

ATEB consulting Newsletter 28 - August 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	11	12	13
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	11	12	13
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	11	12	13
Director/Partner		✓	✓	✓		✓							✓
Compliance / A&O Function	✓			✓		✓			✓				✓
Sales Advisor													
T&C Supervisor													
Back Office													

*Includes Mortgage arms of IFA and APF firms

1. Commission payments and inducements which firms must disclose in the KFI

We have received a number of queries on payment disclosures to clients post "mortgage day".

Currently, the MCCB is explicit in the approach which firms should adopt. Referring to the MCCB, good practice notes, page 9 A5 Fee & Benefit disclosure and page 19 (i) Confirming Fees and charges. Quote:

"You should identify the separate components of all fees and charges....separate fees should not be combined in one total i.e. a valuation fee that includes an administration fee must have the administration fee split out and detailed separately"

The FSA guidance is far more comprehensive. Why say something in 30 pages when you can say it in 500 pages!!

From "Mortgage Day" disclosure will be made via the KFI. Two main parts for disclosing payments being Section 8: 'What fees must you pay?' [Includes administration, application, arrangement, solicitor, valuation fees, etc] & Section 13: 'Using a mortgage intermediary' [includes total amount payable by the lender to the mortgage intermediary and any third parties and includes fees paid, directly or indirectly, to regulated or unregulated firms]

Bundled valuation fees from 'selected' surveyors

Some firms receive a cheque for a valuation for £X, but they have negotiated a discount on the valuation so they pay the surveyor £X minus an "administration charge". All fees should be disclosed under section 8. If, post "Mortgage day," the firm decides to receive the "valuation discount" discreetly from the surveyor, then in ATEBs view this would be a potential inducement and should be disclosed.

Mortgage Packaging Fees Disclosure - MCOB 5.6.117

All fees payable by the lender should be disclosed under section 13, the FSA have made it clear in ps186 page 17 that firms should not set up separate entities to 'evade' the need to disclose.

MCOB 2.3 Inducements - 2.3.1 G Principles 1 and 6 require a firm to conduct its business with integrity, to pay due regard to the interests of its customers and to treat them fairly.

ATEB view:

The purpose of MCOB 2.3 is to ensure that a firm which carries on regulated mortgage activities does not conduct business under arrangements which might give rise to a conflict with its duty to customers. If in doubt, particularly where a conflict could exist, **you should disclose.**

Action required by you:

Firm principals should be thinking about how they aim to ensure that the KFI which the firm adopts is sufficiently comprehensive to cover all the requirements including that there is full and frank commission and fee disclosure.

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2. Withdrawing commission from the client account

We have been receiving a number of questions on when Client money can be withdrawn from the trust bank account

Before commission can be withdrawn from the client account

- The client must have paid the premium to the intermediary ['received' basis]
- Commission must be 'due and payable' to the intermediary firm for its own account.

'Due and payable' - The terms of business of the insurer to whom the premium is to be paid will usually set out when the commission element of the premium will become 'due and payable' For example it may state that commission will be 'due and payable' immediately on receipt of the premium from the customer or after, say, 30 days.

Other Issues:

- Before commission becomes 'due and payable', it will remain client money
- Withdrawal of commission must correspond to the terms of business of the insurer to whom the premium is payable.

- Where the insurers terms do not specify, Brokers may assume that commission will become immediately 'due and payable' on receipt of the premium from the customer
- Where commission is 'due and payable' immediately, then the premium must be treated as a mixed remittance (i.e. part client money and part other money). The commission element of the premium must then be paid out of the client bank account as soon as reasonably practicable and, in any event, within 25 business days of the payment clearing the client bank account.
- Where commission becomes 'due and payable' some time after receipt of the premium from the customer, it must be identified as commission to be paid out of the client bank account at the point the regular client account calculation is undertaken

ATEB view:

None, for information only

Action required by you:

Your own terms of business with your clients should of course be clear on these aspects.

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3. Interest bearing accounts – Can you retain the interest?

It is not uncommon for some firms to temporarily accumulate sizeable amounts of client's money (for example amounts due to be paid to the Insurer). The current practice is quite often to place this in an interest bearing account and retain the interest. Under the FSA regime, in relation to retail customers, a firm must take **reasonable steps** to ensure that its terms of business adequately explains and, where necessary, obtain a client's informed consent to, the treatment of interest derived from it's holding of client money. If no interest is paid to the retail customer then this should be identified in the terms of business.

However, where the firm reasonably believes that the amount of interest earned will be £20 or less per transaction in relation to insurance mediation activities carried on with a retail customer the firm does not need to include any explanation.

ATEB view:

None, for information only

Action required by you:

None, for information only

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4. Annual Reviews: Maintaining Competence - A Reminder

The types of review will range from a basic appraisal to a more detailed assessment of skills and knowledge under examination conditions. The review is an excellent opportunity for the firm to check that its staff are meeting the requirements which their respective roles demand. The FSA gives firms flexibility in their approach. There are key FSA T&C rules which apply, in particular to 'Investment Advisers', and need to be considered, for example: TC 2.6.1 R A firm must have appropriate arrangements in place to ensure that an employee who has been assessed as competent to engage in or oversee an activity maintains competence.

Other FSA guidance is more general, for example the second and fourth commitments state that authorised firms should ensure that: 'Its employees remain competent for the work they do and Its employees' competence is regularly reviewed'. The Fit and Proper Sourcebook also explains that approved persons competence is maintained and a review would help satisfy the requirement.

ATEB view:

It's interesting that the FSA ask about this in their circulation of T&C questionnaires. If we are being honest it's not an area that is particularly well documented within IFA firms.

Action required by you:

ATEB recommend an annual review for all advisers and key compliance positions, we have proformas to help [Section 5 Compliance Manual - Phase 5], please speak with your local ATEB consultant or contact steve@ATEBconsulting.co.uk if you would like assistance or further information.

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5. Advising on Non Regulated Contracts? - UCITS, Hedge Funds, Film

partnerships etc

Section This article applies to IFAs and authorised professional firms which advise and arrange non-regulated products such as UCITS, Hedge Funds, Film Partnerships and Property Investments etc.

You may wish to consider the following:

- Has your firm met the requirements of section 238 of the Act (Restrictions on promotion)? **An authorised person must not communicate an invitation or inducement to participate in an unregulated collective investment scheme**
- If you are relying on a particular exemption is this documented?
- Does the firm restrict promotion to only a select type /profile of client?
- If “yes” to the above – how well have you established and documented this?
- Have all the relevant risk warnings been issued to clients?
- Have you applied “know your customer” and “suitability” principals as part of normal best practice?
- Hedge funds (for example) come in different guises – does the firm have the right investment types under its scopes of permission to advise on the product?
- As above – does the investment adviser have the “appropriate” qualification? – Either way, it may seem unsuitable to rely on the Financial Planning Certificate.
- Does the adviser have documented and relevant CPD in this area prior to giving the advice?
- Does the firm have a written policy in this area and has the intended advice been researched thoroughly?
- In larger firms if only a couple of advisers are working in this area, how do you monitor and control accuracy and consistency?
- Have firm principals had the opportunity to check the advice?

Finally, don't forget that if a private client were to complain re some advice they received on a 'non-regulated' contract, i.e. a hedge fund whereby advice was given by an FSA authorised adviser and through an FSA authorised company, the client has potential access to the FOS. The client can complain and the Ombudsman will have jurisdiction to consider the complaint. Jurisdiction is determined by **status of firm being regulated** and **not the product** being regulated. In other words, the Financial Ombudsman considers actions of the regulated firm and its advice and not necessarily it being a regulated product.

ATEB view:

The simple answer to the above is those three words “Systems and Controls”.

Based on the various FSA consultations and discussion papers [Property Investments, Hedge funds, Collective investment schemes, etc] we are confident that the restrictions on the promotion of unregulated schemes will be relaxed and the FSA appears to appreciate that, for certain types of clients, these 'non-mainstream' schemes can be an important part of a client's portfolio. However, we would warn firms not to 'jump the gun'. The rules which exist currently tell us that we need to very be careful to follow a strict process and select only the right profile of client to receive your advice in this area.

Action required by you:

This will depend on how you have answered the questions above.

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6. FOS dismiss case without considering its merits – Humorous

Under FOS rules, in certain circumstances, the ombudsman service can decline to consider some types of complaint. The following illustrates a real situation (published in Ombudsman News) where FOS decided to dismiss a case without considering its merits [thank God!!]

Background:

A client complained to FOS about the firm which provided his personal pension. He said he was unhappy about the firm's practice of rounding figures to four decimal points (for prices) and to three decimal points (for units) when it provided information about its pension fund.

When the firm refused to uphold his complaint, the client referred to FOS. He said he had carried out his own calculations and considered that, as a result of the firm's 'rounding', he had **lost approximately one third of a penny** on a transfer from one fund to another. The client pointed out that, over time, his loss would grow.

FOS told the client that it would not be appropriate or proportionate for them to look into his complaint, in view of the tiny sum of money in dispute.

7. Complaints - Increase your chances of success with the FOS

Although there has been an increase in the number of complaints received by IFAs, notably about mortgage endowments, splits and high-income bonds, numbers are still very low compared with direct sales. It is also reassuring to know that with regard to mortgage endowment complaints, less than 10% of complaints dealt with by FOS are against IFA firms and of those that go to adjudication, 80% are not upheld i.e. FOS agree with the IFA firm. It is also worth noting that only 400 IFA firms out of over 4,000 had more than two ombudsman cases last year.

ATEB have said for some time now that a well presented case to FOS will increase the chances of a successful outcome. We understand from sources that this is indeed the case. We also understand that firms can make matters worse simply because of their approach to handling the complaint. For example, where a firm knows that a client is lying about their complaint and the IFA firm simply refuses to investigate it.

ATEB view:

Because most IFAs have little experience in dealing with complaints it is easy to be caught out. If you do not treat the client fairly in your investigation or do not follow a structure, you are leaving yourself open and certainly creating the wrong impression.

Action required by you:

It may be useful to refer again to ATEB practice Bulletin 14 published in January 2003 in which we detailed notes to assist giving yourselves the best chance of a successful outcome to any complaint, whether internal or referred to FOS.

8. VAT treatment of services by Financial Advisers

This article is aimed at IFAs and Professional firms charging fees to their clients. Please do not interpret this article as ATEB providing advice on VAT, we are simply attempting to highlight an area that you should consider carefully. It is you, however, who must decide the most appropriate action for your firm.

Many more IFAs are charging fees than ever before, however the understanding of how VAT should be charged appears to be contradictory and confusing. In fairness to the HM C&E, they have produced an information sheet (See link below) which states clearly "the value of your supply for VAT purposes will be the amount charged to your customer".

Therefore, following this guidance. If you offset the bulk of your fee by commission, it's the balance (Fee less the commission) which will be 'charged to the customer'. ATEB suspects that where Firms are agreeing **commission offset** with the customer then it will be the lower amount (the difference) that is chargeable.

HM C&E also talk about a 'predominant service', which seems to suggest that where a firm is charging flat fee for a 'holistic (comprehensive) advice service' and minimal arranging of policies takes place, then VAT could be charged on the whole service.

ATEB view:

Getting this wrong due to HM C&E lack of clarity will not affect anyone except the advising firm, it's a hassle, but you must understand and apply the correct procedure based on how your individual firm operates.

Action required by you:

We recommend that firms take individual professional guidance on this and / or telephone the National Advice Service on 0845 010 9000.

Other issues you may wish to clarify and consider are:

- Under commission offset, how much should you invoice the client for – is it the balance or the full fee amount?
- If you charge the full fee amount, and commission is used to offset this, is the commission deemed taxable as income of the client?
- Are there benefits of having separate terms of business agreements, one for 'holistic advice' and one for 'arranging'?
- If you are VAT registered are you entitled to reclaim all (or only some) VAT on your business expenses?

More Information is available at:

- VAT Information Sheet 02/2003
<http://www.hmce.gov.uk/forms/graphics/info0203.pdf>
- Notice 701/49 & 701/36
<http://www.hmce.gov.uk/forms/catalogue/catalogue.htm#700>
- 700 chapter 32
<http://www.hmce.gov.uk/forms/graphics/700-p192-238.pdf>

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9. Mortgage Sales & Financial Promotions (including cold-calling)

The FSA has the view that cold calling can expose consumers to high pressure sales tactics, which mean that they end up with an inappropriate or over-expensive product (or service). The financial promotion rules, therefore, ban unsolicited real-time promotions (cold calling) unless there is a **pre-existing customer relationship** through which the consumer expects to receive such promotions.

FSA rules will allow firms to continue to use legitimate lead generation techniques, such as consumer questionnaires, providing consumers clearly understand how their data is being used and consent to being approached by the mortgage firm.

Under the FSA new mortgage regime (see MCOB 3.7.1R and 3.7.3R), real time qualifying credit promotions (in layman terms this means marketing of a mortgage product) can take one of two forms: 'solicited' or 'unsolicited'.

Unsolicited: if unsolicited, a firm can't make the promotion unless the consumer has an **established existing customer relationship** with the firm, such that the consumer envisages receiving unsolicited qualifying credit promotions. Broadly speaking, an existing customer relationship is one that is maintained over a long period. A firm that has helped a consumer in the past, for example, a broker who arranged a mortgage for a consumer once several years ago, is unlikely to have a relationship with the consumer which is maintained beyond the conclusion of the mortgage. In these circumstances, it will be difficult for the firm to show there is an established existing customer relationship. Regularity of contact will also be an important factor in determining if there is an existing established customer relationship in place.

Solicited: to be considered a solicited real time promotion, the call, visit or other interactive dialogue must take place only where it is either initiated by the consumer, or in response to an **express request** from the consumer. Broadly speaking to satisfy the definition of 'express request' the consumer must positively opt-in and it must be definitely and specifically stated. Express consent is normally associated with a signature although this is not mandatory. The consumer must be aware that their agreement will result in a call or visit from a firm to discuss qualifying credit, and know which firm is likely to call or visit. The express consent must be clear and it cannot be discreetly hidden in small print. There are time limits on express consent and firms should remember that issuing terms of business on a regular basis is not only good practice but will also help renew consents.

ATEB view:

Customer consents are very important. For Firms looking to develop long-term value, as part of their planning, they should consider obtaining consents today for use tomorrow. Important FSA and Data Protection rules amongst others can be easily breached leaving the firm vulnerable to censorship.

Action required by you:

Work with ATEB [and your legal advisers] to incorporate the correct consents into your terms of business. You also need to be certain that where leads have been provided for you by third

party organisations (e.g. lead introduction companies) then these have been obtained correctly and that you are not breaching any guidelines. Remember, as a regulated firm **you will be responsible** for ensuring compliance and not the introducing firm.

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10. Is your description of your clients' risk profile wooden?

ATEB are still finding that this area is not recorded well. Some firms are still using basic 1 to 10 or generic headings to describe and categorise customers. We feel that some of these descriptions included in suitability letters are still rather wooden.

Ask yourself the following questions:

- Do you always include your client's own words in any description of their risk profile in any suitability letter?
- Do you refer to evidence of their existing knowledge of investments to help demonstrate an understanding of risk?
- Do you differentiate the clients risk profile before and after the advice?
- Do you differentiate the clients risk profile for different areas of financial advice?
- Where the clients risk profile does not appear to match their financial circumstances do you point this out clearly?
- Where a client recommendation includes higher risk investments contained within a medium to low risk portfolio, do you ensure that the risks are adequately explained?
- Does all your risk terminology match up in all documents such as fact find, suitability letter, risk profiler, sales aids, etc?

ATEB view:

Getting this documented correctly is probably the single most important part of the overall process; you cannot afford to have gaps in your paperwork in this area. We still suggest that you need to summarise [relating specifically to the client's own words] why a particular risk profile applies. We would not suggest that you rely solely on the profiling and modelling tools which are widely available.

Action required by you:

You should be answering 'Yes' to these questions. If you are not, then we would suggest that you revisit your systems and processes.

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11. Charging clients who make a complaint

In general, the FSA is not comfortable with IFAs charging clients who make complaints, or adding clauses to this effect in their terms of business.

However, they do recognise that **frivolous or vexatious** complaints may raise unnecessary administrative burdens for both firms and the FOS alike. In these circumstances, the FSA believes it would be legitimate for firms, through their terms of business, to seek to reclaim costs and expenses reasonably incurred by the firm as a result of defending these complaints through the FOS. The question of what is frivolous or vexatious would need to be determined on a case-by-case basis. If the FOS dismissed a case during its initial review under rule 3.3.1 (2) of the FSA Dispute Resolution, then this could be seen as the first step in the complaint being regarded as frivolous or vexatious.

ATEB view:

ATEB cannot see any obvious reason why firms could not add a general warning in their "Complaints Procedure" sent out to clients who make a complaint and / or adapt their terms of business to refer to **frivolous or vexatious** complaints. We would recommend that firms take legal guidance on this area.

Action required by you:

There is a useful article in the Small Businesses part of the FSA website which can be found on

http://www.fsa.gov.uk/ifas/keeping_you_informed/complaints.html

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12. Thinking about purchasing Computer Hardware?

Are you considering purchasing new computer hardware in the near future?

If your answer to the above question is yes, you should consider talking to ATEB before going ahead with any purchasing. We are now able to offer significant discounts on new computer hardware including desktops, laptops, servers and networking peripherals.

ATEB view:

None, for information only

Action required by you:

Talk to ATEB IT Solutions first.

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13. Increase in FSCS Levy / PASS subsidies

As many smaller firms are now painfully aware, the FSCS levy rocketed this year. The increase was due mainly to an increase in claims relating to mortgage endowment complaints, precipice bonds, split capital trusts and the closure of a number of larger advisory firms. PASS subsidies are now available: The subsidy scheme operated by Pass Fees Ltd on behalf of IFA product providers is offering subsidies of 15% of FSCS fees to eligible firms. Subsidies of 8% are also available on FSA fees.

ATEB view:

I think its fair to say many firms were frustrated by the lack of any prior warning regarding the increases. The subsidies are not the answer to the growing problem of how the compensation scheme is funded although at present they are a welcome relief.

Action required by you:

The website link is www.pass-fees.com/home/home.asp

Details of how to claim can be found here. Deadline for completed subsidy forms is **29th October 2004**

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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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