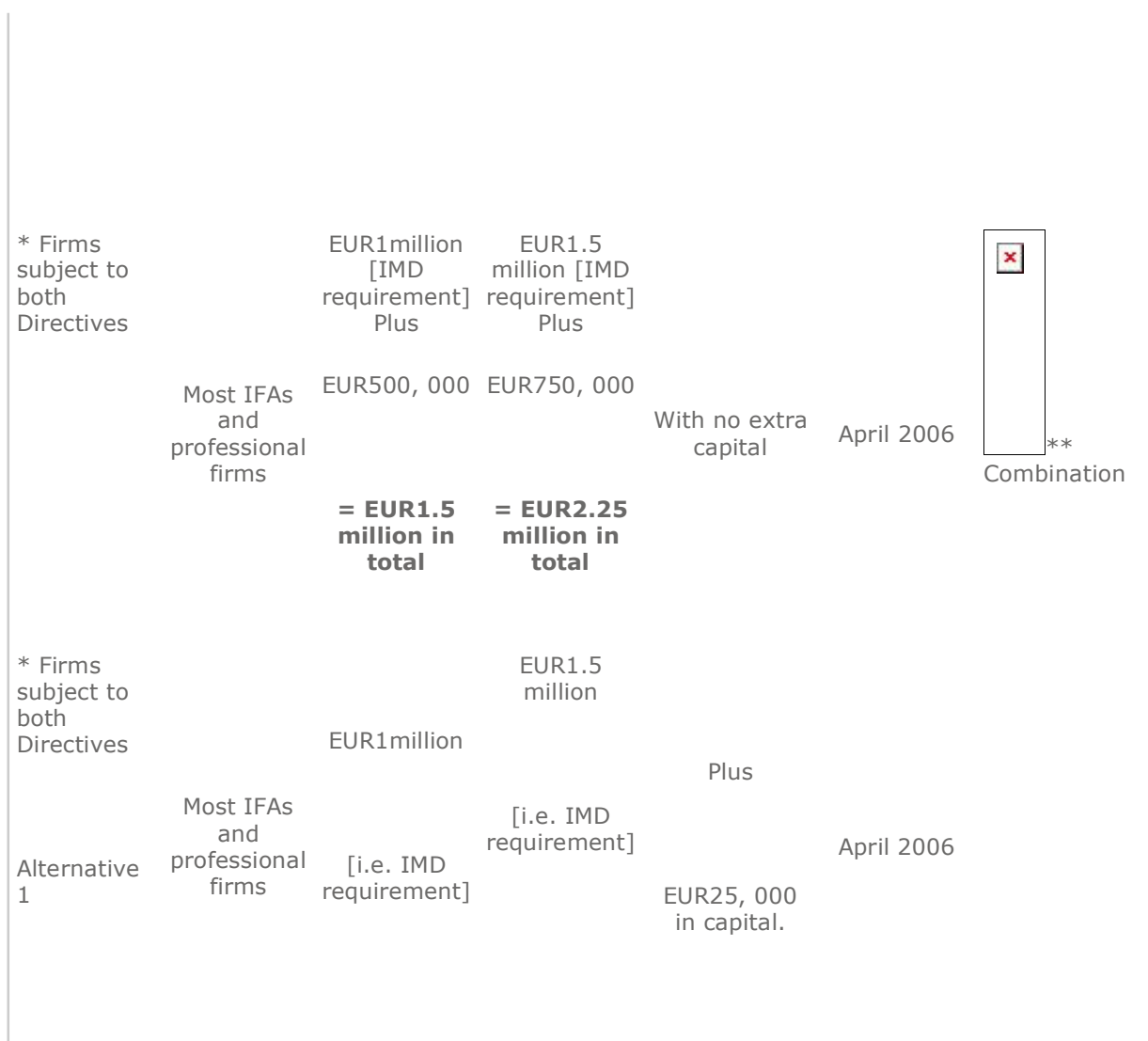
MIFI marks a sea change away from the world in which a 'host state' (i.e. the state of the consumer) may impose conduct of business rules when services are provided into its territory from another member state. Host states will be stripped of the majority of these powers in a move towards the 'Holy Grail' of a single set of compliance and operational procedures for pan-European business. Instead, the power to impose conduct of business regulation will lie with either the home state of the firm (usually the member state in which it has its registered office) or, where this is different, the member state in which a branch is located and from which the service is provided.

The other key point to note is that MIFI is likely to usher in a new era in which much, if not most, of the detailed prudential and conduct of business rules applicable to day-to-day business will be set at a European level. ***The future will see much more focus on the consultations by the Commission and the Committee of European Securities Regulators (CESR), rather than exclusive concentration on domestic consultation from the Financial Services Authority (FSA).***

Almost all IFAs and general insurance brokers will need to comply with the IMD when it comes into force as it applies to all intermediaries who arrange any contracts with an element of insurance. The MiFID will also catch most IFAs because it applies to investment advice and it covers collective investments, including most ISAs.

So, what are the new PII Requirements?

Legislation	Who are likely to be affected?	Min per claim	Min in aggregate	Additional Capital	Deadline for compliance	
Firms subject to IMD only	Persons who arrange insurance which includes most IFAs	EUR1million	EUR1.5 million	Yes – variable depends on excess and individual firm requirements.	January 2005	Warning Double check your cover meets the requirements
* Firms subject to MiFID only	Some IFAs and professional firms	EUR1million	EUR1.5 million	With no extra capital	April 2006	 ** Combination
* Firms subject to MiFID only					April 2006	
Alternative 1	Some IFAs and professional firms			EUR 50, 000 capital		



* Reference: Directive 2004/39/EC of the European Parliament and of the council of 21 April 2004 article 67 amendment of directive 93/6/EEC

** Firms will be able to choose a combination of PI and / or capital, which gives equivalent protection. It will be for FSA to determine what is "equivalent protection".

ATEB view:

PII needs to be proportionate to the risk and at the moment, the bureaucrats are clearly not aware of the diversity in the markets, seemingly, the only winners at present are the PII companies. There is a requirement in MiFID for the EU Commission to review all PII requirements, including those for intermediaries, by April 2005 and there is a chance of a positive outcome to the review. It appears that other intermediaries across Europe may also be encountering PII problems similar to the UK.

Action required by you:

You may wish to consider lobbying, the EU Commission or the FSA to help develop more flexible requirements for intermediaries. For once, it's not the FSA that we are moaning about, its Europe!

Also, check you PI policy and ensure that it meets with the IMD requirements particularly in terms of its level of cover. Firms will need to have a minimum of 1 Million Euros [and 1.5 Million Euros in the aggregate] by 15th January 2005. Most firms will have this cover but smaller firms may well be renewing cover later than next January and find that the cover is below the IMD threshold.

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3. Restructuring businesses and PI insurance

The FSA has produced a 'Simple change of entity application pack'. It can only be used by small firms (i.e. less than 26 advisers) who are already authorised and who wish to change only their legal status.

There are conditions in order to be able to use the pack.

- Scope of permissions and activities must remain the same
- The new company must take over the obligations of the previous firm

The FSA has confirmed that where firms accept to taking over the obligations of the previous firm, the new entity need only have PI insurance to cover business undertaken by the new entity. The upshot here is that the new firm could in theory choose to self-insure its past liabilities if PI cover is unobtainable or unacceptable.

ATEB view:

If you are considering restructuring your business, you should consider professional and legal advice or speak to FSA before taking any action.

Action required by you:

None for information only. The pack can be accessed at www.fsa.gov.uk/pubs/other [cost £1500]

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4. Financial Services Authority will regulate home reversion schemes

- Enhanced protection for all equity release customers
- Level playing field with lifetime mortgages

The Treasury has recently announced that the Financial Services Authority will in the future regulate home reversion schemes. This decision follows the Treasury's full public consultation. The Treasury has announced that it will consult shortly on the definition of home reversion plans for the forthcoming legislation. When the scope of regulation has been defined, the FSA will then consult on the details and rules of the regulatory regime.

Home reversionary schemes, where consumers transfer the ownership of all or part of their home to an equity release provider in return for an advance and a lifelong lease, will fall under the same regulatory requirements as those for *lifetime mortgages (*Equity release mortgage-based schemes).

ATEB view:

This is an expected and predictable outcome but nevertheless a good result for future consumers.

Action required by you:

None, for information only

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5. Stakeholder Pensions

In April the FSA published a fact sheet for consumers which can be found on <http://www.fsa.gov.uk/pubs/public/stakeholder.pdf> If you want to reproduce it, you should see the notes on http://www.fsa.gov.uk/pubs/pensions/stakeholder_pensions/index.html

ATEB view:

None, for information only

Action required by you:

None, for information only

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6. Money laundering Identification of the client: timing

We have been asked to clarify the timing of obtaining money-laundering evidence, as there appears to be quite a variation in the approach.

A few rule quotes before we begin:

* *ML 3.1.3 R (1) ".....A relevant firm must take reasonable steps to find out who its client is by obtaining sufficient evidence of the identity....."*

ML 3.1.8 (1) A relevant firm must comply with the obligation in ML 3.1.3 R (1) **as soon as reasonably practicable after** it has contact with a client with a view to:

(a) agreeing with the client to carry out an initial transaction; or

(b) reaching an understanding (whether binding or not) with the client that it may carry out future transactions.

*** JMLSG 4.26. Regulation 4(3) requires that satisfactory identification evidence must be obtained as soon as is reasonably practical after contact is first made between the firm and the applicant for business and where satisfactory evidence of identity is not obtained, the business relationship or one-off transaction must not proceed any further.**

JMLSG 4.29. "transaction" includes the giving of advice. Advice is not, however, intended to apply to the provision of information about the availability of products or services or to apply to a first interview/ discussion prior to a relationship being established.

* Joint Money Laundering Steering Group (JMLSG) / FSA Money Laundering Sourcebook (ML)

Interpretation of the above rules

Following a conversation with the JMLSG, we suggest that firms need to obtain evidence soon after issuing terms of business. This is because the **business relationship** usually commences at this point. If someone is 'shopping around' and are likely to see a number of people before making a decision then practically **the JMSG accept** it is difficult to get any type of evidence at this stage. On our rounds, ATEB is finding that evidence is being obtained at the time the application is completed and in many cases after this.

A number of firms have also pointed out that if a transaction is taking time to complete then the evidence that was used could become out of date. For example, a utility bill is dated May 2004 but the transaction does not complete until 4 months from now. It is important to remember that money-laundering evidence is a 'snap shot' at that point in time. Therefore, if the relevant person appointed by the firm obtains and documents evidence in line with the firm's procedures and this is dated in May 2004 then that's it. Although you may wish to check with the product provider in advance, because they have a tendency to 'rewrite' the rules to cater for their own needs!

ATEB view:

If you need to change your systems slightly by sending a pre appointment letter requesting evidence in advance then this may need some consideration. ATEB accept that there are practical difficulties for firms changing the way they operate however, we do advise that firms take note as in our opinion it's just a matter of time before we see more themed visits in this area.

Action required by you:

Think carefully about how you obtain evidence at present and consider making a few fine adjustments and make sure that all staff are briefed on the changes. ATEB can support you in this process if you so wish.

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7. An Introduction to Integrated Reporting

This impacts on Mortgage Brokers, General Brokers, IFAs and any other organisations which are caught by FSA regulation.

This year the FSA will begin to implement changes to the way in which they collect data from firms. One of the main changes for regulated firms will be the introduction, from April 2005, of electronic reporting of complaints data for regulated firms and from July 2005 the Integrated Regulatory Return for firms undertaking mortgage lending and administration and retail mediation activities (consulted on in CP197). The FSA expect to collect all firms' returns electronically by 2007.

The Integrated Regulatory Return, which was introduced in CP198, will combine all of the data they request from firms into one return, helping the FSA monitor them more effectively and reducing overall costs.

The reporting timetable will be aligned with a firm's own accounting reference date to allow management information within a business to be used to meet the regulator's requirements. Reporting will be six-monthly for firms with, broadly speaking, income under £5 Million. There

will be a 30-day period to assimilate information for each return similar to that currently under Complaints Reporting.

What intermediaries may find very interesting is that product providers will start to request information regarding which sales were advised upon and which were 'non advised'.

This information will then need to be reported by the provider as part of **their returns!**

ATEB view:

Not sure how the FSA will cope with all the additional information. However, in the longer term if the new system works well it could be less costly and time-consuming than the old approach.

Action required by you:

Start thinking about how you will produce this information in a timely fashion. You may wish to discuss with ATEB as part of your regular visit.

More information: http://www.fsa.gov.uk/mgi/mgi16_newsletter.pdf

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8. Mortgage advice – Do borrowers clearly understand the risks?

A recent report shows that borrowers do not clearly understand the risks they are exposed to which may impact on their ability to sustain home ownership.

Advisers also need to fully understand these risks and be able to give advice or steer clients in the right direction to obtain the necessary advice.

ATEB view:

None, for information only

Action required by you:

ATEB would recommend that mortgage principals and advisers look at the report which can be found on:
http://www.odpm.gov.uk/stellent/groups/odpm_housing/documents/page/odpm_house_028397.hcsp

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9. Holding money as agent – Check your agreements

This article applies to General Insurance Brokers

Where an intermediary has contractual authority to commit an insurer to risk (often referred to as a 'binding authority agreement'), the FSA believe that in most cases a court will recognise the intermediary is holding the insurer's money as agent. So, the FSA rules require that the binding authority agreement must state that the intermediary is to act as the agent of the insurer to receive and hold:

1. Premiums (if the intermediary has authority to commit the insurer to risk);
2. Claims money (if the intermediary has authority to settle claims on behalf of the insurer); and
3. Premium refunds (if the intermediary has authority to refund premiums on behalf of an insurer)

It is feasible that other agency agreements, while not giving an intermediary authority to commit an insurer to risk, may nevertheless result in them holding money as an insurer's agent. So, if the terms of an agency agreement make the intermediary the agent of the insurer to collect and receive premiums, it will result in the intermediary holding premium money as agent. This, in the FSA's view, will transfer risk in relation to the premium to the insurer.

Merely facilitating the introduction of business

Finally, some agreements between an intermediary and an insurer may be general, merely facilitating the introduction of business to an insurer. These types of agreement are unlikely to result in the intermediary holding money as agent of the insurer, though some intermediaries could be mistaken into thinking that they do.

ATEB view:

You need to be sure of your agreements and the limitations.

Action required by you:

If in doubt ask the insurer for clarification. Once you are clear about the legal relationship with the insurers, then you can prepare for any additional client money requirements with effect from January next year.

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10. FSA Application - Firms looking to operate Risk Transfer and Trusts

This article applies to General Insurance Brokers

ATEB and a couple of intermediaries had approached the FSA for clarification relating to Question 53 (treatment of client money) on the FSA application because the answer to the question could be interpreted as a confirmation by the broker firm of adopting **both** trusts and risk transfer.

The FSA have confirmed that firms that will operate a trust and risk transfer from January next year will need to select (e) "Mix of b to d". The FSA has confirmed that in answering (e) the broker firm is confirming it intends using [either a statutory trust or non statutory trust or both] combined with risk transfer.

ATEB view:

None, for information only

Action required by you:

Check your provider agreements to confirm if your firm will operate under 'risk transfer' and make sure that you have selected the right option.

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11. Extract from Speech by Sarah Wilson Director, High Street Firms

Preparing for general insurance regulation BIBA Conference 20 May 2004

"It is increasingly the FSA's view that the general insurance market has a great deal to do to sort out its documentation of transactions. This is necessary so that firms (intermediaries and insurers) understand their obligations, and so that clients understand the basis on which insurance is offered and/or their funds are held. ***It seems to us that there is often at present an inappropriate degree of reliance on unwritten or implied terms and arrangements"***

"..... the client money rules include ***various requirements for notification, informed consent or agreement in writing*** from clients. The issuance of a terms of business agreement may be an acceptable means of meeting those requirements. There are two notable examples:

1. a requirement that a firm takes reasonable steps to ensure that its terms of business or other client agreements ***adequately explain***, and obtain the ***client's informed consent*** to, the firm holding client money in a non-statutory trust; and
2. a requirement to ensure that any ***retail customers whose client money may be invested are made aware of this*** (whether through terms of business, client agreements or otherwise in writing) and are given an opportunity to give their informed consent."

ATEB view:

Clearly, from this speech the FSA believe that there are still considerable gaps, which firms need to bridge before authorisation. Firms need to think about how they explain and communicate issues to clients and, if something is misleading or unclear, then the firm makes every effort to remedy this otherwise they may well be breaking FSA specific rules or falling outside the FSA broader principles.

Don't forget, there is only one group of people which the FSA will hold responsible for any breaches and they are senior managers / business owners.

Action required by you:

Identify any shortfalls in documentation against the new rules and make corrective action.

Then ensure that your staff are trained and aware of the changes.

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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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