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# Taking the stress out of compliance

## ATEB Consulting Newsletter 52 - March 2009

### Investment Firms

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1. FSA Pension Switching Review
2. Retail Distribution Review - Update
3. Annuity Illustrations
4. Cash Funds
5. FSA Factsheet - Platforms: Using Fund Supermarkets & Wraps
6. Can I Switch Clients from One Fund to Another En Masse?
7. Recording of Telephone Calls
8. Unfair Terms in Consumer Contracts Regulations 1999
9. Changes to Professional Indemnity Insurance Indemnity Levels
10. TCF Assessments
11. Systems & Controls Rule Changes
12. Data Protection Licence for Self-Employed IFAs
13. Revised TCF Workshop Programme
14. Moneymadeclear Guides
15. Mortgage Quality of Advice Factsheet: Fact Finding and Suitability
16. Key Rules for Mortgage and Home Reversion Brokers
17. FSA to Regulate Sale and Rent Back Regulation

### 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	16	17
Directors/Partners	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Compliance / A&O Function	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Money Laundering Officer	✓	✓	✓	✓	✓	✓	✓	✓		✓	✓		✓	✓			
Advisers & Trainees	✓	✓	✓	✓	✓	✓	✓	✓		✓		✓	✓	✓	✓	✓	✓
T&C Supervisor	✓	✓	✓	✓	✓	✓	✓	✓		✓		✓	✓	✓	✓	✓	✓
Back Office	✓	✓	✓	✓	✓	✓	✓	✓		✓			✓	✓			
Mortgage Related (M)		M					M	M		M		M	M	M	M	M	M

### 1. FSA Pension Switching Review

Undoubtedly, the hot topic of the moment! Apologies for the length of this article, but it is very important that you understand the implications for your firm.

### **FSA Thematic Review**

As you know, the FSA has recently undertaken a thematic review into the quality of pension switching business. They advise that whilst carrying out this review, they have not only encountered serious failings in the switching advice itself, but also a lack of understanding of their 11 Principles of Business, insufficient Systems and Controls and a lack of TCF culture.

The review includes all types of pension transferred into a PP or SIPP. Excluded from the review are switches to group schemes. SIPP transfers from occupational schemes arranged prior to April 2007 (before SIPP regulation) are also excluded where the investment held by the SIPP was unregulated.

### **FSA Report**

You should obviously read the report carefully. Even those of you who do not conduct pension switching will benefit, as it gives an excellent indication of the standards expected in general. It is well laid out and not difficult to read. It will take you no more than 15 minutes to digest the key issues. The report can be found [here](#).

Fundamentally, the FSA want you to focus on **Client Outcomes**. You must ask yourself whether switching pensions will realistically result in a positive outcome for the client. Whereas your response to this question might be 'well of course it will, why else would I have recommended it', can you back this up with concrete evidence?

You should also realise that while this report centres on pensions switching, you can extend the requirements to all forms of switches or replacements, particularly investment consolidation onto wraps and platforms. Does your recommendation result in a positive outcome for the client or does it just ease your administration?

### **FSA Road Show**

Many of you will have been invited or, should I say, 'strongly encouraged', to attend the FSA road show and there is a good chance that you will receive a follow up FSA inspection visit in the second half of the year. If you have been invited, you should attend.

### **Internal Review**

Now, we have had clients who have already attended a workshop. It was interesting that, whereas the reports and letters that the FSA have issued following their thematic review imply strongly that firms should assess the quality of past pensions switching business, the FSA spokesman was adamant that a 'review' of past business was not compulsory. This has been confirmed from more than one source.

However, the letter on the FSA website to proprietors and compliance officers ([here](#)) states that "we (FSA) are asking you to assess, in the light of the contents of this letter, the advice your firm provides to customers to switch their pensions" and "if we identify failings concerning the suitability of advice relating to pensions switching and find that firms have not undertaken appropriate action in response to this letter, they may be subject to regulatory action".

We are understandably confused, therefore. All we can think of is that there could well be questions asked by PI insurers should firms identify cases that potentially require compensation. **For this reason, we strongly recommend that you seek PI approval to undertake the review.** We see no reason, however, why, if properly informed, your insurers should object.

Ultimately, we don't believe you have any alternative other than to undertake some form of internal review. We would suggest that you:

1. Gain PI approval for the review.
2. Identify all pension switching cases since April 2006.
3. Classify them – from where, to where, fund size, adviser, etc (FSA would expect you to be able to produce this type of management information).
4. Sample a cross section of files – different types, different advisers.
5. If you find issues, extend the audit.
6. Decide if any remedial action is necessary (if so, discuss with PI).
7. Assess the quality of your process and systems and controls and amend if necessary e.g. you may decide to check all pension switches pre-sale or out-source all such cases.
8. Document your review.

The FSA has very kindly provided you with a "Suitability" template and a further insight into what areas it will be expecting you to consider. This is all downloadable from their website [here](#).

It is not imperative that you use their template, although you must ensure that you include all areas covered on the FSA template in your checks. Please also note that this template only forms part of your overall file review process and they have advised that it must not replace any existing file review checks you already have in place. Other regulatory issues such as disclosure, fact finding, needs analysis/research, money laundering, etc should also be

checked.

ATEB clients have access to our file checking template – please liaise with your usual consultant.

### Outsourcing of Pension Switching

Some firms have taken the view that, from a risk management perspective, they do not carry the expertise or have the necessary systems in place, to be able to undertake pension switching business to the required standards. It may be that following your review of past business, you decide that you too would be better to out-source pension switches. If this is the case, there are firms that specialise in this market and, should you wish, ATEB can refer you; however, you must ensure that you undertake due diligence prior to entering into any such arrangement/agreement.

A summary of the key points from the FSA report can be found [here](#).

#### ATEB view:

It is important to take on board the comments made by the FSA following this review. This is another area of advice being covered under the TCF programme. The FSA are planning to assess a range of firms in the 3rd quarter of 2009 to review the action they have taken following their letters and workshops to test the quality of advice given on pension switching.

#### Action required by you:

Undertake an internal review, but read our comments above firstly. **It is vital that you don't breach any conditions of your PI policy.** Ensure also you take into account TCF outcomes 1, 3, 4 & 5; these were the particular ones the FSA focused on when carrying out the review [here](#).

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

## 2. Retail Distribution Review - Update

These are the key issues that affect IFAs as we see them:

<b>Implementation</b>	December 2012
<b>Consultation</b>	Until June 2009 when further statement will be made
<b>Independence</b>	Advice must be 'unbiased' and 'unrestricted' – including portfolio management, wraps and platforms  Must hold suitable qualifications  Must offer fee based advice
<b>What Qualification?</b>	Qualifications and Curriculum Authority (QCA) level 4 – for most, this will mean the CII Diploma  By December 2012 for existing advisers. New entrants may need higher qualifications by 2010
<b>Remuneration</b>	Cannot be determined by provider  'Factoring' (essentially initial commission that is taken as charges from the product over a period of time) abolished  You set your own charges  For example, £100k available, adviser agrees charge of £3k = £97k actual investment  Can be paid by provider or up front by client, although VAT implications are yet to be finalised  Trail commission yet to be fully defined – suspect that an 'amount' will be agreed between adviser and client in advance, for a defined service and to be deducted from value of funds at defined intervals  You can use hourly rates, fixed fees, % of investments, etc
<b>Capital</b>	Minimum raised to £20k or 25% annualised overheads

**Adequacy** We don't agree with FSA's assertion that most firms will not be greatly affected

**ATEB view:**

While there is still some water to go under the bridge, you cannot ignore the implications and you need a strategic plan.

**Action required by you:**

Consultation is ongoing at the moment and more information will be published in June 2009. We strongly recommend that you monitor progress and take every opportunity to lobby the FSA about the proposed changes to capital adequacy requirements.

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

### 3. Annuity Illustrations

The falling markets have raised issues that none of us have needed to previously consider.

One such issue relates to the purchase of an annuity. Invariably, annuities take considerable time to finalise and will not reflect the rates quoted in the illustration, which are only guaranteed for a defined period.

Historically, the final rates have not varied significantly from those quoted. However, in recent times, we have seen significant drops in tax free cash and income due to the falling markets.

**ATEB view:**

There is a distinct potential for client complaints.

**Action required by you:**

You need to make sure that the client understands the potential implications i.e. that the actual rates may fall (although conversely of course, they may rise).  
You need to consider and discuss with the client the possibility of switching the client into a cash fund as soon as you know that the annuity purchase is the definitive strategy.  
Once the annuity is finalised, you should make sure that the client understands the cancellation rights.

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

### 4. Cash Funds

Following on from the above article and in light of the recent issues surrounding the Standard Life Sterling fund, do you fully understand the fund makeup of all 'so-called' cash funds that you may recommend?

I strongly suspect that if we have another Sterling type issue, IFAs will not be able to defend themselves on the basis that 'I thought it was a pure cash fund'.

You now know about the potential issues and if you feel that clients' funds are at risk because of these issues, it is imperative that you take action.

**ATEB view:**

Our understanding is that there are very few true cash funds available and this may well have a detrimental effect on clients' investments, particularly those nearing retirement.

**Action required by you:**

This issue needs to be considered when making a pension provider selection.  
You also need to consider how exposed existing clients are and whether any action needs to be taken now.

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

### 5. FSA Factsheet - Platforms: Using Fund Supermarkets & Wraps

If you use any of the above or are considering doing so, please read the FSA Factsheet, available [here](#).

It explains and raises a number of issues that you should be aware of, namely:

- the Management Controls you need to have in place
- the associated Risks to your firm
- potential Conflicts of Interest

- T&C implications
- Asset Allocation issues
- Suitability for clients
- maintaining Independence
- communications with clients

**ATEB view:**

Essential reading for most firms.

**Action required by you:**

Ask yourself the questions raised in the Factsheet objectively and if you cannot answer positively, remedial action will be necessary.

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

## 6. Can I Switch Clients From One Fund to Another En Masse?

We are often asked this question.

This is because many of you will operate portfolios where you monitor fund performance regularly and where necessary switch funds in and out of the portfolio. So even if you decide to move fund A out of your portfolio and bring in fund B, this invariably results in the need to switch numerous clients from A to B.

This issue is covered in the FSA Factsheet on Platforms (see previous article), under Asset Allocation issues. It clearly states that unless:

- you hold FSA permission for discretionary portfolio management;
- your staff are qualified in investment management; and
- you have the client's authority

**You must not switch clients from one holding to another without their express consent for each change.**

Please note the use of the word 'each'. An authority to do ongoing switching from the client is not sufficient.

While we fully appreciate that this is an issue that potentially limits your ability to monitor portfolios, these are the rules.

**ATEB view:**

This is the message we have been giving firms for many years.

**Action required by you:**

Make sure that you are not in breach of this rule as it could have serious consequences.

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

## 7. Recording of Telephone Calls

Rules to tackle market abuse come into force from March 2009. They require only certain firms to tape calls. Some telecommunications companies are targeting firms to get them to buy their services and in some cases they are misrepresenting the rules. The FSA knows there has been some misunderstanding of the rules which has meant that some firms believe they are caught by the rules and have assumed that all calls need to be taped.

The FSA has received numerous calls from financial advisers who were targeted by technology providers informing them that they are within the scope of the proposals and would be required to record their calls. **This is incorrect.** They have also seen some advertisements which completely misrepresent the rules and try to persuade firms that they should buy extra services. **These services are not required by FSA rules.**

**What types of firm are outside the scope of the rules?**

The rules exclude:

- retail financial advisers,
- insurance brokers,
- mortgage brokers,
- solicitors,
- estate agents and
- those receiving and executing loans.

**What types of product are outside the scope of the rules?**

The rules do not apply to:

- insurance products;
- dealing in the units of most collective investment schemes;
- corporate treasury activities; and
- corporate finance business.

#### What types of product are included?

The rules apply to products included in the market abuse regime. These are qualifying investments (include shares, bonds, options and futures) traded on a prescribed market (or investments that are related to these investments). For example, markets operated by EDX London Ltd, ICE Futures Europe, LIFFE, London Stock Exchange plc, PLUS markets plc, SWX Europe Limited, The London Metal Exchange and other EEA regulated markets.

#### ATEB view:

Looks like there are going to be a few disappointed phone companies.

#### Action required by you:

While not required by the rules, this is nevertheless something to consider, particularly as technology becomes cheaper. It would certainly provide increased risk management.

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

## 8. Unfair Terms in Consumer Contracts Regulations 1999

Under the above regulations, the FSA has the right to challenge firms who are using terms that the FSA deem to be unfair.

On the FSA website, you will see what is referred to as an 'Undertaking' [here](#) in which the FSA detail what they consider to be one firm's unfair use of terms in a client agreement.

The agreement required the client to sign on the basis that: *"I confirm that I have received, read and understood this agreement and agree to the terms set out within".*

The FSA state that *"a term is deemed to be unfair under Regulation 5 of the Regulations if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract, to the detriment of the consumer. Firms should draft contracts in plain and intelligible language and must also give consumers a proper opportunity to read all of the terms of the contract. Consumers should check the details of the contracts they enter into. But a contract term requiring consumers to declare that they have read and understood the terms of the contract is likely to be unfair because it binds consumers to terms which, in practice, they may not have any real awareness of."*

The firm concerned has amended its terms to: *"This is our standard client agreement upon which we intend to rely. For your own benefit and protection you should read these terms carefully before signing them. If you do not understand any point please ask for further information."*

The firm also agreed not to rely on the original term in an unfair way in contracts with existing clients.

#### ATEB view:

We suspect that similar terms will exist in numerous agreements.

#### Action required by you:

Review all your agreements.

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

## 9. Changes to Professional Indemnity Insurance Indemnity Levels

Intermediaries which give advice on or sell insurance based products (both investment and non investment types) will be subject to new PII minimum indemnity limits from 1 March 2009. The limits have been changed, as required by the Insurance Mediation Directive (IMD), in line with the increase in the European Index of Consumer Prices, over the five year period since the IMD's entry into force.

The minimum limits for firms will be raised to €1,120,200 for a single claim (currently €1 million) and €1,680,300 in aggregate (currently €1.5 million). PII indemnity limits for firms not subject to the IMD remain unaffected

FSA expects PII cover taken out in a currency other than the Euro to meet the minimum indemnity limits when converted into Euros both when the policy is first effected and at renewal.

**ATEB view:**

For information only.

**Action required by you:**

Check your PI Policy and refer issues to your PI broker.  
Even if you are mid-term or have just renewed, you need to increase your limits.

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

## 10. TCF Assessments

Here is a flavour of what you can expect from an FSA TCF visit or by desk based monitoring.

**Questions:**

- What does TCF mean to you and your customers?
- How have you identified TCF gaps?
- How do you maintain knowledge and competence?
- What methods do you use to improve processes?
- Describe your sales process
- How do you assess the quality of advisers and their work?
- Who does the file checks?
- How do you take TCF into consideration in you day-to-day dealings with customers?
- What information do you gather about customers?
- How do use this information from a TCF perspective?
- What controls do you have in place to ensure TCF?
- How do you know these controls are working?
- What review processes do you have in place to ensure the controls are working?
- Do you use customer surveys?

**Evidence:**

- Looking for evidence to back up all your answers e.g.
- TCF Gap Analysis
- TCF Management Information (MI)
- Adviser competence records (tests go down well)
- File check results and importantly, follow through

**Brownie Points:**

- Show your gap analysis and any other audits.
- Show that you review these periodically – built into your compliance monitoring plan.
- Be able to produce good quality MI.
- Most important of all, you must be able to demonstrate that you have acted upon and made changes because of your gap analysis, your MI, your complaint trends, your customer survey results, etc. Don't just answer the question - provide examples.

**ATEB view:**

This is not a comprehensive or exhaustive list, but by now, with all you've seen and heard on TCF, you must be seeing the key issues.

**Action required by you:**

Please do not think that this applies only to 'big' firms. All of this applies to you as well.

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

## 11. Systems & Controls Rule Changes

On 1 April 2009 changes to the FSA's Senior Management Arrangements, Systems and Controls sourcebook (SYSC) will come into force. The changes will mostly affect mortgage and insurance intermediaries and IFAs, although they apply to all firms not subject to the Markets in Financial Instruments or Capital Requirements Directives (MiFID), except for insurers.

Currently, you are subject to SYSC 2 – senior management arrangements – and SYSC 3 – systems and controls. From 1 April 2009 the FSA will apply the 'common platform' (SYSC chapters 4 to 10) to these firms instead of the requirements in SYSC chapters 2 and 3.

The changes focus on such areas as outsourcing, managing conflicts of interest and training and competence.

The key change affecting IFAs will be the requirement to have a Conflicts of Interest policy in place.

The FSA are making these changes in line with their move to principles-based regulation, creating one common set of high-level provisions for all firms for oversight and systems responsibilities, which can be applied flexibly and proportionately.

All firms should familiarise themselves with the changes and take action if necessary. See [here](#).

**ATEB view:**

For information only.

**Action required by you:**

ATEB will be briefing its clients on the requirements in more detail and will assist you in formulating a conflicts policy. Please liaise with your usual consultant.

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

## 12. Data Protection Licence For Self-Employed IFAs

One of our fellow compliance consultancy firms has identified this issue.

They have confirmed with the Information Commissioner that self employed IFA's are required to notify and be registered in their own right. They would not be covered under a company registration.

If your advisers are self-employed, they must register directly. The cost is £35 and you can point the relevant staff to a step by step guide [here](#).

They place themselves at risk if they do not register, as well as possibly providing a problem for the firm.

The issue has also been raised about the situation where administration work is contracted out. The principle is the same because they have access to confidential information and should therefore be registered in their own right.

**ATEB view:**

For information only.

**Action required by you:**

Self-explanatory.

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

## 13. Revised TCF Workshop Programme

The FSA are accelerating the TCF programme – more regions, more workshops, more firms!

**ATEB view:**

For information only.

**Action required by you:**

Be prepared.  
Watch out for your invite.

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

## 14. Moneymadeclear Guides

The following Moneymadeclear guides have been updated and are available from the FSA website:

- Your pension - it's time to choose
- Income withdrawal
- Retirement options
- Insurance

For more information see <http://www.moneymadeclear.fsa.gov.uk/>.

**ATEB view:**

For information only.

**Action required by you:**

We believe that giving clients generic guides such as these is good practice because it increases the client's overall knowledge and reduces the amount of information needed in the suitability letter,

which can concentrate on the specific recommendation.

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

## 15. Mortgage Quality of Advice Factsheet: Fact Finding and Suitability

This is the FSA's second in a series of factsheets for mortgage advisors on the processes you go through before giving your clients mortgage advice.

This factsheet focuses on the type of information you should collect to decide whether the mortgage you recommend is suitable for your clients. It sits alongside their previous factsheet on assessing affordability, which you can access [here](#).

When assessing whether the mortgage you recommend is suitable for a client, you need to decide whether the product meets the client's needs and circumstances. The FSA say **"You should not just rely on what the client tells you they want"** – you need to gather enough information about your client's circumstances and preferences, discuss this information with them in order to understand what would be best for them. This will allow you to make an **informed recommendation**.

A product is deemed suitable if you have reasonable grounds to conclude that:

- The client can afford it over the repayment term.
- It is appropriate to the client's needs and circumstances.
- It is the most suitable of those you have available to you within the scope of service you provide to the client. **You cannot recommend the 'least worst' product if you do not have access to a product that is appropriate to the client's needs and circumstances.**

To help improve your suitability process, the FSA have outlined some examples of good practice found when visiting firms.

### Remortgaging and charges

- Consideration given to best interest of the client and would they gain financially by remortgaging before making a recommendation.
- Associated costs, such as legal fees, broker fees and any early repayment charges were all taken in to account.
- If no financial gain to client and no other overriding considerations, then a recommendation to stay with their existing lender.
- Prior to any recommendation to remortgage, full details of existing mortgage should be obtained to see if there was an early repayment charge. If there was, consider the amount of the charge and the end date to see whether you should recommend to client to delay remortgage.

### Collecting information

- Ensuring all advisers complete a full and thorough fact-find. Making sure fact-finds are up-to-date when dealing with new business for repeat customers. Check in case any circumstances have changed.
- Ask clients about any plans that might affect their mortgage to ensure that if they planned to make overpayments or move there were no restrictions that reduced product suitability.

### Lending into retirement

- Working beyond a retirement age of 65, will client be reliant on work income to pay their mortgage. Discuss these plans with the client to establish how likely they would be able to continue their line of work.
- Consideration to be given to a reduction in the mortgage term, rather than continuing the mortgage into retirement. What would be more appropriate for the client.

### Meeting the lender's criteria

- In order to get accurate pictures of client's credit history, consideration given to clients obtaining their own credit report. This ensured the client's credit history met the lender's criteria, and meant fewer applications were declined.
- Detailing why the client wished to borrow more money and record this on the fact-find. This ensured the client met the lender's criteria as some lenders will allow remortgages for certain purposes such as for home improvement but not for paying off debts.

### Interest-only

- Demonstrating that a client planning to convert from an interest-only to a repayment mortgage would be able to afford the higher payments in the future.
- 'sense check' of the repayment strategy and recording it. If the client intended to convert to a repayment mortgage at a future date the advisor established and recorded any relevant changes in circumstances, such as a promotion.

### Subprime

- Sufficient enough evidence of the client's credit history to show why a subprime product recommended and why the client would not have been eligible for a prime product.

- Recommendation of products of a prime lender if the client only had minor credit problems that met prime lenders' criteria.

#### Self-certification

- Demonstrate why clients could not find proof of their income and why this was case.
- Demonstrated how this would affect their choice of products by showing them the sourcing results for both full-status products and self-certification products and giving them every opportunity to provide proof.
- Sufficient enough evidence on the file to demonstrate the recommendation of a self-certification product, and why this was appropriate compared with a full-status product.

#### ATEB view:

It is not rocket science, the majority of firms will already be carrying out this process when conducting mortgage business. It's remembering to document it all that some firms fail to do!

#### Action required by you:

We recommend you take into account each sub heading covered by the FSA's review and see if your firm incorporates this feedback already into your own Sales Process. This is another good way of reviewing TCF and making improvements or amendments to your firms systems.

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

## 16. Key Rules for Mortgage and Home Reversion Brokers

The FSA have produced a new Key Rules guide. This guide puts the rules that are most relevant to mortgage brokers in their customer facing work, in an easy to read format.

Should you require the demolition of a further tree, this handbook is available in hard copy format from the FSA and can be ordered online [here](#).

To download, click [here](#).

The guide covers:

1. Principles for businesses
2. Conduct of Business rules
  - Financial Promotion
  - Initial Disclosure
  - Arranging and suitable advice
  - Selling standards : home reversion plans involving unauthorised reversion providers
  - Product information
  - Distance Selling
  - General
3. Complaints Handling
4. Electronic Commerce
5. Systems & Controls

#### ATEB view:

At last something that won't take you at least a year to read and a further few months to decipher the rules. This document is in small manageable chunks and provides the core details regarding FSA rules and guidance. Reliance solely upon this document is not recommended and firms should always ensure they know how to access the main handbook for reference.

#### Action required by you:

We recommend that you download this document and spend a little time digesting its content before saving it onto your systems for easy reference.

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

## 17. FSA to Regulate Sale and Rent Back Regulation

Sale and rent back schemes involve individuals selling their home, usually at a discount, and obtaining an agreement to remain in the property for a set period - typically through an assured shorthold tenancy of 6 to 12 months.

The FSA have published a consultation paper setting out proposals for regulating such schemes that are designed to reduce harm to consumers in this growing area of the housing market. They propose a two-stage approach, with an interim regime from July to address the most significant problems consumers face as soon as possible. This will be followed by a full regime in the second quarter of 2010.

#### ATEB view:

An area that should be regulated.

**Action required by you:**

If you are involved in this marker, we suggest you read the consultation paper available [here](#).

[🏠 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 Huw Reynolds email [huw@atebconsulting.co.uk](mailto:huw@atebconsulting.co.uk).*

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