ATEB consulting Newsletter 42 - March 2007

Investment Firms

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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:

	1	2	3	4	5	6	7	8	9	10	11	12	13	14
Directors/Partners	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Compliance / A&O Function	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Money Laundering Officer														
Advisers & Trainees				✓	✓		✓				✓			✓
T&C Supervisor		✓		✓	✓		✓				✓	✓	✓	✓
Pensions Transfer Specialist														
Back Office														
Mortgage Related (M)											M	M	M	M

1. The Financial Services Compensation Scheme (FSCS) to be overhauled

It has been announced that the FSCS will be expanded significantly and its funding radically overhauled. The annual capacity of the scheme will rise from £3.7 billion to £4.4 billion, under new FSA proposals. This is designed to allow the FSCS to cope with ongoing issues such as endowment mis-selling, as well as with future potential claims.

The scheme's funding is to be changed to a 'widening circle' model, where firms will be classified into one of five broad classes of firm – life and pensions, investment, general insurance, deposit or home finance. Each class will then split into two further sub-classes - providers and intermediaries. Under the 'widening circle' model compensation costs arising from a particular 'sub-class' will initially be borne by those firms. However, beyond a certain limit any further costs will be shared among the broader class of firms – both providers and intermediaries.

The changes for contribution groups, thresholds and the cross-subsidy through the wider general retail pool are proposed to come into effect on 1 April 2008. The FSA will consult later this year on proposals for setting the amount each firm will pay. This will be based on a percentage of the income from each contribution group they do business in and will apply from 1 April 2009.

Ateb view:

The proposals appear to be fairer as a firm's contribution will, after a transitional period, be calculated according to its relevant income from its activities and products.

Action required by you:

You can see how the changes will affect your type of firm by looking at the illustrations in Annex 3 of the current consultation paper. These show how current fee groups will be transferred in the proposals, and what the FSCS fees could look like for different firms if compensation needs to be paid.

More information can be found at:

http://www.fsa.gov.uk/pages/library/policy/cp/2007/07_05.shtml

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2. Changes to the T&C Sourcebook

Proposed changes come into force on 1 November 2007 to coincide with changes required by the Markets in Financials Instruments Directive (MiFID).

The focus is on more principle based regulation (MPBR), and being more 'outcome' based. It is aimed at streamlining, but the FSA emphasises it does not mean a relaxation of standards. The FSA's long term aim is to remove the T&C sourcebook altogether and rely on high level principles. There will not be any transitional provisions because it does not apply any new rules. Proposed changes include allowing firms to determine their own requirement for timescales for passing exams. The two year rule is being removed.

Ateb view:

There's nothing very controversial; it is aimed at slimming down the guidance and reinforcing their more principles based approach. We cannot see there being a need for any significant procedural changes for firms on T&C. The exam requirements stay the same as does the need to have an appropriate system to assess skills, knowledge & experience on an ongoing basis.

Action required by you:

We are keeping a watch on this and will provide more details when we can.

More information can be found at:

http://www.fsa.gov.uk/Pages/Library/Policy/CP/2007/07_04.shtml

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3. TCF update – FSA expect six outcomes

To stimulate action by firms that were being slow to appreciate the significance of TCF, the FSA introduced the March 2007 deadline. They said that all firms should be at least in the 'implementing' phase of their TCF work in a substantial part of their business by this date. It's worth noting that the March deadline is not a rule. It is a helpful supervisory tool that the FSA use to maintain focus and momentum.

In a speech given by Sarah Wilson, Director Retail Firms Division, on 19 March 2007, she covers the outcomes the FSA are looking for following a successful TCF initiative;

Six Outcomes:

1. The fair treatment of customers is central to all firms' corporate culture.
2. Products and services marketed are designed to meet the needs of identified consumer groups and are targeted accordingly.
3. Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.
4. Consumer advice is suitable and reflects their needs, priorities and circumstances.
5. Consumers are provided with products which perform as firms have led them to expect and the associated service is both of an acceptable standard and as they have been led

to expect.
6. Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.

Ateb view:

All firms by the end of this month should be well on the way to implementing changes that they have decided for themselves they need to implement in order to comply with the FSA Principles.

Action required by you:

Sarah Wilson's speech can be found at:

http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2007/0319_sw.shtml

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4. FSA fines firm over poor information gathering

The FSA has fined an advisory firm £10,500 for failing to properly monitor the quality of sales within an Appointed Representative firm. It did not record sufficient "Know Your Customer" information to be able to demonstrate suitability. They lacked enough detail on client objectives, attitude to risk and affordability. Suitability letters were also found to be inadequate and there were failings in its T&C scheme. The FSA was concerned that the firm had not heeded its findings from a previous visit and also required the firm to appoint an industry expert to carry out a past business review.

Ateb view:

This again shows the importance of strong fact finding at the outset. It is impossible to show that a recommendation is suitable if you cannot show that you have gathered enough personal information on which to base the advice. Distant memories of client discussions are not enough. It must be well documented. To scrimp in this area is false economy. Not only has this firm got to pay the fine, it has the cost impact on its reputation and of financing a third party review of its business. Interestingly, the FSA's action was for breaches of high level principles, rather than rules. Therefore, for them, the burden of proof could be said to be lower because it has only to prove that the outcomes of the firm's actions are not to the standards it would expect. However, it is a higher hurdle for firms because even if you have technically complied with a rule, the FSA can still find that you have not done enough, not acted in the right way or not treated the customers fairly.

Action required by you:

Ensure that your file checking systems are robust and make changes as necessary.

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5. FSA issue Protection Payment Insurance (PPI) questionnaires

PPI is a generic term that includes, but is not limited to, policies with one or more of the following types of benefits; accident, sickness, unemployment, personal accident and unemployment.

Following on from FSA work during 2006, a number of firms have now received a questionnaire on PPI. The FSA may decide to visit your firm following receipt of the completed questionnaire.

The questionnaire is part of a new phase of work to determine the extent of changes required to the sale of PPI products. The four main elements of the programme involve visits to firms, enforcement action where appropriate, information aimed at consumers, and a review of current FSA rules on PPI.

Ateb view:

Hopefully the FSA work will drive providers to simplify their products and make the ability to claim more realistic. For many firms however, there is a counter argument to the FSA work; We would question whether most high street advisory firms actually advise enough PPI.

Action required by you:

In a nutshell you need to understand the eligibility definitions of ant PPI sale and ensure that the product meets the demands and needs of your client and that you communicate the sale in a compliant and clear manner.

More information is available at:

www.fsa.gov.uk/pages/Doing/small_firms/insurance/practice/ppi.shtml

You may find the following document useful to check your current practices

http://www.fsa.gov.uk/pubs/other/factsheet_extras.pdf

Also if you would like some more background reading (Original OFT report) behind then changes then go to:

http://www.oft.gov.uk/shared_oft/reports/financial_products/oft869.pdf

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6. SIPPS Regulation (Menu will need amendment by 6th April 2007)

With effect from 6 April 2007 the Regulatory Activities Order will be amended to bring the regulation of all personal pension schemes, including SIPPs, within the FSA scope.

IFA firm's already advising and arranging stakeholder and personal pensions will obtain an automatic extension to their existing permission as a result of changes to the Regulated Activities Order, providing they have "stakeholder" listed under their permissions.

From 6th April firms which intend advising on SIPPs or Personal Pensions will need to amend their menu slightly to include an additional wording under table 1 & 2.

Ateb view:

None - for information only

Action required by you:

Where it applies, ATEB will ensure that the changes to your menu are in place for 6th April.

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7. REIT (Real Estate Investment Trust)

Real Estate Investment Trusts were launched on 1 January 2007 as a new tax vehicle for investing in commercial and retail property. REITs are closed-ended investment trusts. Each REIT has to be listed on a recognised stock exchange, meaning that REITs are subject to the FSA's Listing Rules.

Like any other type of tax vehicle, it has its advantages and limitations and is more appropriate for some situations rather than others.

Advisers who wish to be able to recommend REITs are likely to be limited to investment through Investment trust savings schemes, ISAs, Collective investment schemes, Investment platforms and WRAPs.

REITs have operated in the US, Australia and Holland for several decades. So far, about 15 UK companies have converted, including Land Securities and British Land. They make up some three quarters of the sector worth more than £45bn. In general, there are certain tax advantages for investors over other opportunities such as buy-to-let property. In particular, UK REITs have income tax and stamp duty benefits.

Ateb view:

If you are of the opinion that property should form part of a diversified portfolio, then REITs will form part of your 'whole of market' analysis and research.

Action required by you:

Ensure that you fully research REITs and ensure that you understand all the advantages and disadvantages and risks before you recommend them.

More information and fact sheets are available from http://www.reita.org/live

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8. Risk management – Do you remember Pension Mortgages?

We have been involved in a 'pension mortgage' investigation recently and the evidence available to defend the case was very limited. When we examined the historic key features and quotations we discovered they were aimed at providing a pension rather than a mortgage. Whereas endowment sales documents generally contained warnings and specifics relating to the mortgage, pension mortgage documents do not. This particular case was also pre-suitability letter and, therefore, the firm was really struggling to defend the case. The problem is also compounded by the fact that the client is restricted to the tax fee cash which is normally 25% of the overall fund, which means that if the client has remained in a badly performing fund over a prolonged period the shortfall can be quite significant.

Ateb view:

With the growth of the complaints culture - can you afford to wait until these historic cases become complaints? Your paperwork may leave you in a vulnerable position. A sensible alternative may be to identify and pro-actively address the issues before someone else does.

Action required by you:

Start by checking your records to see if you can identify any pension mortgage cases. Conduct reviews with your clients and bring all records and understanding up to date.

It may be worth reviewing other interest only mortgages, such as ISA mortgages, as part of the same exercise. We also recommend that you check with your PI insurers before contacting clients, just to ensure that they do not have any objections.

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9. E-learning: Markets in Financial Instruments Directive (MiFID)

This short course has been designed to give you an overview of the Markets in Financial Instruments Directive (MiFID). This is the first of a suite of e-learning on MiFID that the FSA will be releasing during the course of this year.

This course is designed to explain the context behind the implementation of MiFID and to give a broad overview of the key issues for investment firms. It will be of particular relevance to investments firms, particularly investment banks, securities and derivatives firms, asset managers and smaller firms giving investment advice. It will have limited relevance to those firms undertaking insurance or mortgage activities.

Ateb view:

None - for information only

Action required by you:

For further information go to:
http://www.fsa.gov.uk/pages/Doing/Events/learning/mifid_e.shtml

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10. Mortgage Endowments – Time barring

The FSA has carried out extensive supervisory work – ranging from data collection and visits to monitor firms' performance, to requiring some firms to review past files and, in some cases, taking enforcement action.

Amongst the many leaflets and guidance that they have issued is, more recently, the "Review of firms' approach to time barring mortgage endowment complaints (MECs)"

In this document they explain that in a small number of time barred cases, firms are seeking to time bar complaints on a basis other than the ABI code letters procedures.

Some of these rejections are based on misinterpretations of the time barring rules or rely on unsustainable assumptions.

The FSA are therefore asking firms who have time barred on these bases to re-open relevant cases.

Ateb view:

Given the increasing proportion of complaints that may be time barred over the next year, firms need to ensure that their procedures and approach to time barring are appropriately resourced, accurate and fair.

Action required by you:

Where firms continue to exercise the time bar from a point other than the issuance of a 'red' ABI code letter, specific attention should be given to the detailed findings set out in the annex to this paper. More information can be found at:

http://www.fsa.gov.uk/Pages/About/What/Supporting/mortgage_endowments/index.shtml

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11. Changes to MCOB - Home Purchase and Reversion Plans

From 6 April 2007, MCOB applies to activities carried on for three types of product: regulated mortgage contracts (which include lifetime mortgages), home purchase plans and home reversions. Together, these products are referred to under the umbrella term 'home finance transactions' and there will be a number of related new terms in the FSA sourcebook and glossary.

The small number of firms that have varied their permissions to include Home Purchase and Reversion Plans will find the link below useful.

Ateb view:

None - for information only

Action required by you:

More information including FAQs can be found at:

http://www.fsa.gov.uk/pages/Doing/small_firms/mortgage/home_finance/index.shtml

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12. Changes to Mortgage Disclosure Documents from 6th April 2007

Following the introduction of regulation of 'Home Purchase and Reversion Plans', as mentioned in the previous article, firms will need to alter their IDD or CIDD from 6th April 2007.

Firms who have applied to vary their permission will need to remove reference to Home Reversion Schemes being unregulated and not covered by the regulatory protections.

However, the majority of firms that have not varied their permission will need to amend their document to remove reference to 'Home Reversion Plans'

Ateb view:

None for information only

Action required by you:

Templates for disclosure templates

http://www.fsa.gov.uk/pages/Doing/small_firms/mortgage/disclosure/index.shtml

Please note however as at March 26th, the FSA have not updated their templates for the CIDD as it still makes reference to home reversion being unregulated.

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13. FSA letter on Lifetime Mortgages

You may have received a letter from the FSA in February headed: "Lifetime Mortgages – firms carrying out low volumes of business".

The FSA's frequent warnings about this form of business must give rise to the thought that those who provide advice, but have not made an in-depth study of the subject and have insufficiently robust systems in place, may well be building up future problems for themselves.

Ateb view:

No surprises within the letter. The same principles can be applied to other high risk areas of business.

Action required by you:

If you have not seen this letter we recommend that you read it. The letter can be found at:
http://www.fsa.gov.uk/pubs/other/letter_lifetimemortgages.pdf

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14. FSA Issues Findings on Quality of Mortgage Advice Review

The FSA carried out mystery shopping, visits and questionnaires between June and October 2006 and published disappointing results to the industry - ¾ of firms failed to hit the benchmark. Key recommendations from the FSA:

- Ensure all advisers are appropriately qualified and review the effectiveness of your T&C procedures
- There needs to be sufficient evidence on file of research to show why the product and provider were recommended
- Evidence must be retained of penalties involved in switch / replacement business cases
- Make sure that disclosure documents are accurate and clear
- Have KPIs / management information in place to ensure trends can be identified
- Regular file checks need to be in place to show oversight of quality of sales
- Check processes to be able to demonstrate affordability – adequacy of the fact find

Ateb view:

The high level of failures found in this review is disappointing. You cannot rest on your laurels, and need to keep systems and controls under regular review. Current low levels of complaints should not be taken as the only indicator of effective compliance! Regular controls and oversight are essential. No doubt the FSA will do the rounds again to evaluate whether firms are heeding these warnings – so act now and avoid future issues.

Action required by you:

More information can be found at:

http://www.fsa.gov.uk/pubs/newsletters/ma_newsletter_feb07.pdf

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