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# Taking the stress out of compliance

## ATEB Consulting Newsletter 53 - June 2009

### General Insurance Brokers

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### Ladies & Gentlemen

*Please find enclosed the latest compliance and industry news.*

*As usual, sit 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
Directors/Partners	✓	✓	✓	✓	✓	✓	✓	✓	✓
Compliance / A&O Function	✓	✓	✓	✓	✓	✓	✓	✓	✓
Advisers & Trainees	✓	✓	✓	✓	✓	✓	✓	✓	✓
T&C Supervisor				✓	✓	✓	✓	✓	
Back Office									

### 1. Transparency, Disclosure and Conflicts of Interest

BIBA have recently issued an industry guidance paper entitled "Transparency, disclosure and conflicts of interest in the commercial insurance market". This paper has been confirmed by the FSA for 3 years from the 24th March 2009, although they retain the right to revoke the guidance at any time.

In their letter to BIBA confirming the guidance, they state:

*"The FSA has reviewed this industry guidance and has confirmed that it will take it into account when exercising its regulatory functions. This Guidance is not mandatory and is not FSA*

*Guidance. This FSA view cannot affect the rights of third parties."*

So, it's not mandatory, and firms may adopt other means of achieving compliance, but the general view is that the FSA have handed these issues over to the industry to sort out and that if the industry does not adopt this guidance (or other comparable solutions) enthusiastically, then this guidance may end up being mandatory FSA rules.

As part of their supervisory duties, the FSA will take this guidance into consideration. It is in your best interests to evaluate the contents of this guidance very seriously therefore.

The paper is available to download from the BIBA site at <http://www.biba.org.uk/industryGuidance.aspx>

This article only summarises the key points; the full paper is, we would suggest, **vital reading** for you all.

1. The FSA are seeking to achieve 5 outcomes for commercial customers, namely:

**Outcome 1:** Commercial customers should have clearer and more comparable information about the commissions intermediaries receive.

**Outcome 2:** Commercial customers should have clearer and more comparable information about the services intermediaries are providing.

**Outcome 3:** Commercial customers should have clearer information about the capacity in which an intermediary is acting.

**Outcome 4:** Commercial customers should be alerted to their right to request commission information.

**Outcome 5:** Commercial customers should be made aware where there is a chain of intermediaries.

2. Senior management must implement an internal **Conflicts of Interest** policy. This requirement is derived from the FSA Principles for Business. Your interests should not conflict with the interests of commercial customers or any insurers on whose behalf you may act. You should ensure that any conflict arising out of remuneration arrangements of business models are properly disclosed and managed. You must have rigorous internal controls to identify and manage potential conflicts. You must at all times protect the interests of your commercial customers. Your conflicts policy should not be written and then filed away, but must be fully considered and embraced. ATEB has templates that can be used as a basis.

3. You should ensure that your commercial customer is made fully aware of the capacity in which you act i.e. on behalf of the customer, the insurer, or both. Furthermore, it must be clearly explained to the customer in which capacity you will search the market, place the insurance and handle a claim. It goes on to say that commercial customers generally overestimate the extent to which brokers search the market on their behalf (based on 2007 FSA research) and states that such information should be disclosed on a contract by contract basis. Please note that the guidance states that **relying on the TOBA in this respect is not sufficient**. The guidance contains a template as a suggested means of achieving this requirement.

4. The 'upon request' commission disclosure requirement is maintained, but the guidance provides direction. Again, the inference is that **TOBAs provide an inadequate means of informing commercial customers of their rights to request disclosure**, as FSA research shows that most customers do not know that they have the right to ask. Suggestions for disclosing the customer's rights include oral disclosure and that any written statement should not be in documents of greater than one page in length.

5. When commercial customers do request commission disclosure, you must have procedures in place that discloses fully all means of remuneration, including profit shares and volume overrides (note that the FSA Glossary describes commission as 'any form of commission or remuneration, including a benefit of any kind, offered or given'). ATEB has a template that can be used.

6. Distribution chains must be fully explained. Any use of a sub-broker should be fully disclosed. This could include the need to disclose the total remuneration for the chain if asked to do so.

Some ATEB Suggestions:

- Whatever means you use to address the 5 outcomes, ensure that you cannot be accused of 'circumnavigating' the FSA requirement for you to be 'fair, clear and not misleading'.

- Review your TOBA. It's probably a long time since you've done so, so take this opportunity to review in line with this guidance.

- Decide at what stage in the sales process you are going to adopt the transparency requirements.

- Explain clearly to the customer the basis upon which you act. Most of you will be independent, so make sure that this is based on a fair analysis of the market. When you use schemes or restricted markets, fully disclose this. Do you have a defined (and documented) re-marketing strategy?

- Review and update your Conflicts of Interest policy. Make it part of your TCF culture.

- Ensure that you have a documented commissions disclosure procedure and template. Do your staff know what to do if asked to disclose?

**And finally, a word of comfort.** When mandatory commission disclosure was introduced into financial services in the mid nineties, there was an outbreak of what can only be described as mad panic, far exceeding anything seen in these swine flu times in which we live. It is fair to say that the actual impact was minimal and remuneration disclosure is now part and parcel of everyday life for a financial adviser.

**ATEB view:**

Very, very important stuff.

**Action required by you:**

Read, digest, read again, decide strategy and implement.

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## 2. Agency Law and Remuneration Disclosure

Following on neatly from the previous article, some food for thought.....

The commission disclosure rules contained in ICOBS 4.4 relate to the disclosure requirements for commercial customers. There are no equivalent rules for consumer (retail) customers.

However, the guidance contained in ICOBS 4.4.3, although used in the context of the disclosure requirements for commercial customers, does state that "the commission disclosure rule is additional to the general law on the fiduciary obligations of an agent" and "the essence of these fiduciary obligations is generally a duty to account to the agent's principal".

Under agency law, when you recommend and ultimately sell a product to a customer, you are likely to be acting as the agent of the customer and therefore have a fiduciary duty to act in the best interests of that customer. This is the case whether the customer type is consumer or commercial. Any benefit that you receive as a result should only be retained if the customer, with full knowledge of all of the material circumstances, agrees. Otherwise, it could be argued that you are being remunerated without the customer's knowledge and are making what accountants sometimes refer to as a 'secret profit', in which case you have potentially breached the trust placed in you by the customer.

Although not directly related to insurance mediation, you may be interested to know that the court of appeal has recently ruled in favour of customers who claimed that they were unaware that payments were being made by a lender, to the broker, for the arrangement of a loan, even though the customer had been told that a payment 'may be made' to the broker.

The Court of Appeal concluded that a payment to an intermediary cannot be a secret when the client is told about the possibility of the payment being made i.e. the 'may be made' statement. However, it did find that the customer's informed consent to the payment had not been obtained as the client had not been told how much the broker was to be paid. This was a breach of the broker's fiduciary duty to the client in the court's opinion.

It is clear therefore, that you must make sure that all customers understand the basis of your remuneration. Whether disclosure of this fact in the TOBA is sufficient, is a point for discussion. Some might argue that, according to agency law, this statement should be more explicit.

**ATEB view:**

This article is for information purposes only and you should not rely or act upon it without seeking expert, professional advice.

**Action required by you:**

Consideration should be given to the impact that agency law has on your obligations to customers.

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### 3. Reporting Tailored Income in RMAR Returns Means Lower Fees

The FSA, FOS and FSCS fees are calculated using data you submit in section J of the RMAR, which is completed once per annum.

It has always been the case that firms have the option to report 'tailored income' under the FOS and FSCS columns in section J. The definition of 'tailored income' is income generated from customers who have the right to refer disputes to FOS and FSCS i.e. all private individuals (consumers) or commercial customers whose turnover is less than £1M. Such customers are referred to as 'eligible customers'.

Therefore, for brokers who have large corporate customers, tailored income will be less than total income.

The effect of reporting tailored income is that the fees you pay FOS and FSCS will be reduced (because you don't have to pay for customers that can't refer disputes).

In truth, the effect this has on fees, from our experience, is not significant, but of course it depends on the volume of customers you deal with that have £1M + turnovers.

As a matter of interest, we have used the FSA Fees Calculator to see what difference reporting tailored income can make. A quick calculation, for a standalone GI broker with a £1M income, that reports £1M in all 3 columns (FSA, FOS and FSCS), shows that FSCS Fees are £496 and FOS Fees £160. If we reduce the FOS and FOS incomes to £500k (i.e. we tailor them), FSCS Fees come down to £317 and FOS Fees to £80 (a total saving of £259\*).

If we do the same for a £2M turnover, firstly using £2M across the board (FSA, FOS and FSCS) and then repeating with £2M for FSA and £1M for FOS and FSCS, the difference between the 2 sets of fees is £523\*.

(\* for illustration purposes only)

#### **ATEB view:**

The FSA has more recently started questioning why firms are not reporting tailored income.

#### **Action required by you:**

You therefore need to be aware of this issue and wherever possible report accurate tailored income under the FOS and FSCS columns in section J. We appreciate that this is data that most firms will find difficult to produce, but with the FSA increasingly scrutinising the RMAR data you submit, you should consider what controls you need to build into your financial reporting in order to comply fully with the requirement and be able to demonstrate how you calculated the figures reported in section J.

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### 4. FSA TCF Assessments

For most of you reading this newsletter, the FSA TCF Assessments will take place in September (covering the North East, Cumbria and Scotland). Hopefully you will have attended the FSA road shows and some of you also participated in ATEB's TCF workshops.

The key messages are:

1. Understand the 6 consumer outcomes and be able to discuss and demonstrate how they relate to your day-to-day activities. Ensure that you understand what an 'outcome' is – processes and procedures are not outcomes, but a means of achieving an outcome.
2. Questioning in the assessments will concentrate on consumer outcome 1 – Culture.
3. Embedded in outcome 1 are 5 key drivers, namely:

#### 3.1 Leadership

TCF is a top-down initiative; business principals must buy into the concept and drive implementation

#### 3.2 Business Decisions & Strategy

You should be able to demonstrate that your strategic decisions have been influenced by TCF thinking

#### 3.3 Controls

Be able to talk confidently about the controls you have in place to maximise TCF.

Examples would be file checking, client questionnaires, defined T&C programmes, etc

#### 3.4 Recruitment & T&C

A defined recruitment and T&C process is essential. Know what your procedures are – application form, references (what do you ask for), vetting (checking data supplied by the applicant against documentary proof e.g. credit card balances), induction programme, how advisers attain competence, how advisers maintain competence, etc

#### 3.5 Reward & Recognition

What is your remuneration structure? Commission only – why? Is good compliance rewarded?

#### 4. Documentation required by the FSA pre-assessment:

4.1 TCF Gap Analysis – no prescribed format, but should show TCF gaps you have identified, which ones have been addressed, which ones have not been addressed.

4.2 Compliance audit report. Be conversant with it and be able to demonstrate that deficiencies identified have been addressed.

4.3 Disclosure Documentation. Remember that by 31 August, you must have implemented the new Key Facts about our Services & Costs document.

4.4 Structure Chart. This should show reporting lines and roles & responsibilities. Each role should nevertheless be supported by a job description.

4.5 Website address. This means that the FSA are likely to check your website before the assessment. Has it been vetted, signed off and logged in your financial promotions log?

4.6 New Business Register.

#### 5. Other documentation that is essential to demonstrate TCF:

5.1 Management Information (MI) / Key Performance Indicators (KPI). MI is any form of data that can be used by managers / principals to make important decisions, including reading, discussions, assessments, etc. For example information from the FSA pensions switching review, or from compliance consultants meetings or from one-2-one meetings with staff. KPI tend to be statistical and measured against a benchmark e.g. persistency.

5.2 File checking results and follow through – Completing the cycle is essential.

5.3 T&C documentation – one-2-ones, accompanied visits, development plans, CPD records, etc

### **ATEB Preparation Days**

ATEB is offering assistance to help firms prepare for TCF assessments.

Half day preparation involves a thorough role play and coaching session that will identify potential issues. You will also be provided with any necessary templates that you can use e.g. TCF gap analysis.

Full day preparation, will be as for the half day, but will also include assistance with hands-on implementation e.g. TCF gap analysis.

### **Costs**

½ Day (3.5 hours)	- £300 ATEB Clients; £375 non-ATEB clients
Full Day (6.5 hours)	- £550 ATEB Clients; £700 non-ATEB clients

#### **ATEB view:**

You don't see the FSA that often, so this is your chance to keep them away from your door for the foreseeable future.

#### **Action required by you:**

To achieve this, prepare thoroughly!

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## 5. TCF Client Surveys / Questionnaires

Under the Leadership driver (Consumer Outcome 1, see previous article), the FSA highlights client questionnaires as one method of ascertaining feedback from clients about the quality of your service.

There are some important points to consider when undertaking such surveys.

1. Don't focus purely on client satisfaction. The client might think you have the manners of Tim Henman, the looks of Michelle Pfeiffer and are funnier than Eric Morecambe; but do they understand what the heck you've set up for them?

Ensure that your questionnaires obtain information about the clarity of information provided (written and verbal) and the level of understanding the client has.

2. Are your response rates low? If so ask yourself why and consider changing the process. Do you send out with masses of other paperwork, hence making the questionnaire easy to ignore? Are there incentives for returning e.g. charitable gift for each questionnaire returned? Would you be better sending out en masse or monthly? Would a mixture of postal and telephone surveys increase feedback?

There is no right or wrong answer, but you should be aiming to maximise the benefits of the surveys by maximising the number of returns.

3. Are the results always 'excellent'? If so, you're probably not getting a good cross-section – there will always be a few clients who will want things done better and there should be some genuine comments that will help you to improve your processes and service.

4. Who evaluates the responses? Ideally, this should be done by a third party so that full objectivity is achieved.

### **ATEB view:**

Surveys that focus purely on satisfaction are of little use. You need to gather information that helps you evaluate the quality of your service.

### **Action required by you:**

To achieve this, prepare thoroughly!

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## 6. Complaints and Compensation Arrangements for Smaller Firms

Certain kinds of small businesses, including FSA authorised small businesses, are eligible to seek redress through the Financial Ombudsman Scheme (FOS) or claim compensation through the Financial Services Compensation Scheme (FSCS).

Firms which are eligible to seek redress through the FOS include FSA authorised businesses which have a group annual turnover of less than £1 million. This definition will change from November 1st 2009. The new definition of a small business adopts the European Commission's definition of a micro-enterprise. This is an enterprise which employs fewer than ten persons and whose annual turnover and/or annual balance sheet total does not exceed €2 million.

FSCS was set up mainly to assist private individuals, although some smaller businesses are also covered. Larger businesses are generally excluded.

For claims made under an insurance contract, small businesses are protected. A small business under FSA rules is one that has an annual turnover of less than £1m. The same levels of compensation apply whether the claimant is a private individual, small business, or a small company.

Firms often hold the same FSA permission as other FSA authorised firms they do business with. For example, the majority of financial advisers and mortgage brokers also hold the relevant FSA permission to conduct insurance mediation activities (e.g. term assurance), which is often the same permission as that held by their insurance broker who they use to purchase their own commercial insurance policies, such as professional indemnity insurance.

Please note that where a firm making the claim holds the relevant FSA permission to transact the business themselves (and hence the same FSA permission as the firm against which they are making the complaint or from whom they are seeking compensation), the firm making the claim will not normally be eligible to seek redress through the FOS or claim compensation

through the FSCS.

Whilst firms may not be eligible to seek redress through the FOS or claim compensation through the FSCS in the above circumstances, firms are still entitled to pursue a claim through the Courts.

**ATEB view:**

You probably don't know that if you have a dispute with your insurance broker, you may not be eligible to take this to FOS or FSCS.

**Action required by you:**

For information only.

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## 7. Financial Ombudsman Service

Frequently Asked Questions put to the Financial Ombudsman regarding Complaints can now be accessed via their website. This information provides "common sense" information regarding the procedures a firm should adopt when dealing with a complaint and the type of information you would be expected to provide. This well documented publication gives you an insight into the types of activity the Ombudsman service cover, recommended procedures your business must have in place and how to deal with your complaints.

**ATEB view:**

This is an informative guide which can provide a foundation to your own procedures taking into account the areas FOS will look at.

**Action required by you:**

We recommend that FOS's small business guide is saved in its PDF format and attached to your Firms Complaints procedure. You may wish to consider implementing some of their recommendations, feel free to discuss this with your local ATEB consultant.

Complaints FAQ:

<http://www.financial-ombudsman.org.uk/publications/ombudsman-news/77/77-about-us.htm>

Also check out the small business guide at:

<http://www.financial-ombudsman.org.uk/publications/pdf/intro-to-the-service.pdf>

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## 8. Regulation of Connected Travel Insurance

On 1 January 2009, the FSA began to regulate travel insurance sold alongside a travel product, such as a holiday or a train ticket. This is known as connected travel insurance (CTI). Firms selling CTI must be FSA authorised or be an appointed representative (AR) of an authorised firm.

The FSA is concerned that some firms may be selling CTI without meeting these requirements. To date, very few travel firms have become directly authorised, although there have been hundreds of ARs set up.

If firms sell CTI without being authorised or becoming an AR, they will be in breach of the Financial Services and Markets Act 2000 and will be committing a criminal offence.

**ATEB view:**

None for information only

**Action required by you:**

None, although there may be an opportunity to acquire ARs

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## 9. An Update on Unfair Contract Terms - Review of Terms used in Legal Expenses Insurance

In late 2008, the FSA reviewed the contract terms of a number of insurance companies to determine whether they had amended their terms and conditions to take account of undertakings they had given to the FSA. The review focused on terms in legal expenses insurance providing cover for costs incurred through legal action.

The FSA had obtained an undertaking on such terms in July 2006 and were disappointed to find

some insurers still had the same term or similar terms in their contracts.

Those insurers have now been asked by the FSA not to rely on the term for existing customers and to amend it in contracts with new customers.

You should note that although this does not impact directly on you, the FSA nevertheless expects all firms to have fair terms in their standard contracts with customers. To have fair terms, firms need to comply with the requirements of the Unfair Terms in Consumer Contracts Regulations 1999 and the principle of Treating Customers Fairly (TCF).

The FSA expects firms to proactively review their contract terms and encourage all firms to review other firms' published undertakings and consider their own contracts in line with them, where appropriate.

Further reviews of contract terms are planned.

**ATEB view:**

None for information only

**Action required by you:**

More information is available at

<http://www.fsa.gov.uk/Pages/Doing/Regulated/consumer/index.shtml>

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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 Huw Reynolds email [info@atebconsulting.co.uk](mailto:info@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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