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Taking the stress out of compliance

ATEB Consulting Newsletter 54 - October 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	10
Directors/Partners	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Compliance / A&O	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Broker / Account Exec	✓				✓					
T&C Supervisor	✓				✓					
Back Office	✓				✓					

1. Treating Customers Fairly

The first part of the TCF assessment process taking place in Scotland, the North East and Cumbria, is now complete, although a random selection of firms will be subject to follow up, verification visits (where the FSA check to see that what the firm has told the FSA in the assessment, is actually the case in practice!).

These assessments have not affected mainstream GI broker firms, only those selling high risk

products, predominantly premium protection insurance. Of course, it is only a matter of time before GI firms will be subject to TCF assessments and so you cannot rest on your laurels.

We are pleased to report that ATEB firms have fared extremely well during the assessments, and indeed the quality of documentation the FSA has examined has been complemented. The ATEB TCF template therefore works so long as you follow it!

The FSA has recently issued updates to their 'examples of good and poor TCF practice'. ATEB is flattered to see that they have adopted the same approach as us in that they have categorised these under each of the 6 consumer outcomes, exactly as we have done in our TCF gap analysis documents.

We recommend you read the document carefully and 'score' yourself against the practices outlined. Any issues that you identify should be added to your TCF Gap Analysis document.

ATEB view:

These examples of good and poor practices are useful documents and can be viewed at:

<http://www.fsa.gov.uk/smallfirms/tcf/examples/index.shtml>

Action required by you:

Read the examples of good and poor practice above and consider how they affect your firm.

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2. RMAR – Common Reporting Errors

The FSA now has automated systems that analyse data submitted by you, primarily via the RMAR. These systems focus in particular on the financial data you submit, as one of the FSA's key objectives is ensuring the financial stability of firms that it regulates.

The FSA state that "*it is critically important that when you are submitting financial data items then these should agree with the underlying accounting records as you may be asked to validate them to us. Any data item submitted should not give a misleading impression of the firm. A misleading impression is likely to arise if a firm wrongly omits or includes a material item or presents a material item in a wrong way*".

Here are the key areas where weaknesses have been identified

Corporation Tax

Taxation should be based on an estimate of the likely effective tax rate for the year applied to the profit or loss arising. This is true at both the 6 month submission and full year return.

Commission Clawback

Insurers are required to provide the FSA with details of individual clawback amounts paid to intermediaries. This in turn should be reported by the intermediary as part of their return as a liability.

Recoverable & Readily Realisable Debtors

Monies owed to the firm must be recoverable and readily realisable. If a firm has reason to doubt that a debt may not be repaid in full or not paid at all, or that it will take a significant time to recover, then these should be excluded.

Subordinated Loans

Firms wrongly classify a loan as subordinated when there is no compliant agreement in force. Any repayment of an eligible loan must be with the agreement of the FSA. For more information on Subordinated loans, see

http://www.fsa.gov.uk/smallfirms/resources/faqs/subordinated_loans.shtml

Cumulative Profit Figures

A firm can choose to include unaudited interim profits in its returns but these must not be double counted in the full year submission e.g. included twice. This gives a misleading impression of the firm's finances.

Cash Equals Capital Requirement

Too often firms believe that an amount in a bank account equivalent to its base requirement means that it meets its capital resources requirement. This is not the case. A firm must have sufficient eligible capital to meet this requirement.

Capital Adequacy Assessed Twice Yearly

Firms only measure their capital adequacy when required to do so by the FSA in their returns. A firm must be able to demonstrate that its own funds were equal to or greater than its own funds requirements throughout the reporting period.

Material Post-Balance Sheet Events

Material events can occur between reporting periods, therefore, when a firm is aware of a material change to its capital excess it should immediately notify the FSA. This could be due to an adverse assessment of its assets after it had reported, or where dividend payments are substantially higher than envisaged at the time of reporting.

ATEB view:

The FSA's automated verification systems now allow them to identify anomalies easily and quickly. It goes without saying therefore that your returns must be completed accurately.

We fully appreciate that for smaller firms having full Profit & Loss and Balance Sheets completed twice yearly is an onerous requirement. Unfortunately, there is no way around this.

Action required by you:

Your accountants must be involved. ATEB will help you to complete your returns, but we are **not accountants**.

We have seen too many instances of data being supplied by accountants that does not fit the format of the RMAR P&L and Balance Sheet – this could lead to errors that may now be picked up by the FSA's systems.

You need to ensure that your accountants are well briefed and we recommend that you give them online access to complete and validate the data directly into the RMAR.

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3. Client Money – Importance of Adhering to the Client Money Rules

The client money rules are there to protect customers' money and a clear separation between money that belongs to customers and money that belongs to a firm, is essential. The FSA has had client money rule adherence high on their list of priorities since they began to regulate general insurance in January 2005. They have monitored this closely and have taken enforcement action against a number of firms whose systems and controls have not protected client money sufficiently.

The FSA are aware that the vast majority of firms want to apply the rules properly, but are also aware that some may find the rules difficult to understand and apply.

Between May and July 2009 the FSA carried out a review of a sample of firms to assess the awareness and understanding of client money rules. Their findings were that although nearly two thirds of firms reviewed had a good awareness of the rules some firms were found to lack knowledge in this area and therefore need to improve their understanding and application of the client money rules.

Some of the key areas where the FSA feels that firms can improve immediately are shown below (please note that the text is taken directly from the FSA website, so all references to 'we' and 'us' should be read as being the FSA):

Risk Transfer Agreements

A significant amount of firms have appropriate Risk Transfer Agreements (RTAs) in place for all their business covering all funds received from or due to clients, and therefore do not require the client money permission. We have encouraged these firms to vary their permission appropriately to reflect the correct position.

We do not want firms to hold unnecessary permissions. There is no benefit to us or to the firm in doing this. If you have the permission to hold client money this may prompt us to ask particular questions when we analyse your returns and you will also be required to hold additional capital as your minimum capital requirement will be higher.

Before you go about removing your Client Money permissions you will need to discuss this with your insurers in order to agree any changes that need to be made and to ensure you do not breach the Terms of Business Agreements which you have in place with them'. In addition any pre existing client money trust accounts that are used will need to be transformed into insurers trust account.

Firms should be aware that a breach of a Terms of Business Agreement can result in the agreement being voidable and then a firm which had removed its client money permission would in fact then be holding client money without having the correct permission and having the correct capital requirements being applied.

You can check whether you fall into this category by working through the [client money flow chart](#) [PDF]

Client Money Reconciliations

In some cases we found that the client money account was not being reconciled appropriately

and surpluses due to commissions were not being removed from the client money account. This can potentially invalidate the trust status of the account as keeping the firm's money in the account increases the risk for clients that the client money accounts will become 'polluted'.

Firms must make sure that when the client money calculation identifies a surplus that this is removed from the client money account and moved to the business account. Similarly if a deficit is identified firms should arrange to immediately rectify this by topping up the client money account as appropriate to rectify the deficit.

Auditors' Report

We found that some firms are not adhering to the rules with regard to the audit of their client money account.

Where a firm holds a non-statutory trust or has held more than £30,000 in a statutory trust client bank account at any time, the firm must arrange for a client money audit to be carried out.

Co-mingling

If a firm wants to mix - or co-mingle - money held as agent of an insurer with client money it must have the insurer's agreement to do so. Some firms were deficient in this area and found to have no mention of co-mingling and subordination in their Terms of Business Agreements (ToBA) with their insurers.

Firms should review their TOBAs to ensure they are current and not out of date and include, where relevant, the insurer's agreement permitting a firm to co-mingle its client money with that held as agent of an insurer.

Written procedures

We found very few firms with any written procedures for their client money process.

While there is no specific requirement in the Client Asset Sourcebook (CASS) to maintain written procedures we suggest it is good practice to do so. It makes sense to maintain written procedures to enable another elected individual in the firm to carry on the running of the client money account in adherence within the client money rules. Should the individual who is usually responsible be absent.

ATEB view:

We know that you will have seen numerous articles in our newsletters on this subject, but so long as it continues to be a high priority on the FSA agenda, then we will continue to report issues.

Action required by you:

Please read the information overleaf carefully. For example, are your client money procedures written down?

For more detail about the rules and how to implement them, see [Client money guide for General insurance intermediaries \[pdf\]](#)

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4. Transparency, Disclosure and Conflicts of Interest

Reminder – have you addressed the issues raised by BIBA's industry guidance paper entitled "Transparency, disclosure and conflicts of interest in the commercial insurance market"?

For full information, please refer to article 1 of our June newsletter ([here](#)).

ATEB view:

Cannot be ignored – hence the reminder!

Action required by you:

As we said last time, this is very important stuff, so read, digest, read again, decide strategy and implement.

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5. Big Fine for Big Institution – Nothing to do with me Guv!

You may not think that a huge fine to one of the banking giants has little relevance for you. Think again!

Earlier this year, the FSA fined HSBC nearly £3.2m for poor data security. The FSA discovered that large amounts of confidential unencrypted customer details had been sent via the post or courier to third parties, or had been left on open shelves or in unlocked cabinets. The financial regulator also concluded that staff had not been given sufficient security training.

"These breaches are very disappointing. The firm failed its customers by being careless with personal details which could have ended up in the hands of criminals," said Margaret Cole, head of enforcement at the FSA.

"It is also worrying that increasing awareness around the importance of keeping personal information safe, and the dangers of fraud, did not prompt the firms to do more to protect their customers' details."

So, do you:

- Send unencrypted confidential information by post?
- Leave confidential information readily accessible?
- Fail to provide staff training on data security issues?

If you can answer yes to any of the above, the FSA could deem your systems and controls to be inadequate.

ATEB view:

Not something you can simply ignore.

Action required by you:

We remind you about the FSA fact sheet on this subject available at

http://www.fsa.gov.uk/smallfirms/resources/factsheets/pdfs/data_security.pdf

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6. Disapplication of CF8 (Apportionment & Oversight function) – are you affected?

The more observant amongst you will have noticed that your CF8 controlled function may have been removed from the FSA Register. From 1 April 2009 under changes to the FSA SYSC 2 rules, the Apportionment and Oversight controlled function (CF8) has been disappplied for non MiFID firms which have at least one governing function under the approved persons regime.

CF8 will be retained for those firms not required to allocate governing functions, mostly secondary insurance intermediaries or members of a profession.

Please note that in practice, there is no change. Senior personnel will still be subject to the requirements under the Systems & Controls (SYSC) rules to adequately apportion duties and oversee operation in their firm – business as normal therefore.

ATEB view:

For information only.

Action required by you:

If you are unsure about how this affect you, particularly if you are a secondary intermediary or professional firm, please seek further guidance or speak to your ATEB consultant.

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7. FOS Definition of a 'Small Business' and Fee Data Reporting

As discussed in our previous newsletter, the definition of a 'small business' for FOS eligibility, is changing. This is as a result of the Payment Services Directive which comes into effect in the UK from November 2009. It aligns the ombudsman's traditional definition of a 'small business' with the definition of 'micro-enterprise' used in EU legislation

From this date, businesses with an annual turnover and/or balance sheet total of up to €2 million will be covered by the ombudsman – as long as they have fewer than ten staff, raising the turnover limit from the current threshold of £1 million, but also introducing the new, separate requirement relating to the number of staff.

Although it is not entirely clear from the FOS website, business with turnovers of up to £1M, regardless of the number of staff, will still be covered.

For those of you who report 'tailored income' in your Fee Tariff returns (submitted annually via Gabriel), this has implications because more businesses are now brought under the scope of the FOS and hence there is less scope for reducing fees due by reporting tailored income. This will affect general insurance brokers more than IFAs and mortgage brokers, and GI brokers should refer to article 3 in our June 2009 GI Newsletter.

ATEB view:

Should not have a major ongoing impact.

Action required by you:

1. You may need to change Terms & Conditions of Business if your TOBA defines eligible businesses.
2. If you report tailored income in your Fee Tariff returns, the calculation will have to be amended.

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8. The Rehabilitation of Offenders Act & Recruitment Checks

When appointing any individual who will undertake an Approved Persons role (i.e. someone who becomes registered with the FSA), senior management must use a risk based approach to assessing the suitability of the individual for the role.

The combination of checks used will depend on the risk posed, but could include some or all of credit and other financial references, previous employer references, professional references and individual testimonies.

Whether you need to seek a criminal records check will be dependent on the role and the knowledge gained about the individual.

Financial services firms and the FSA are now able to consider all spent offences committed by individuals applying for approved person's status and other specified roles. This is because of an amendment to the Rehabilitation of Offenders Act 1974 (Exceptions) Order 1975. Previously only those spent offences defined as 'relevant' (e.g. fraud and dishonesty) under the Act could be considered. Firms can access this information through the [Criminal Records Bureau](#) (CRB) either directly or through an umbrella body.

Providing misleading information, including the non-disclosure of criminal records is an offence under Section 398 of FSMA and the FSA has the power to prosecute this offence.

ATEB view:

Information only.

Action required by you:

Something to bear in mind if recruiting someone who you don't know.

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9. Notifications to the FSA, Particularly Changes in Control

The FSA has recently highlighted an issue in that firms are not notifying them of important issues that could affect the firm's regulatory status.

They remind firms about principles 4 and 11. Principle 4 states that:

"An approved person must deal with the FSA and with other regulators in an open and cooperative way and must disclose appropriately any information of which the FSA would reasonably expect notice";

While principle 11 requires firms to deal with the FSA in an open and cooperative way and to tell them anything relating to the firm which the FSA would reasonably expect to get notice of. Note that Principle 11 applies to unregulated activities as well as regulated activities and takes into account the activities of other members of a group which your firms may be part of.

There are obvious examples of the type of notification that the FSA will be particularly interested in, such as capital adequacy problems, civil, criminal or disciplinary proceedings, instances of fraud, events that affect the reputation of the firm or its ability to provide adequate services to clients, etc.

Please note that such notifications are to be made immediately for serious cases, but also as soon as you are aware that they might happen, for example, if you think your capital adequacy may be a problem in 3 months time.

The one notification requirement that, from our experience, often catches firms out, is the need for pre-notification and approval by the FSA, for changes in the firm's structure and/or ownership that may trigger a change in control. Firms are likely to be understandably, discreet when the control of the firm is changing, for example when a director sells shares. However, if the change in structure triggers a change in control (not all changes will) then it is a legal requirement for the FSA to pre-approve such changes. Failure to notify the FSA often leads to a hefty fine.

For the technically minded, the rules relating to changes in control were amended this year by The Acquisitions Directive, implemented across the European Union (EU) on 21 March 2009, and established a EU-wide procedural and evaluation criteria for the prudential assessment of acquisitions and increases of holdings in the financial sector. Its main aim is to improve the process of supervisory approvals for acquisitions of financial services firms by enhancing legal certainty, clarity and transparency. The Financial Services and Markets Act 2000 (Controllers) Regulations 2009 give effect to the Acquisitions Directive in the UK by making various changes to Part XII of FSMA. These include changes to the assessment criteria and information requirements for controllers. As a result of this, from 21 March 2009 all applications will need to be submitted on forms that meet the new requirements.

You can find out more about changes in controllers at:

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

ATEB view:

The vast majority of you will not hopefully have serious problems to deal with, as described in the first part of this article. However, from time to time, most of you will need to deal with changes in control. We do not expect you to tell us everything that is going on in your firm and understand that much will be confidential, but this is why **you need to be aware of the need to check with the FSA if in any doubt about the need to notify**. We have found the controllers department at the FSA to be most helpful.

Action required by you:

We remind you about the FSA fact sheet on this subject available at

http://www.fsa.gov.uk/smallfirms/resources/factsheets/pdfs/data_security.pdf

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10. Common Commencement Dates

Did you know that a number of key government departments issue all their changes in regulations twice a year, on 6 April and 1 October? These dates are called common commencement dates (CCDs).

Business Link provide a useful summary of regulatory changes that may affect your business. Did you know for example, that from 1 October 2009, Limited Liability Partnerships (LLP) are subject to new record-keeping requirements, such as the need to keep a register of its members that contains prescribed information; the LLP must also tell Companies House where the register is kept available for inspection.

The summary can be found [here](#).

ATEB view:

Useful information

Action required by you:

Sign up for the regulation updates [here](#).

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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.

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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