

COMPLIANCE RULES



Welcome to the third edition of *Compliance Rules* for 2010. *Compliance Rules* is BIBA's quarterly newsletter on all things regulatory and is compiled using feedback from our members. If there is a regulatory topic you would like featured in a forthcoming edition, please let Steve or Vanessa know.

In this issue of *Compliance Rules* we bring you our usual centre-spread roundup of BIBA's regulation updates, together with a back-page article on the current funding model of the Financial Services Compensation Scheme.

Change to the regulatory infrastructure

Following the formation of the Conservative and Lib Dem coalition, Government announced their plans for a fundamental restructure of the UK's regulatory infrastructure on 17 June 2010.

The announcement confirmed that the FSA will cease to exist in its current form. In its place, three new bodies will be created, with the Bank of England (BoE) playing the lead role in prudential regulation. The Financial Policy Committee (FPC) will report to the BoE on macro-prudential issues and will have the tools to intervene if and when necessary. The Prudential

Regulatory Authority (PRA) will act as a subsidiary of the BoE and be responsible for the day-to-day prudential regulation of banks, building societies and insurers. For all other firms, the prudential regulation will be the responsibility of the Consumer Protection & Markets Authority (CPMA), who will also be responsible for the conduct of business regulation of all firms.

Clearly this announcement raises more questions than it currently answers, so as more information is released, BIBA will share this promptly with members. In the meantime we continue to lobby for the most appropriate, proportionate and cost-effective regulation for our sector.

FSA fees and levies

At the time of writing the recently issued annual FSA fee and levy demands have been the cause of great concern to members of all sizes. The increases have been caused by two main factors – firstly the FSA has introduced a minimum annual fee of £1,000 (first consulted about in 2009 in CP09/26) and a 'straight line recovery'. This has the effect of increasing FSA fees for the smallest plus largest firms (though the 80% or so in the middle have actually seen a reduction in their year-on-year

FSA fee). Secondly (and more considerably) is the significant increase in the Financial Services Compensation Scheme (FSCS) levy. Further details of the FSCS can be found on page four of this edition of *Compliance Rules* plus in the FSCS Key Facts document referred to on the centre pages.

The level of fees and levies charged to insurance intermediaries in the UK are a matter of huge concern. Our members pay significantly more in regulatory costs than their peers in any other European state, a fact that we are bringing to the attention of politicians and civil servants, both at home and in Europe.

Revision of the Insurance Mediation Directive (IMD)

This Autumn the EU Commission will be publishing a consultation paper setting out their plans for revising the IMD. In addition, there is likely to be a public hearing, in Brussels, where interested parties can put their questions to the policy writers and decision makers. BIBA continues to be actively involved in the revision process, via our close participation in BIPAR, but we will welcome the full engagement of our members in this consultation process.



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Member helpline:
0844 77 00 266



BIBA

REGULATORY ROUND-UP

Lloyd's pandemic protocols

BIBA is lending its support to the Lloyd's pandemic protocols which provide clarity about how those firms active in the market can continue to transact business should something affect access to their offices or the Underwriting Room e.g. during a flu pandemic. BIBA member firms which are accredited Lloyd's brokers are being requested to compile relevant contact details for all staff who are authorised to arrange and transact negotiations remotely between insureds and underwriters in the event of a pandemic-type emergency. Members who have yet to send to BIBA the relevant contact information or link to their website can contact Vanessa Young on 0207 397 0233 or youngv@biba.org.uk for further assistance.

Regulator launches new Online Notifications and Applications (ONA) system

The Financial Services Authority has rolled out a new computer system called Online Notifications and Applications (ONA) which is designed to make firms' applications processes easier to manage. ONA is a web based system that will allow firms to submit the following regulatory applications via the internet:

- approved persons;
- appointed representatives;
- variations of permissions;
- passports;
- cancellations;
- waivers; and standing data.

Initially, ONA will be available on an optional basis, i.e. firms may continue to submit applications via the current paper based process / Firms Online. However, the system will become mandatory for all applications listed above in the early Autumn of 2010.

The FSA has produced a One Minute Guide on ONA which can be found by clicking on the link below:
www.fsa.gov.uk/smallfirms/

resources/one_minute_guides/83_ona.shtml

FSA publishes findings of post-implementation review of ICOBS

The FSA has published a post-implementation review statement of findings about the introduction of the Insurance: Conduct of Business Sourcebook (ICOBS) in 2008. The review sought to assess:

- the effects of taking a more principles-based approach on general insurance markets;
- determine whether new rules for protection products were being implemented as intended and assess the impact of more detailed oral disclosure requirements on consumer outcomes; and
- examine consumer outcomes in the private medical insurance market.

www.fsa.gov.uk/pages/library/latest/index.shtml

FSCS Key Facts for brokers

BIBA has produced a factsheet in response to numerous enquiries from smaller insurance brokers about sharp increases in their levy to the Financial Services Compensation Scheme for 2010/11. The factsheet can be found at:

www.biba.org.uk/BrokerContentDetails.aspx?ContentID=1667

EC furthers debate with proposals on insurance guarantee schemes

The European Commission (EC) has published a White Paper setting out a framework for EU action on insurance guarantee schemes (IGS) which will provide a last-resort protection to consumers when insurance undertakings are unable to fulfil their contractual commitments. The paper proposes a directive to ensure that all EU member states have an IGS that complies with a set of minimum requirements.

The proposals will apply to all life and non-life insurance companies,

including those which offer both types of product. They do not, however, extend to pension funds as defined by Directive 2003/41/EC13 or to reinsurance.

The new directive would be a minimum harmonisation directive which would allow member states to provide greater protection than is provided for in the relevant EU legislation if they wish to. The EC has also suggested that the IGSs could be pre-funded by insurers.

The consultation period on the paper runs until 30th November 2010 and any comments about its contents should be sent to the EC at the following address, MARKT-H2@ec.europa.eu. http://ec.europa.eu/internal_market/consultations/docs/2010/whitepaper-on-igs/whitepaper_en.pdf

HMRC publishes guidance on changes to IPT

Members will be aware of changes in the application of insurance premium tax to certain fees charged by intermediaries which were introduced in the budget from 24 March 2010 as a result of the HomeServe case. HM Revenue & Customs has now published guidance on the new legislation which can be found at:

www.biba.org.uk/PDFfiles/IPTGuidanceSeperateContracts.pdf

FSA publish financial crime review for small firms

The FSA has released their report into the financial crime systems and controls in small firms. The review looked at 159 small firms across the retail and wholesale sectors. It covered three main areas:

- anti-money laundering and financial sanctions,
- data security, and
- fraud controls.

The review can be found on the FSA website at www.fsa.gov.uk/smallfirms/pdf/financial_crime_report.pdf

The key findings of the review were:

- Few firms had appropriate due diligence systems in place to identify or deal with higher risk customers or situations.
- The majority of firms relied on policies and procedures that had been prepared by consultants, which in a number of cases were not tailored to their business.
- Many small firms did not have appropriate formal vetting and referencing procedures for staff, at the initial recruitment stage or on an ongoing basis.
- Small firms need to do more to meet their fraud risk obligations in order to mitigate the risk that their business might be used to facilitate fraud.
- Generally, small firms remain weak in their knowledge and implementation of the UK financial sanctions regime.

The FSA has released a one-minute guide on anti-money laundering and updated financial crime good and poor practice on the small firms' website.

www.fsa.gov.uk/smallfirms/resources/one_minute_guides/37_money_launder.shtml

www.fsa.gov.uk/smallfirms/good_practice/protecting_your_business/financial_crimes.shtml

SOCA help on SARs

The Serious Organised Crime Agency (SOCA) has provided BIBA with a series of communication documents which are designed to assist members with their anti-money laundering compliance. Particularly noteworthy, is the information about submitting electronic Suspicious Activity Reports (SARs) via the SAR Online system. This system has been designed for use by those required by the Proceeds of Crime Act 2002 and the Terrorism Act 2000 to submit SARs and allows for the reports to be constructed and

submitted in a secure and efficient manner.

www.biba.org.uk/BrokerContentDetails.aspx?ContentID=1638

BIBA Compliance Manual and Update Service 2010 ready

The BIBA Compliance Manual and the Update Service for 2010 are now on sale and represent better value than ever as prices are being held at 2009 rates. Further information can be found on the BIBA website.

www.biba.org.uk/BrokerComplianceManual.aspx

www.biba.org.uk/PDFfiles/BIBAManual2010Renewal.pdf

FOS' annual review for 2009/10 shows PPI complaints still soaring

The Financial Ombudsman Service (FOS) has published its annual review which showed that it had resolved a record 166,321 disputes (+ 46%) for the year to 31 March 2010. Insurance disputes increased by 38%, and complaints about banking and credit rose by 30%, while investment complaints stayed at the same level.

Insurance complaints represented 42% of the total number of new cases received. The number of new insurance complaints rose from 50,168 cases in the financial year 2008/2009 to 69,034 in 2009/2010. This rise was largely due to a 58% increase in new payment protection insurance (PPI) complaints which increased to 49,196 during the year. Most PPI complaints were in relation to product sales rather than claims handling.

www.financial-ombudsman.org.uk/publications/ar10/ar10.pdf

FSA proposes changes to training and competence regime in CP10/12

The FSA has proposed

changes to the Training and Competence (TC) regime which will see a strengthening of competence requirements for individuals carrying out retail activities and a greater emphasis placed on standards of ethical behaviour. The proposals seek to increase standards of professionalism across the industry, complementing the Retail Distribution Review plans and rules that are already in place for investment advice.

Consultation Paper CP10/12 is entitled '*Competence and ethics*' and includes details of how the FSA intends to modernise its qualifications framework, the Statements of Principle and Code of Practice for Approved Persons (APER) and the Senior Management Arrangements, Systems and Controls (SYSC). The paper will be of particular interest to those general insurance intermediaries which also have a permission to carry out investment business and those approved persons carrying out a significant influence function.

Comments about the document should be submitted to the FSA by 6th September 2010. Rules will be published in a Policy Statement towards the end of 2010.

www.fsa.gov.uk/pubs/cp/cp10_12.pdf

FSA warns brokers over risk of corrupt practices

Serious weaknesses identified in some commercial brokers' anti-bribery and corruption systems and controls mean that there is a significant risk of illicit payments or inducements being made to, or on behalf of, third parties to win business, according to the findings of an FSA review.

The report entitled '*Anti-bribery and corruption in commercial insurance broking – Reducing the risk of illicit payments or inducements to third parties*' concluded that firms needed to do a lot more to ensure they minimise the risk of becoming involved in bribery or corruption, unwittingly or

otherwise. The FSA is hoping that by publishing examples of good and poor practice in the report brokers will look to for improving their systems and controls and raising awareness about the issue.

The FSA said that although it had found some good examples of good practice, a number of common concerns had been identified which included:

- Weak governance of anti-bribery and corruption efforts and a poor understanding of bribery and corruption risk among senior managers.
- Failure to implement a risk-based approach to anti-bribery and corruption in practice.
- Poor responses by many firms to significant bribery and corruption events which should have led them to reassess the adequacy of their preventative systems and controls.
- Very weak due diligence on, and monitoring of, third party relationships and payments with a worrying lack of documentary evidence of due diligence taking place.
- Very little or no specific training was provided on anti-bribery and corruption, even for staff in higher risk positions.
- Although payment authorisation controls appeared generally adequate, virtually no firms took steps to identify unusual payments to third parties. As a result, some firms failed to report suspicious activity until after the FSA visit or follow-up work.
- Inadequate compliance and internal audit monitoring of anti-bribery and corruption work.
- Weak vetting of staff compared with other financial sectors, with a heavier reliance on personal referrals and market gossip than usual.
- Although controls over staff expenses and accounts payable generally appeared to be effective, some firms gave large cash advances

to staff to assist travelling in higher risk countries where they said credit cards were not readily accepted.

- Some firms awarded their brokers large bonuses directly related to the income or profit they generated. This could encourage risk-taking and negligence, and increase the risk of bribery and corruption, particularly where brokers use third parties to win business.

The FSA concluded that broker firms have approached higher risk business involving third parties far too informally and many firms are still not operating at acceptable standards. The regulator also believed that many firms are not currently in a position to demonstrate adequate procedures to prevent bribery – a defence to the Bribery Act 2010's new criminal offence of 'failing to prevent bribery'.

www.fsa.gov.uk/pubs/anti_bribery.pdf

Law Commission looks at the insured's post-contract duty of good faith

The Law Commission has published Issues Paper 7 which focuses on the insured's post-contract duty of good faith. At this stage of the review of insurance contract law the Law Commission is concentrating on claims, and in particular how the duty to act in good faith operates in the context of making a claim. In March 2010 the Law Commission published Issues Paper 6 on Damages for Late Payment, which focused on insurers' duties when receiving a claim. Issues Paper 7 considers the other side of the same coin: what are policyholders' duties when submitting a claim, and what remedies should be available to insurers when policyholders act fraudulently?

The consultation period on Issues Paper 7 is open until 11th October 2010.

www.lawcom.gov.uk/docs/issues7_duty-of-good-faith.pdf

FINANCIAL SERVICES COMPENSATION SCHEME (FSCS) FUNDING MODEL 2010-11

GENERAL RETAIL POOL AGGREGATE CAPACITY £4.03bn				
PROVIDERS £690m max £2m budget	FUND MANAGEMENT £270m max £3m budget	INSURERS £775m max £41.5m budget	BANKS & BUILDING SOCIETIES	PROVIDERS £70m max £0 budget
INTERMEDIARIES £100m max £11.5m budget	INTERMEDIARIES £100m max £24m budget	INTERMEDIARIES £195m max £61.4m budget	£1,840m max £4m budget	INTERMEDIARIES £60m max £0.6m budget
LIFE & PENSIONS £790m max	INVESTMENT £370m max	GENERAL INSURANCE £970m max	DEPOSIT CLASS £1,840m max	HOME FINANCE £130m max

NB. The budget figures are used by FSA in setting annual FSCS levies

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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BIBA apologises for the bright colours, but we think they help the chart above to explain how the FSCS funding model currently works. The scheme is split into five ‘classes’ – Life & Pensions, Investment, General Insurance, Deposit (not unsecured lending) and Home Finance (mortgages).

The table shows the maximum capacity of each class and sub-class. So, for example, the maximum capacity of the General Insurance class is £970m – this is split £775m for the insurers and £195m for intermediaries. The table then goes on to show the FSCS’s current budget figure for each sub-class – this shows that the current FSCS budget for the insurance intermediary sub-class is £61.4m and it is this budget figure that the current levies are based upon.

The huge increase in FSCS levies this year has sharpened members’ interest in the workings of the current funding model and has again highlighted the inequity. The current year’s FSCS levy is based on approximately 30% of what the budget could

eventually rise to, though it is too early to predict with any accuracy what the 2011-12 budget will look like.

What we do know is that the Financial Ombudsman Service is continuing to see an increase in complaints activity regarding payment protection insurance and that around 90% of these complaints are upheld. This is continuing to force a number of mainly credit brokers out of business, with the outstanding compensation payments liability then passed over to the FSCS.

BIBA continues to be actively involved in the FSA’s fundamental review of the FSCS. The regulator will be publishing a consultation paper by the end of the year, with any new rules and funding mechanism to come in from April 2012. It will be very important for members to actively engage with the consultation process – read the paper and formally respond to the FSA with answers to the questions raised in the paper. BIBA will of course let members know when the consultation paper is published

and will suggest some suitable answers.

In the meantime, the unfairness of the current funding model continues to be BIBA’s number one lobbying issue through 2010 and will undoubtedly continue to be so in 2011.