

# COMPLIANCE RULES



Welcome to the first edition of *Compliance Rules* for 2010. BIBA's quarterly regulatory newsletter has now entered its third year of publication and is proving as popular as ever, judging by the feedback from our members. If there is a regulatory topic you would like featured in a forthcoming edition, please let Steve White or Vanessa Young know.

In this issue of *Compliance Rules* we bring you our usual centre spread round-up of BIBA's regulation updates, together with a back-page article by Vanessa on data security.



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## FSA fee and levy proposals – CP09/26

Members will recall that the large hike in the Financial Services Authority's (FSA) fees in Spring 2009 led to calls from firms across the entire industry for the regulator to reconsider the design of its fee structure. These calls were heeded and as a result the FSA issued Consultation Paper CP09/26 late in 2009.

The paper states the FSA's desire to introduce a fairer and more transparent basis upon which regulated fees are levied to individual firms. It announces plans to raise the minimum annual fee from £450 to £1,000 – a substantial increase, affecting firms with a commission/fee income of up to £300,000.

The other major relevant proposed change is to remove the current set of tiered rating based on commission/fee income and replace it with a 'straight line recovery' rate, proposed at £2.27 per £1,000 annual income. This proposal adversely affects firms with an annual income of more than £35 million.

BIBA has responded formally to the FSA and members are encouraged to read our reply which is on our website.

## Changes to IPT

The Government announced in its *Pre-Budget Report 2009* (PBR) an amendment to the rules governing insurance premium tax (IPT). As a result of the decision in the recent 'Homeserve case', which Her Majesty's Revenue & Customs (HMRC) lost in the Court of Appeal, HMRC has decided to impose IPT on broking/administration fees charged in respect of individuals buying insurance in a personal capacity (excluding mid-term adjustments and cancellations).

As this measure is deemed 'anti-avoidance' legislation, the effective date of the change will be 9 December 2009 (the date the PBR was published). Additionally, HMRC plans to continue to collect IPT directly from insurers.

The timing of this announcement came as a surprise to the insurance industry and BIBA has been in detailed discussions with HMRC about the scope of the legislation and issues regarding the collection of the tax.

These discussions have been both cordial and constructive and at the time of writing we are hopeful that the proposed legislation might be amended so as not to catch the majority of broker administration charges. We will not however be able to change the implementation date, which will remain as 9 December 2009.

## Conservative Party proposals

BIBA recently attended a seminar run by the Conservative Party's Shadow Treasury team to look at some high-level issues around the creation of a Consumer Protection Agency (CPA).

Members will recall that the Conservatives issued a White Paper setting out plans to 'abolish the FSA' and replace the current structure with a combination of the Bank of England and the CPA. BIBA had previously met Mark Hoban, Shadow Chief Secretary to the Treasury, to discuss the Conservative Party's plans and the issue forms a key component in BIBA's 2010 *Manifesto*.

## REGULATORY ROUND-UP

### FSA criticises firms' protection of client money and assets

The Financial Services Authority (FSA) has sent a 'Dear CEO' letter to firms raising its concerns about the handling of client money and assets. The letter from Sally Dewar, FSA Managing Director, Risk, has been sent to around 1,000 relationship-managed firms. It expresses concern that firms are not always achieving an adequate level of protection for client money and assets.

A report accompanying the letter sets out the findings from visits to a range of investment firms and insurance brokers during the past nine months and highlights the priority areas where the FSA expects to be focusing its resources and to see improvements in practice in the coming year.

Weak areas discovered include: poor management oversight and control; lack of establishment of trust status for segregated accounts; unclear arrangements for the segregation and diversification of client money; and incomplete or inaccurate records, accounts and reconciliations.

Section three of the report sets out further work that the FSA intends to carry out in relation to CASS. The regulator will continue to carry out visits to firms during 2010 and has promised regulatory intervention where it finds compliance failings. It will also produce a report on the findings from these visits in 2010 and a number of consultations in regard to changing provisions within CASS.

[www.fsa.gov.uk/pubs/ceo/ceo\\_letter0119.pdf](http://www.fsa.gov.uk/pubs/ceo/ceo_letter0119.pdf) – letter

[www.fsa.gov.uk/pubs/other/cass\\_risk.pdf](http://www.fsa.gov.uk/pubs/other/cass_risk.pdf) – report

### BIBA responds to FSA regulatory fees and levies proposals

BIBA has published a formal response to the FSA's Consultation Paper CP09/26 *Regulatory fees and levies: policy proposals for 2010/11* in the members' only section of its website. The paper put forward proposals for the simplification of the structure for the fees it levies on regulated firms and is designed to enhance fairness and transparency.

The FSA proposed the introduction of a standard minimum fee that all firms will have to pay to cover the basic cost of being regulated. This minimum fee will be approximately £1,000, based on 2009/10 costs. There would be one exception to this – the smaller credit unions will continue to pay a lower minimum fee (of either £160 or £540, depending on size), as they offer basic savings and loan facilities to their members.

The paper also proposes that "variable" fees over and above this basic minimum amount increase in direct relation to the size of a firm – by introducing a "straight line recovery" rate to replace the current variable rating structure. This results in an increase in fees for the largest firms reflecting the greater regulatory engagement they receive.

The FSA plans to consult on fee levels for 2010/11 using this new fee model in February 2010, although this will be dependent on the outcome of this consultation.

[www.fsa.gov.uk/pubs/cp/cp09\\_26.pdf](http://www.fsa.gov.uk/pubs/cp/cp09_26.pdf) – CP09/26

[www.fsa.gov.uk/Pages/Doing/Regulated/Fees/calculator/index.shtml](http://www.fsa.gov.uk/Pages/Doing/Regulated/Fees/calculator/index.shtml) – fees calculator

[www.biba.org.uk/PDFfiles/2010CP09-26%20response.pdf](http://www.biba.org.uk/PDFfiles/2010CP09-26%20response.pdf) – BIBA response

### FOS announces new Chief Ombudsman

The Financial Ombudsman Service (FOS) has appointed Natalie Ceeney as its Chief Ombudsman and Chief Executive. Ceeney will join the FOS in March 2010 from the National Archives, where she is Chief Executive and Keeper of the Public Records. She was formerly Director of Operations and Services at the British Library – and previously led strategic consultancy projects across a range of industries at McKinsey & Company.

### Amendments to FSCS compensation limit

The FSA has published a useful *One Minute Guide* to the FSCS's new compensation limits, which came into effect on 1 January 2010. The limit of protection in respect of non-compulsory general insurance and pure protection contracts (eg, term, critical illness and income protection insurance): is for 90 per cent of the claim, with no upper limit. In respect of compulsory general insurance, the protection is unlimited.

The *One Minute Guide* can be found on the FSA's website at:

[www.fsa.gov.uk/smallfirms/resources/one\\_minute\\_guides/71\\_compensation.shtml](http://www.fsa.gov.uk/smallfirms/resources/one_minute_guides/71_compensation.shtml)

### Law Commissions reveal plans for consumer reforms

The Law Commission and the Scottish Law Commission have published a joint report recommending clarification of the law about the information which a consumer should tell an insurer when taking out a policy. Accompanying the report is a draft Bill which applies only to consumers and deals only with the issue of what a consumer must tell an insurer before entering into or varying an insurance contract.

The proposals abolish the consumer's duty to volunteer material facts. Instead, consumers must take reasonable care to answer

their insurer's questions fully and accurately. If consumers do volunteer information, they must take reasonable care to ensure that the information is not misleading.

The bill also establishes a statutory code to determine for whom an intermediary acts when arranging insurance. This code is based largely on the existing law, as supplemented by FOS practice and industry understanding.

[www.lawcom.gov.uk/docs/lc319.pdf](http://www.lawcom.gov.uk/docs/lc319.pdf)

### New consumer champion at FSA

Julian Edwards has joined the FSA in the newly created role of Consumer Senior Adviser. The FSA has established the role as part of its commitment to deliver better outcomes for consumers through intensive supervision and rigorous risk assessment. The new approach also includes a commitment to strengthen the FSA's understanding of consumer issues. Edwards has more than 30 years' experience as a consumer champion working for various organisations including Which? and Consumer International.

### OFT considers changes to consumer credit licensing fees

The Office of Fair Trading (OFT) is seeking comment on proposed revisions to the charging structure for consumer credit licensing fees. The OFT has published a consultation document providing background to the licensing regime and setting out its views on what factors it should take into consideration when developing any revised charging system. The document also highlights some of the criteria that might be chosen to differentiate between different classes of licence applicant.

The OFT noted that any

revised charging structure that is considered suitable for implementation will be thoroughly tested before being formally introduced in April 2011.

The consultation period closes on 11 March 2010.  
[www.offt.gov.uk/shared\\_offt/consultations/oft1149con.pdf](http://www.offt.gov.uk/shared_offt/consultations/oft1149con.pdf)

### Good practice guide launched to assist customers buying insurance online

BIBA has been working with its members, the Association of British Insurers and consumer body Which? to improve some of the areas that we criticised relating to insurance products listed on comparison sites.

BIBA raised concerns with the FSA regarding issues about clarity and treating customers fairly in 2008. Developments since then have led to the insurance industry developing this new guide which covers excess levels, total price disclosure, policy information, add-ons, signposting and referrals.

BIBA believes this new good practice guide, titled Ensuring positive customer experiences of buying insurance online, is a positive step in the right direction. It is urging those of its members that trade online to adopt the practices in this guide.

[www.biba.org.uk/PDFfiles/ComparisonWebsiteGuide2010.pdf](http://www.biba.org.uk/PDFfiles/ComparisonWebsiteGuide2010.pdf)

### FSA's RDR raises investment adviser professional standards

The FSA has set out how it proposes to enhance the professionalism of investment advisers under the Retail Distribution Review (RDR). Consultation Paper CP09/31 details how retail investment advisers will demonstrate a greater level of knowledge and skills and meet enhanced standards in dealing with clients by the end of 2012.

The FSA is proposing the creation of a new in-house

governance structure to ensure advisers achieve this greater level of professionalism through the achievement of new, higher level qualifications; meeting enhanced standards of continuing professional development; and adhering to common ethical standards. The regulator also clarified the new level of qualification investment advisers will need to meet by the end of 2012.

Intermediaries should read section four of the paper if they advise on pure protection products. Here, the FSA considers whether it is appropriate to apply the RDR proposals to providing advice on pure protection products. The FSA concludes that they should consider further reading across adviser service labelling into the GI sector, but that adviser charging should not apply. The regulator asks for views on whether elements of professional standards should apply to advice on pure protection products.

The FSA intends to consult on a proposal to require commission disclosure for pure protection sold under the *Insurance Conduct of Business Sourcebook* (ICOBS) rules where advice is given alongside investment advice.

Comments on the consultation paper should be submitted to the FSA by 16 March 2010.

[www.fsa.gov.uk/pubs/cp/cp09\\_31.pdf](http://www.fsa.gov.uk/pubs/cp/cp09_31.pdf)

### Insurance intermediaries escape extension of remuneration code

The FSA will not extend the application of its new remuneration code of practice to firms other than large banks, building societies and broker dealers from 1 January 2010.

The regulator said in Feedback Statement FS09/5, which provided comment on chapter six of Consultation Paper CP09/10, that it would not

be introducing any new rules on remuneration, nor extending the existing rules to any other sectors at this stage. The regulator based its decision on a number of factors including the large body of work currently underway on European directives containing remuneration provisions, the Walker review of corporate governance, and the progress of the Financial Services Bill.

The FSA will be reviewing the effectiveness of the remuneration code in mid-2010. In the meantime, the regulator expects firms to continue to focus on remuneration risk management. The FSA will continue to focus on this issue during the course of its usual supervisory activity.  
[www.fsa.gov.uk/pubs/discussion/fs09\\_05.pdf](http://www.fsa.gov.uk/pubs/discussion/fs09_05.pdf)

### FOS corporate plan and budget revealed

The FOS has published its corporate plan and consultation on its proposed budget for the next financial year (2010/11) in which it expects to settle a record 210,000 complaints from consumers. This continued growth in the ombudsman's workload will involve an increase in operating costs from £96.6 million (forecast for 2009/10) to £113.5 million (in 2010/11).

The ombudsman has budgeted to break even in 2010/11. The FOS does not as a consequence propose to increase either the total levy paid by financial services firms subject to its compulsory jurisdiction or the amount of the case fee (£500), which will remain at 2009/10 levels. It also plans to close significantly more cases and its 2010/11 budget will increase in line with the additional case fees.

The FOS also forecast that its unit cost – the average cost of handling a case, taking all overheads into account – will be £587 for the current year

(2009/10) and is expected to fall by eight per cent to £540 in 2010/11.

The FSA sets the levy payable by individual regulated firms in the compulsory jurisdiction and it will be consulting on this in a separate consultation during January. Annex B of the FOS corporate plan sets out, on an indicative basis, how this levy might be divided.

The minimum levy in each block looks likely to stay the same or reduce for most blocks – except for an increase of £5 in block 17 for general insurance mediation. The total levy in each industry block also looks set to increase for general insurance intermediaries. A typical levy on an insurance intermediary in the compulsory jurisdiction with £0.5 million commission income is likely to be £120 in 2010/11 as against £80 in 2009/10, subject to the FSA consultation.

Consultation on the plan closes on 22 February 2010.

[www.financial-ombudsman.org.uk/publications/pb10/index.html](http://www.financial-ombudsman.org.uk/publications/pb10/index.html)

### FSA sets out stall in financial crime fight

Margaret Cole, a Director in the FSA's Enforcement and Financial Crime division, provided insight into the scope of the regulator's financial crime mandate and the breadth of work it carries out in this area in a recent speech to the British Bankers' Association.

Cole's speech focused on crime prevention and the FSA's frontline work in its roles, first as 'gatekeeper' ensuring the fitness and propriety of those wanting to operate in the UK and second as industry supervisor.

[www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/1119\\_mc.shtml](http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/1119_mc.shtml)

## Is your data secure?

HSBC, Norwich Union and Nationwide are just some of the household names that have experienced the pain of getting data security wrong, with their shortcomings resulting in fines from the Financial Services Authority (FSA), adverse media commentary and reputational damage.

Financial services firms have a duty to protect personal information under the Data Protection Act 1998 (DPA). Those stakes are set to get higher, however. New powers for the Information Commissioner's Office (ICO) will soon allow it to fine businesses up to £500,000 for serious DPA breaches.

The FSA has also upped the ante. The regulator's financial risk outlook for 2009 identified the recession as having the potential to increase firms' exposure to financial crime such as data theft. This threat is unlikely to abate in 2010. While in July 2009, Margaret Cole, the FSA's Director of Enforcement, warned: "Fraud, particularly identity theft, is a major concern to everyone and firms must ensure that their data security systems and controls are constantly reviewed and updated to tackle this growing threat... In areas where we have previously warned firms of the need to improve, people can expect to see fines increase to deter others and change behaviour in the industry."

PRIN 3 of the FSA's *Principles for Businesses* requires a firm to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. Under PRIN 2, a firm is also required to conduct its affairs with due skill, care and diligence. Additionally, SYSC 6.1.1R requires firms to establish, implement and maintain adequate policies and procedures sufficient to ensure compliance with its obligations under the regulatory system and for countering the risk that they might be used to further financial crime. Data security is also an essential aspect of Treating Customers Fairly.

There are a number of ways in which customer data can be compromised, including:

- the physical security of premises
- visitors to the building
- employees leaving and joining the firm
- staff working offsite – what data is going out of the office, why and how?
- unnecessary access to customer data by employees
- disposing of data
- outsourcing.

Firms should have in place a written policy and procedures governing data security which are proportionate to the risks facing their business and relevant to their day-to-day operations. In drawing these plans up firms should consider:

- securing paper and electronic files when not in use
- introducing an enforced clear-desk policy
- the best way to protect the integrity of computer systems
- using effective passwords
- ensuring that recruitment and staff management processes give comfort that staff are honest
- possibly restricting staff internet and email access and monitoring usage
- ensuring that when outsourcing third-party procedures are at the same level as internal policies
- shredding all confidential paper waste
- have all visitors sign-in and supervised when on the premises
- when throwing away or recycling old computers, ensure that data is wiped clean
- restrict access to sensitive areas of the business.

## Staff

Staff are vital in combating data loss and theft. They need to understand the importance and relevance of data security policies and procedures. Training and awareness programmes to ensure employees are fully aware of more-basic risks to customer

data arising from poor physical security are a must. Firms must also develop an open and honest culture which encourages staff to report data security concerns.

Staff can also prove to be a major threat on the data security front, however. Disgruntled staff, those facing redundancy, in financial difficulties or moving can be a problem. Staff recruitment/vetting is important to weed out those who may be susceptible to stealing data or committing fraud.

Employees need to access customer data as part of their normal duties. Firms should control this access to customer records and it should be revised accordingly as a person's role changes.

The ICO has declared that it is inappropriate for customer data to be removed from the office on laptops or other portable electronic devices, such as Blackberrys and memory sticks, unless it is encrypted. The FSA supports this view. Firms should therefore use encryption for these devices and introduce policies and procedures for restricting the removal of customer data offsite. When transferring data to third-party suppliers, secure internet links, encryption, and registered or recorded mail should be used by firms.

## In the event of loss

Do not delay. Under PRIN 11, firms have a duty to deal with its regulators in an open and co-operative way. A firm must disclose to the FSA appropriately anything about it of which the regulator would 'reasonably expect notice'.

The loss of thousands of unencrypted customer records is something that the FSA will want to know. The regulator will also want to hear about remedial action, so do have in place detailed plans for reacting to data loss or theft, including when and how to communicate with affected customers.

**Data Security in Financial Services**  
[www.fsa.gov.uk/pubs/other/data\\_security.pdf](http://www.fsa.gov.uk/pubs/other/data_security.pdf)

## 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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