

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	14	15
Director/Partner	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Compliance / A&O Function	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Sales Advisor									✓				✓	✓	✓
T&C Supervisor	✓	✓							✓				✓	✓	✓
Back Office															
Mortgage Related (M)										M	M	M	M	M	M

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?

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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.

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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

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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.

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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.

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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/>

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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.

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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.

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9. New "Equity Release" exam from 6th April 2007

The current Lifetime Mortgage (LTM) examination will be changed into an "Equity Release" examination from April 2007. Basically the current LTM examination is being "beefed up" to include more information on Home Reversion Schemes (HR). There will also be a 'top up' examination for competent HR advisers as described below.

Advising on LTM currently and no intention of transacting HR business from April 2007

If the firm is not applying to vary permissions, then there is no action needed because the current exams already cover generic alternatives such as HR.

Don't forget that those firms (which will be without the FSA permission to advise on HR from April) can and should continue to consider HR as an alternative at a generic level. This reflects the fact that those advising on LTMs are required under FSA rules to consider whether there are more suitable alternative means of raising the required funding before recommending an LTM.

Those advising on LTM and HR prior to April 2007 who want to advise on FSA regulated HR from April 2007

The following categories will be required to pass a 'top-up' module for HR business only. This must be passed by April 2009, provided that advisers have been assessed as competent to undertake HR business immediately before the start of HR regulation (April 2007).

- 'Grandfathered' on LTM: Those assessed as competent in LTM immediately before 31 October 2004 without the need to pass an appropriate LTM exam; and
- Assessed as competent in LTM: Those who have an appropriate LTM exam and have been assessed as competent.

In the meantime, they will be allowed to continue doing HR business. ***If they have not passed the top-up module by April 2009, they will have to stop HR activities until they have passed the new equity release examination in full.***

New advisers who want to advise on HR and / or LTM from April 2007

Anyone who starts to conduct an HR or LTM activity after April 2007 will have to pass the new equity release examination. The FSA are removing the time limits for exams so advisers will have to be supervised until they pass the exam within a time limit imposed by their employers.

ATEB view:

None - for information only

Action required by you:

Information from exam providers can be found at:

<http://www.cii.co.uk/app/news/default.aspx?endstem=1&id=792> and
http://www.ifslearning.com/qualifications/courses/ceer_topup.cfm

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10. Home Reversion Schemes – Deadline reminder

New rules for the regulation of Home Reversion plans (HRs) and Islamic law-compliant Home Purchase Plans (HPPs) will come into force on 6 April this year.

The FSA started to accept authorisation applications for these new 'home finance' activities from 6 November last year.

If you were undertaking this business on or before 5 November 2006 and you lodge your application with the FSA by **23 March 2007**, you will be eligible for interim authorisation.

ATEB view:

None - for information only

Action required by you:

If this is an area that you are likely to give advice then you should consider submitting an application sooner rather than later.

<http://www.fsa.gov.uk/pages/Doing/How/index.shtml>

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11. Mortgage Client Money

The Financial Services Authority (FSA) has agreed to a concession on the way in which client money rules are applied to procurement fee monies which firms rebate to a client. This concession will affect all independent mortgage advice and will remain in place until the FSA finds a longer term solution.

The problem:

There are a number of examples where firms are technically viewed as holding client money and, therefore, are required, amongst other rules, to meet increased capital adequacy standards:

- An upfront fee is charged and it is agreed that any procurement fees are to be rebated to client;
- The procurement fee will be used to offset a fee paid upfront and, therefore, part of the procurement fee will to be rebated to the client;
- It is agreed that all or part of the procurement fee is to be retained on behalf of a client to offset future fees charged by the firm.

In each of these situations, the FSA could determine that firms are holding client money once the procurement fee had been received. The concession obviates firms from, amongst other

rules, meeting increased capital adequacy standards.

ATEB view:

The MiFiD could impact on this concession so we shall need to watch this space.

Why make something simple when you can make it complicated!

Action required by you:

Check the wording in your TOB and / or fee agreement to make sure that monies are treated as owned by the firm and then refunded to the customer. Further information is available at: http://www.fsa.gov.uk/Pages/Library/Communication/Statements/2006/client_money.shtml

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12. Appointed Representatives (AR) handling valuation and / or surveyors fees

This article mainly impacts on ARs who package mortgages.

If an AR receives a cheque made payable to themselves in respect of a surveyor or valuation fee it will be considered **client money** by the FSA. As such the principal firm would be required to have permission to hold client money.

Where a Principal also has investment permissions, it is not possible to limit client money permission in relation to regulated mortgage activities only. As such the principal firm would now fall within the new MiFID and CRD requirements resulting in a base capital requirement of 125,000 euros.

For clarification (at present) money that is due and payable to an intermediary, for example, and an administration or procuration fee is not considered client money. (See previous article)

ATEB view:

None - for information only.

Action required by you:

So what are the options?

- Continue with current set up in which case the Principal will need to vary their permission to include handling client money and increase capital considerably.
- Stop holding client money and have the fees paid to the respective third party direct i.e. surveyor.
- Re-establish the AR as a directly regulated mortgage & insurance only firm. This will allow the firm to hold the client money permissions, but will be exempt from the additional requirements mentioned above. Also, there are no separate client money segregation rules for mortgage business as there are in other sectors.

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13. Payment Protection Insurance (PPI) – Be Careful!

The FSA have updated their website to include the results /outcomes of the programme of visits on PPI last year.

The key findings are:

- Firms explaining clearly in the sales conversation
- Not being made clear that PPI is optional
- Customers are not being told cost.
- Firms covering key exclusions
- Failing to gather sufficient "Know your Customer" information
- Firms not demonstrating suitability
- Bias towards a single premium policy

ATEB view:

Think about three fundamental areas – File checks, Training and Observations

These should tell you if there is a problem – Do this before the FSA do it for you!

Action required by you:

More information is available at:
www.fsa.gov.uk/pages/Doing/small_firms/insurance/practice/ppi.shtml
www.fsa.gov.uk/pages/Library/Communication/PR/2007/003.shtml

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14. Mortgages – the risk areas

The FSA is on fire on this topic at the moment. You cannot afford to take your eye off the ball and stray into the higher risk areas without adequate systems and controls. Client files must be watertight. **All firms need to look at their own policy, what markets they want to be in and their stance on the hot issues.** In all cases, firms must:

- Ensure all mortgage advisers are appropriately qualified and adequately trained from the outset and ongoing, and control the activities undertaken by trainees.
- Review how you check affordability. A recent FSA audit criticised a firm for allowing the client to 'self certify' that they could afford the product, i.e. a standard line in a suitability letter to the effect that 'you have confirmed that you can afford the payments now and in the future'. It is the clear responsibility of the adviser to make a proper assessment of income and outgoings and conclude if the product is affordable. The FSA do not expect 'war and peace' on every penny spent, but they expect to see budget planners used to identify the key outgoings and result in a realistic figure. All data on file is relevant, so if bank statements show the client is continually overdrawn, then questions need to be answered on affordability. **Don't forget that without affordability, you can't prove suitability.**
- Retain copies of research on file to demonstrate the least expensive option was recommended. In re-mortgage cases, document if penalties are payable on switching lenders.
- For first time buyers, evidence that you have discussed the total financial commitments of home owning and again, show affordability. The disposable income when living at home is largely irrelevant. **The FSA is concerned that advisers are pushing high income multiples, extended mortgage terms and interest only products to first time buyers.**
- For terms extending into retirement, it is not enough for the client to self certify that they will be able to afford it. Consider if they are being realistic about the retirement income.
- **Interest only mortgages are under particular scrutiny.** There needs to be a clearly documented need or customer preference for interest only. The downsides must be clearly explained and documented. FSA is particularly concerned where interest only is done purely for affordability reasons, there is to be no investment vehicle, the customer is counting on property values increasing in order to sell and repay in the future, or the customer states they intend to switch to repayment in a couple of years (but inevitably don't). If you are recommending repayment, but the client declines and wants interest only, document it. You need to show a clear repayment strategy which is suitable for that customer. Consider if there is a realistic possibility of the customer being able to commit sufficient funds into an ISA or pension in the long term to meet their target.
- **Ask the client about their needs and preferences** in relation to the mortgage and document their answers, e.g. whether they prefer to budget etc. FSA stated at an audit that it is not sufficient just to answer "yes" or "no" to the standard preferences questions on the fact find, you must detail why a particular answer was given to help identify which features should be included in the product recommended.

ATEB view:

The FSA are likely to step up the pace in this area – Firms need to be prepared.

Action required by you:

If you feel there are weakness in your systems please speak to ATEB. We have produced an "Interest Only" disclaimer, if you would like a copy please let us know.

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15. Are you arranging Lifetime Mortgages? - Important

During 2006 the FSA carried out further thematic work to check if there had been any improvements since their initial lifetime mortgage work in 2005. Their 2006 work involved a series of visits to firms to assess the quality of advice on lifetime mortgages. They found improvements in some areas, but further changes are needed to improve the quality of advice on lifetime mortgages. The FSA has made a commitment to reassess the advice standards in this market in 2007.

The FSA have produced an excellent document which contains detailed examples of good and poor practice for firms to consider.

FSA findings In summary:

Poor practice

- Firms not considering eligibility for benefits or grants
- Failing to explore the impact of a lifetime mortgage on the client's future options
- Failing to issue the Initial Disclosure Document; and
- Recommending the creation of arbitrary 'rainy day' funds, with no clear rationale

Good practice

- Specialist lifetime mortgage training programmes for advisers
- Compliance checking of cases before final recommendation
- The use of informative client-specific suitability letters and
- Firms using specialist software to assess their client's eligibility for means-tested benefits

The latter are all part of the ATEB recommended lifetime process.

ATEB view:

ATEB are aware of a firm that has been asked by the FSA to review 90 cases since October 2004. This could happen to you if your process is deficient.

You cannot afford to slip up in this area.

Action required by you:

Supervisors should download the attached and brief it to all lifetime staff:

http://www.fsa.gov.uk/pages/Doing/small_firms/mortgage/PDF/lifetime_mortgages.pdf

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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

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