

COMPLIANCE RULES



Welcome to the final edition of *Compliance Rules*, BIBA's quarterly regulatory newsletter, for 2008. In this issue, we bring you an article from Jackie Doyle-Price at the Financial Services Authority (FSA) on treating customers fairly and our usual round-up of BIBA's regulation updates.

We begin, however, with Steve White, BIBA's Head of Compliance and Training, who sets out the high-level picture on the impact of Bradford & Bingley (B&B) plus three Icelandic banking failures, on the Financial Services Compensation Scheme (FSCS).

What are the implications?

The funding of the FSCS changed with effect from 1 April 2008. These changes were the subject of lengthy discussions with the financial services sector – starting with DP06/1 early in 2006 and culminating in PS07/19 in November 2007. Our regulation update in November 2007 described the new funding arrangement thus:

- five broad classes will cover: general insurance, deposit takers, life and pensions, investments and home finance. The classes (excluding deposit takers) will each have product provider and intermediary

sub-classes. A general retail pool will sit above the five classes

- general intermediaries could be called upon to contribute up to £195m in the event of failures in their sector. General insurers would be expected to contribute up to £775m. These estimates are derived from broad estimates of eligible income based on 3.5 per cent for intermediaries and 7.5 per cent for insurers
- should the failure of a general insurance intermediary break the £195m threshold in any one year, general insurers would contribute up to any uncalled proportion of their limit of £775m. The reverse would also apply for general insurance intermediaries
- in the event of a failure exceeding the combined amounts of the general insurance class £970m the other sectors would contribute up to an overall maximum of £4.03bn. Similarly if, for example, a bank failure amounted to more than £1.84bn, the other classes would be called upon to contribute up to the sub-class annual maximum.

And so to the recent 'rescue' of B&B. This was facilitated via a £14bn

loan to FSCS. The terms of the loan are that it is interest-only for the first three years. Interest repayments are likely to amount to around £900m per annum, with the first interest payment for the period October 2008 to March 2009 of £450m due in September 2009.

It has been agreed that levies to cover interest and other management expenses relating to the defaults of all these institutions shall not exceed an aggregate amount of £1bn per annum for the first three years.

At the end of the three-year period, repayment of the outstanding capital (£14bn less whatever recovers the FSCS have been able to make) will be scheduled and at that point it is likely that the banking sector sub-class limit of £1.84bn will be breached and all firms, including insurance intermediaries, will be required to make a contribution.

In the meantime, BIBA continues to lobby about the unfairness of the new FSCS funding model. The UK is the only EU state where insurance intermediaries must contribute to compensation payments after a bank's failure. We will be actively participating in the inevitable debate on the future of compensation.



REGULATORY ROUND-UP

Minimum PII limits for firms set to rise

Article 4(7) of the Insurance Mediation Directive (IMD) requires that professional indemnity insurance limits are reviewed every five years to keep them in line with movements in the European Index of Consumer Prices. The index has increased by 12.02 per cent in the five-year period since the IMD's entry came into force.

The Financial Services Authority (FSA) has therefore proposed an increase in the professional indemnity requirements in the *Prudential Sourcebook for Mortgage and Home Finance Firms and Insurance Intermediaries (MIPRU)* and the *Interim Prudential Sourcebook for Investment Businesses (IPRU(INV))*. The changed levels would come into effect from 1 March 2009.

The changes were set out in chapter three of quarterly consultation paper CP08/16, which proposes that the new PII minimum indemnity limits for firms subject to the IMD be raised to:

- €1,120,200 for a single claim (currently €1,000,000)
- €1,680,300 in aggregate (currently €1,500,000)

The FSA expects these figures to be reviewed again in 2013. Members can access the document at: www.fsa.gov.uk/pubs/cp/cp08_16.pdf

Changes to Financial Services Compensation Scheme limits are put forward

Changes which would raise the current levels of compensation payable through the Financial Services Compensation Scheme have been set out in the FSA's consultation paper 08/15. The paper, entitled *Financial Services Compensation Scheme: review of limits*, also contains proposals to improve the overall scheme and to ensure consistency in respect of compensation limits for investment, insurance and home finance.

Members will find chapter five of CP08/15 of particular interest as it proposes a change to the current limits of compensation on the insurance sub-scheme. The FSA is proposing that the limit for all the insurance sub-schemes (apart from

the limit for compulsory insurance) should be simplified by removing the 100 per cent band applying to the first £2,000 of the loss. Instead, the limit for the provision and mediation of non-compulsory insurance – both life and non-compulsory general insurance – would be amended to 90 per cent of the whole claim, with no upper limit.

The proposals for changes to the other non-deposit FSCS compensation limits will be subject to the usual consultation process. The consultation period for the paper closes on 5 January 2009. Members may access the document at: www.fsa.gov.uk/pubs/cp/cp08_15.pdf

FOS paper on publishing complaint data on financial services firms

Members have a couple of weeks left in which to respond to the Financial Ombudsman Service's (FOS) consultation paper on the next steps in the process towards publishing data on the complaints it handles about firms with the aim of increasing its own transparency and improving how businesses handle disputes from consumers.

The paper, entitled *Publication of complaint data: next steps*, explores the practical measures that the FOS would need to take in order to publish information on consumer complaints that have been full-blown cases – both in terms of their number and their outcomes. Consultation closes on 24 December 2008. The document can be accessed at:

www.financial-ombudsman.org.uk/publications/policy-statements/complaintdata-sep08.pdf

FSA bans broker

The FSA has banned Neil McKay of Ideal Insurance Services Ltd, Chorley, Lancashire, for lacking fitness and propriety after taking client premiums and then failing to arrange insurance. He also cancelled contracts of insurance without customers' knowledge or approval.

McKay was also less than frank in his application to be an approved person by not declaring that he had been convicted of eight counts of obtaining property by deception and sentenced to eight months' imprisonment in 1996.

The regulator identified failings at Ideal during a visit in April 2008, after which the firm's permission was suspended. The FSA has now cancelled Ideal's permission.

The case highlights the importance of firms having a comprehensive vetting policy in place to determine the integrity of their employees and following it when they are recruiting. Checking an individual's credentials should extend to both full-time and temporary staff.

Worryingly low turn-out of applicants for CTI authorisation, says regulator

The FSA has expressed concern about the low number of applications from travel firms wanting to be regulated to sell connected travel insurance (CTI). The regulator is urging firms which have yet to seek authorisation to get in touch as a matter of urgency. Firms selling CTI cover after 1 January 2009 without the necessary authorisation will be committing a criminal offence.

Interested firms are urged to call the FSA's contact centre on **0845 606 9666** or visit its connected travel insurance web page at: www.fsa.gov.uk/Pages/Doing/small_firms/travel/index.shtml

Data loss an increasing concern for firms

Incidents of data loss are increasing in both number and significance each year, compromising the personal details and security of millions of people, according to KPMG. The consultant's data loss barometer shows that there have been 1,034 incidents where information has been lost since 2005, which have affected 280m people. Of the 489 data loss incidents reported since January 2007, 50 per cent arose from internal sources, while 44 per cent originated from outside the organisation.

Such leakages are not only costly but damaging to corporate reputations, according to KPMG. They suggest that firms should ask themselves the following questions:

- Where does our data come from, where it is stored and how it is used?
- Do staff understand the importance of good data handling?
- Can we be confident that our IT networks and systems are secure?
- Do we have a clear plan of what to do in the event of data loss?

Upfront planning on how to handle a breach can help and should reduce the impact of the loss, preserve evidence for investigation, maintain

good relations with the public and press as well as preventing a future re-occurrence, the consultants added.

Separately, Richard Thomas, the information commissioner, at the UK's data privacy regulator, called upon chief executives to take responsibility for the personal information that their organisations hold.

Thomas argued that information can be a "toxic liability" and urged chief executives to ensure that the amount of data held by their organisations is kept to a minimum and that robust governance arrangements are in place. Chief executives must ensure that their organisations have the right policies and procedures in place, that privacy by design features are incorporated in the technology used and that staff are properly trained to counter the risks.

Risk management is also a worry...

The current turmoil in the world's financial markets means that senior finance executives are more worried about their firm's risk management practices than they are about access to capital, according to Towers Perrin.

A recent study conducted by the consultants showed that 72 per cent of respondents expressed concern about their own company's risk management practices and ability to meet strategic plans, while only four per cent perceived the recent financial market meltdown as having a severe impact on their financial prospects. Tower Perrin said the findings suggested that finance executives, regardless of industry, perceive a need to invest in more effective risk identification, measurement and management procedures.

Conversely, Callum McCarthy, the former chairman of the FSA, urged firms to take immediate action to implement measures that would allow them to respond better to future market volatility, rather than carry on with further risk management diagnosis. Turbulence in the global markets had shown that risk management at very many of the best-regarded among the world's financial institutions had failed expectations. Risk management at banks, insurers and brokers had all been found to be wanting, according to McCarthy, who was speaking at the Lord Mayor's City Banquet.

www.fsa.gov.uk/pages/Library/Communication/Speeches/2008/0918_cm.shtml

PPI market failings continue

The FSA has fined Alliance & Leicester £7m for serious failings in its telephone sales of payment protection insurance (PPI). The move came as the FSA promised to increase its level of regulatory intervention in the PPI market after the third phase of its thematic review found evidence of continuing poor processes and systems around sales of the product.

The regulator's work on PPI included a mystery shopping programme that captured customer experiences of face-to-face branch sales of single premium PPI when sold alongside an unsecured personal loan.

The results showed that:

- very few customers were told that the cost of the payment protection would be added to the loan as a single premium and that interest would be charged on this amount
- only half of customers said that they were told about the key limitations and exclusions of the policy – this is fundamental to establishing a customer's need and eligibility
- many customers were not told of both the monthly cost and total cost of their PPI – at the worst-performing firms, very few customers were given adequate information on the cost of their policy.

The FSA is currently considering the most appropriate action to take to deal with ongoing non-compliant sales practices and to identify and remedy non-compliant past sales at firms selling PPI cover.

A further update on the third phase of the FSA's thematic work on PPI will be published in the first quarter of 2009.

www.fsa.gov.uk/pages/Library/Other_publications/Miscellaneous/2008/ppi_update.shtml

Insurance supervisors worldwide promise greater co-operation

The International Association of Insurance Supervisors (IAIS) is to enhance co-ordination efforts among its members and further develop supervisory standards in response to the global financial crisis.

Peter Braumüller, IAIS executive committee chair, said the organisation's standard setting activities will continue to evolve and take into account the lessons being learned from the current financial market crisis, thereby reinforcing

insurance supervisory systems worldwide, strengthening markets and promoting policyholder protection. Braumüller was talking at the IAIS fifteenth annual conference in Budapest in October.

Ten supervisory papers were adopted at the meeting, including six on solvency assessment, two on group-wide supervision, a guidance paper on mutual recognition of reinsurance supervision, and another on the regulation and supervision of captive insurers. The papers can be found by clicking on the following link: www.iaisweb.org/index.cfm?pageID=38

BIBA issues advice

BIBA issued two advice notes to members during September prompted by members' queries in response to the crisis in the banking sector. The first was about client money accounts, while the second looked at how the FSCS would respond in the event of an insurer collapse. The advice can be found on our website at: www.biba.org.uk/BrokerContentDetails.aspx?ContentID=1111


www.biba.org.uk/BrokerContentDetails.aspx?ContentID=1137

And finally...

It is getting very near that time of year again, so we at BIBA would like to take this opportunity to wish all of our readers a very Merry Christmas and a happy, prosperous 2009.

We look forward to seeing you in the New Year.

Your contacts

 We hope that you will find this issue of *Compliance Rules* useful. If you have any comments about the content or have ideas for future issues, please contact either



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Treating customers fairly: towards the December deadline

The Financial Services Authority (FSA) has been seeking to change firms' behaviour by focusing attention on the regulatory requirement to 'treat customers fairly' so as to ensure that customers can expect fair treatment and consumer detriment is minimised.

Such a programme of behavioural change understandably takes time, particularly for the largest firms. Last year, the FSA established a deadline in order to concentrate firms' attention on delivery. Firms have until the end of December 2008 to demonstrate to themselves and to the FSA that they are consistently treating their customers fairly.

Focusing on the outcomes

The FSA will be looking to see that the behaviour of the firm is consistent with the outcomes it wishes they deliver. As a reminder, those outcomes were:

1. Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture
2. Products and services marketed and sold in the retail market 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. Where consumers receive advice, the advice is suitable and takes account of their circumstances
5. Consumers are provided with products that 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.

In June this year, the FSA explained that firms will be expected to:

- demonstrate that senior management have instilled a culture whereby they understand what the fair treatment of customers means; where they expect their staff to achieve this at all times; and where (a relatively small number of) errors are promptly found, corrected and learned from

- be appropriately and accurately measuring performance against all customer fairness issues materially relevant to their business, and acting on the results
- be demonstrating through those measures that they are delivering fair outcomes
- have no serious failings – whether seen through management information (MI) or known to the FSA directly – including in areas of particular regulatory interest previously publicised by the regulator.

Areas of regulatory interest previously picked up by the FSA have included firms failing to explain clearly key information in product disclosure documents, not resolving issues concerning promotional material and using unfair terms in customer contracts (which result in material levels of consumer detriment). This list is not exhaustive and there may be other significant issues in some firms, but it captures some of the main areas which have been the focus of FSA thematic work and which are relevant to BIBA members.

Firms can expect that where they are assessed post-December, and have material issues in any of these areas, they will be judged as posing higher risk to fair outcomes and, as a consequence, should expect stronger FSA intervention.

Industry progress

The FSA witnessed during visits that in most cases firms are making progress with TCF. Firms found to be delivering better than others tended to display the following characteristics:

- commercial strategies were consistent with fair treatment of customers
- active senior management involvement
- the fair treatment of customers was written into personal objectives and reward at all levels within the company
- customer feedback was listened to and acted on.

Overall, such firms have treated TCF as an issue for the firm's culture. Cultural factors which influence whether a firm is treating its customers fairly include: leadership; strategy; decision-making; controls; recruitment, training and competence; and reward.

Cultural indicators include the firm's management information. Ultimately

firms' senior management are responsible for ensuring that the firm delivers against its regulatory obligations. However, the FSA expects firms to make use of appropriate management information and to see evidence of appropriate scrutiny and challenge by senior management. The FSA will be looking to see how senior management satisfy themselves that they are treating their customers fairly.

Firms found failing on TCF

The FSA will use its regulatory tools on those individual firms which have failed to take the TCF initiative seriously, or are failing in their duty to treat customers fairly. For example, the FSA has required firms to undertake a section 166 skilled person's review and referred firms to enforcement. Enforcement cases are being used to highlight the visible application of standards and as a deterrent to other firms in similar situations. More than 30 enforcement cases involving TCF issues have been published since January 2007. For example, on unfair practices in the sale of payment protection insurance, there have been fines of £2.6m so far.

Other examples of regulatory failings relevant to TCF and highlighted in recent enforcement cases include: networks not doing enough to ensure that their appointed representatives are treating customers fairly; misleading 'savings claims' in general insurance adverts; unsuitable advice; and inadequate systems and controls, including firms having insufficient MI.

The FSA has been pleased to work with BIBA during the last year to share good practice and to encourage its members to use the tools developed. Most firms will find that in challenging themselves to meet the December deadline they are examining just how they treat their customers and in a client facing sector that can only be good for business. The minority of firms which fail to treat their customers fairly can however expect tough action.

Jackie Doyle-Price is an associate in the TCF team at the FSA.

