

ATEB consulting Newsletter 41 - January 2007

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:

	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													

1. FSA taped an adviser interview without their prior knowledge

A couple of clients were recently part of the TCF themed project. One visit came as a result of a pre-arranged one hour long telephone questionnaire on the firm's TCF systems and the other as a result of a mystery shop.

However, it was not the usual telephone mystery shopper who generally stands out like a sore thumb! The FSA had recruited individuals to personally visit a selection of firms and go through the whole face-to-face advice process with an adviser. **The sting in the tale is that the "client" was using a concealed device and taped the conversations with the adviser!** This was completely unbeknown to the adviser and formed part of the themed TCF project and did not concern any enforcement issues. There were no other indicators to warrant this technique.

However, there was one final twist in the tale; the mystery shopper visited three other firms before transacting a **very sizeable amount of business** with the firm.

ATEB view:

It is a classic example of taking a sledgehammer to crack a nut. It may be understandable in cases in which there are indicators of improper conduct within the firm, but not for routine project work.

Although it is permitted within the Supervision rules, the FSA is supposed to follow guidance from the Market Research Society. However, it's impossible to know if they followed the code of practice because the FSA will not disclose any details of the client meeting, how the mystery shopping was conducted or provide a copy to the person recorded.

Action required by you:

Be alert to mystery shoppers and ensure that your field sales process is compliant

When was the last time your supervisor conducted an accompanied call?

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

2. Practical Feedback from TCF visits

As you will appreciate, the feedback our clients get from FSA visits is like gold dust to us, and we feel it is extremely important to listen and learn as well as to challenge and question. Key pointers are:

- Ensure that you have undertaken a gap analysis of TCF throughout all aspects of the

firm and its sales process. Most operations affect the customer directly or indirectly, e.g. remuneration, conflicts of interest, T&C and recruitment of quality advisers, advertising, how you communicate by telephone and letter, complaints handling, etc. You need to examine your own practices, identify where you could improve, document and prioritise your action points and **complete the actions by the end of March 2007**.

- How are (investment & mortgage) fees and charges described to the customer? Do all clients genuinely have the opportunity to pay by fee? Do you advise the cheapest way to pay? Is there consistency in the firm?
- Remuneration – is method of pay / bonuses fair and how is it tied to sales volumes? Do you have robust KPIs to identify commission bias? Does your system link reward to compliance standards within the firm?
- Systems and controls - are the right personnel in the controlled functions positions? Are supervisors maintaining skills and knowledge? Is the T&C scheme operating effectively and are all advisers maintaining competence?
- File checks - is the firm overseeing the business quality through file checks on a regularly basis? What system is in place for identifying files checked, reporting issues, identifying trends and rectifying problems? Are you proactive or reactive?
- Know your customer - does the client file contain sufficiently detailed client information to be able to stand up to scrutiny on its own without any verbal input from the adviser?
- Attitude to risk - do you undertake a detailed profile of the client's attitude to risk? The FSA want to see a full risk profile for each product type and each individual client. A circled number on a scale is not sufficient. They want to see consistency among advisers and a common understanding of the product types or asset splits which would typically feature in a portfolio for each client type.
- Research, do you have sufficient back-up to show why the provider / product was selected as suitable? Is there consistency amongst all advisers in the firm?
- Suitability letters – does each client receive a timely, accurate and clear suitability letter for all recommendations and do you go through the letter with each client?
- T&C – do you have a robust process which identifies and documents training needs, personal development plans and training undertaken to meet the needs identified? Can all advisers produce accurate records of training undertaken? Are recruitment checks and a training programme in place for trainees?
- KPIs - do you have an early warning system of regular management information?

ATEB view:

This is by no means an exhaustive list! At the end of the day, this is all about offering the best possible quality service to the customer which should result in a profitable business model for the firm. The FSA sets out TCF visits as being principle based, however, they are still very 'rules based' in our view. They identify rule breaches without quoting the rule applicable – work that one out!?

Action required by you:

You should take action now and gain comfort that you have the best possible control over your business. The old adage is true – if you fail to plan, you plan to fail.

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

3. FSA Phone Survey - (TCF)

Many ATEB firms have been contacted by the FSA as part of its ongoing random review of the progress being made by regulated firms in terms of implementing TCF. The TCF Distance Compliance Survey consists of an informal telephone interview lasting about 40 minutes.

Among other issues, the interviews have covered the following topics:

- Systems and controls
- Clarity of customer documentation
- Competence of directors and proprietors

Firms which have participated in the interview have been advised that the FSA will contact them again early in 2007 to discuss the information which has been provided.

Following the survey, the FSA has asked specifically a handful of firms including two firms that use ATEB's services to support them in a TCF initiative in Edinburgh. The initiative is aimed at developing a range of new tools to help Financial Adviser firms improve practices in three key areas ultimately leading to improvements in the quality of advice provided to customers. **We will keep you posted of developments.**

ATEB view:

None - for information only

Action required by you:

As well as the TCF review that we have completed for firms on our rounds, the following links will be useful to help keep you occupied!

If firms have any concerns about the way in which their firm is implementing TCF please contact ATEB.

Cluster Reports:

Investments

<http://www.fsa.gov.uk/pages/Doing/Regulated/tcf/pdf/advice.pdf>
Fact sheet: http://www.fsa.gov.uk/pubs/other/factsheet_advice.pdf

Mortgages

<http://www.fsa.gov.uk/pages/Doing/Regulated/tcf/pdf/mortgages.pdf>

Insurance

<http://www.fsa.gov.uk/pages/Doing/Regulated/tcf/pdf/insurance.pdf>

Various:

TCF FAQ: <http://www.fsa.gov.uk/Pages/Doing/Regulated/tcf/faqs/index.shtml>

TCF Self Assessment Tool:

http://www.fsa.gov.uk/pages/Doing/small_firms/general/docs/tcf_tool.pdf

TCF what it means for small firms: http://www.fsa.gov.uk/pubs/other/tcf_smallfirms.pdf

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

4. RMAR & Notification of changes in share ownership

One of our clients received an awful letter from the FSA which was heavy handed extremely unclear, unfair and misleading! Here is the story in brief:

- The firm is asked question under section F RMAR: 'have there been changes to your controllers or to the percentage of shares or voting power in the firm held by any of them since the FSA was last informed?'
- The firm answers "Yes" (due to a 4% change) and submits return
- The firm receives a letter from FSA quoting ".....Failure to notify the FSA is a **criminal offence** under section 191(1) of the FSMA ..."

This was rather worrying because the firm had asked ATEB (and the FSA helpdesk) whether a 4% change in shares of a controller was a notifiable event. We quoted SUP 11 and in particular SUP 11.4.2 explaining the various limits at 10, 20, 33 & 50%, etc. Because the firm did not go through these barriers and the fact that we could not see how this was 'material', we decided there was no need to notify.

I therefore sent a tongue in cheek letter to the FSA and extracts from the FSA reply are shown below:

*Thank you for your email dated 29/01/2007 in response to our concerns about your firm's RMAR. **May I take this opportunity to apologise** and advise you that a 4% change of control was not enough to warrant a notification as you have correctly pointed out. In Section F for Controllers you were advised to answer 'Yes' to the following question: 'have there been changes to your controllers or to the percentage of shares or voting power in the firm held by any of them since the FSA was last informed? This was inaccurate and you should have been advised to answered "No".*

ATEB view:

Well, it is very difficult to have a view where the FSA are involved, you just do as you are told!

Action required by you:

This reply means that you should be careful when answering section F if there has been a change which is not notifiable. Either way, we would recommend dropping them an e-mail if you have a change in, say, share ownership even if it is not strictly notifiable.

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

5. Passporting – Advising and arranging outside of the UK

Passporting rights arise under the FSMA single market directives, which include the:

- **Investment Services Directive (ISD)***
Applies to ISD investment firms (excludes majority of IFA firms) transacting collective investments such as unit trusts and OEICs in another EEA state.
- **Insurance Mediation Directive (IMD)**
Applies to intermediaries that transact contracts of insurance including general insurance, pure protection policies and long-term insurance contracts (such as pensions, bonds, endowments and annuities) in another EEA state.

*MiFiD – the Markets in Financial Instruments Directive – comes into effect on 1 November 2007, when it will replace the existing ISD. IFA firms that opt for passporting will be able to make use of it to give investment advice (in another EEA state) in relation to one or more of the MiFiD financial instruments such as unit trusts and OEICs. However, a MiFiD firm (that was previously an IFA B3 firm) that opts for a passport will be subject to higher capital requirements than its Non-MiFiD counterpart. Broadly this would equate to holding an additional 25,000 euros.

Full activities which are 'passportable' are set out in the relevant single market directives. Passporting rights only apply within the EEA. So, for example, they do not apply in the Channel Islands or the Isle of Man, as these are not EEA States. Activities which are not covered by the single market directives are not passportable and a firm would need to seek direct authorisation from the host EEA State for such activities.

Whether a firm transacting business in another EEA state requires passporting depends on the type of activity. 'Arranging' is usually considered to take place in the location where the arranging takes place; 'advising' is generally considered to take place where the advice is received (usually where the customer is located). PERG 5.12.8G has more information. So, for example, an intermediary giving advice on private medical expenses to a customer based in say France, could trigger an application for passporting.

It's worth noting that Appointed Representatives also have passporting rights via their Principal. The Principal should submit a passporting notification to the FSA on the AR's behalf if required.

ATEB view:

None - for information only

Action required by you:

If you feel that you require this facility then firms should notify the FSA by completing a standard form of notice of intention, which is available from the Passport Notifications Unit (020 7066 1000) or <http://www.fsa.gov.uk/Pages/Doing/Regulated/Notify/apply/faqs/index.shtml> on the FSA website. There is no fee for making an application to passport. Changes to existing passporting details must be notified to the Passport Notification Unit in writing. Guidance is given in SUP 13.

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

6. Claims Management Firms regulated from April 2007

The Government has passed the Compensation Act, which will regulate companies and individuals which provide claims management services. The Department for Constitutional Affairs will be the regulator.

From 6 April 2007, it will be an offence to provide claims management services without authorisation or exemption. Businesses have been able to apply for authorisation from November 2006 and, once authorised, will have to comply with a strict code of conduct covering:

- Advertising and marketing
- Taking on business
- Representing a client
- Handling client money
- Handling complaints

The legislation, inter alia, covers claims in respect of financial products.

ATEB view:

We welcome this move.

Action required by you:

Firms may wish to familiarise themselves with the guidance so as to detect rogue ambulance

chasers. You can get further information on the website of the Department for Constitutional Affairs. <http://www.dca.gov.uk/>

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

7. Data Protection - Interactive Training DVD

Following the recent media coverage of identity theft and the dumping of customers' personal information by banks, the Information Commissioner's Office has launched 'The lights are on...'. This new interactive training DVD is being released to improve understanding of the Data Protection Act in the work place and ensure individuals' personal information is effectively protected.

The DVD highlights a few common mistakes and the eight principles of good data protection practice to encourage better compliance with the Act. It explains the problems that can arise for individuals when their personal information is wrongly disclosed to a third party.

ATEB view:

ATEB would recommend that all members of staff receive training on Data Protection. Both they and the firm are open to prosecution.

Action required by you:

To request a free copy visit www.ico.gov.uk and use the site navigation to visit "Request Publications" ordering "ICO The Lights are On" or call 08453 091091.

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

8. FSA making changes to Section E of the RMAR

The FSA Board made rules in April 2006 that changed some of the questions they ask IFAs, insurance mediation firms and mortgage mediation firms for reporting data on professional indemnity insurance. These changes will come into effect on 29th January and will be available on Firms Online from 5 February.

ATEB view:

None - for information only

Action required by you:

None - but please speak to ATEB if you are unsure.

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

9. Client Money web-based training

The course should help firms understand the client money section of the FSA Handbook for general insurance intermediaries (CASS 5).

ATEB view:

This training complements the printed Guide to Client Money for General Insurance Intermediaries and at £20 we would recommend it.

Action required by you:

There is a link to the course from the FSA Industry training pages at: <http://www.fsa.gov.uk/pages/doing/events/learning>

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

10. Commercial customer commission disclosure - Do you have a formal process?

As a result of research conducted late last year the FSA found the majority of firms include a clause in their TOB which reminds clients of their right to request information about any commission received. However, they found a widespread lack of formal process among intermediaries as to what remuneration would be disclosed to a commercial client on request, with not all intermediaries including ALL forms of remuneration. Only a few intermediaries have made consequential changes to their systems and controls to comply with the relevant Insurance Conduct of Business Rule (ICOB) rule.

Such a failure to disclose fully when asked by a commercial customer would be a breach of ICOB 4.6.1R.

More information is available at:

http://www.fsa.gov.uk/pubs/ceo/commission_disclosure.pdf

ATEB view:

This will only affect a small part of the market because most commercial clients do not request commission figures. The FSA has clearly got the bit between their teeth here, so we think firms should take a mature approach whether they agree or disagree.

Action required by you:

Senior Management should establish and maintain procedures to ensure that the firm has the systems capacity and controls to respond to a commercial client's request for information about any commission received. ***ATEB have produced a proforma that can be used by firms to disclose in line with the FSA rules.*** We also have a clause that can be inserted into TOB reminding customers of their rights regarding commission disclosure. If you would like a copy please let us know.

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

11. Contract Certainty - Market failure has been fixed by the industry

The Financial Services Authority (FSA) has announced that the insurance industry has met the challenge laid down to achieve a solution to contract certainty in the UK.

The FSA's decision follows a meeting with insurance industry leaders in which the industry reported that 90% of contracts in the subscription market and 88% in the non-subscription market are now achieving contract certainty.

This change has resulted from a market-based solution where the FSA uses their influence to effect change rather than their formal powers. As such, a market failure has been generally fixed by the industry without a single new rule being introduced.

ATEB view:

Contract certainty will continue to be a supervisory priority in 2007 and the FSA will ask the market to focus its efforts going forward on reducing the number of contracts that do not meet the market's contract certainty standards.

In those cases where it believes that firms have fallen behind the rest of the market it will consider regulatory action to address this.

Action required by you:

Continue to act within the ABI Code and Guidelines. These are available from the ABI website at:

http://www.abi.org.uk/Display/default.asp?Menu_ID=1141&Menu_All=1,946,1141&Child_ID=576

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

12. Non - Statutory Trust Deed

Feedback suggests there is an error in some client's Non-Statutory Trust Deed. This error includes the Deed originally issued by BIBA at one time. Our advice is to check your Deed for this error.

It occurs on the second page, Section 4. There are references to "clause 4.3 below" and "4.2 above". These clauses are actually shown as (c) and (b) respectively.

Therefore Section 4 of the Deed should read as follows:

4) Any *money* (including any *designated investments*) which for the time being is held on the trusts of this Deed is held:

a) for the purposes of and on the terms of (a) paragraphs CASS 5.4 and (so far as applicable as set out below) 5.5 of the Client Assets Sourcebook and (b) the *client money (insurance) distribution rules*;

b) (subject to clause (c) below) for (a) the *clients* (other than *insurance undertakings* when acting as such) for whom that *money* is held according to their respective interests in it, and (b) after all claims in sub-clause (a) have been met, for *clients* which are *insurance undertakings* according to their respective interests in it;

c) on *failure* of the Firm, for the payment of the costs properly attributable to the distribution of the *client money* in accordance with clause (b) above); and

d) after all valid claims and costs under clauses (b) and (c) above have been met, for the Firm itself

ATEB view:

None - for information only

Action required by you:

You should check your Deed and amend it as appropriate and get it re-signed as soon as possible. Take professional guidance as necessary. If you run a Non-Statutory Trust Client Money account and you haven't got a Trust Deed in place, then contact ATEB immediately.

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

13. Key Rules for General Insurance Brokers

This is an FSA publication aimed at helping general insurance brokers understand and comply with the FSA requirements in their day-to-day customer-facing work. These Key Rules are designed for smaller general insurance brokers whose operations and customers are all based in the UK.

The contents cover:

- Principles for business
- Conduct of business rules
- Client money rules
- Complaints handling
- Electronic commerce
- Systems and Controls

ATEB view:

A lot simpler than the main rule book, but still likely to bamboozle the vast majority of you!

Action required by you:

The document is on the FSA website at:
www.fsa.gov.uk/pubs/handbook/keyrules_gi.pdf

[🏠 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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