

# COMPLIANCE RULES



Welcome to the second edition of *Compliance Rules* for 2011. *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 we bring you our usual centre-spread roundup of BIBA's regulation updates, together with an article on page four looking at the FSA's approach to client money audit requirements.



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## FSCS levies and the fundamental review

BIBA's political lobbying on the unfairness of the current Financial Services Compensation Scheme (FSCS) funding model has truly struck a chord with members. Nearly 200 Members of Parliament have received letters from BIBA members using our template and this weight of angst has certainly played its part in the final budget for the insurance intermediary sub-class, which has reduced for the current year from a proposed £93.5m to the final £69.5m. However, there is still plenty of work left to do. The current FSCS funding model is fundamentally unfair and we therefore continue to lobby for three fundamental factors:

Firstly, as the fee and levy bills

firms receive in June are driven by rules in place in April, we need to bring pressure on the Government and the FSA to start the revision process in time for the new model to be in place for April 2012.

Secondly, we want an end to cross-subsidies. There is nowhere else in Europe where insurance intermediaries are potentially required to contribute to the failure of banks, mortgage firms and IFAs.

And thirdly, we want separation within the insurance intermediary sub-class for professional insurance brokers from the 10,000 'secondary sellers' of insurance.

Our political lobbying continues. The BIBA member petition attracted more than 6,700 signatures and was presented at the House of Commons. In early June an Early Day Motion was put down by some supportive MPs, we are hopeful of a Westminster Hall debate and we have arranged for a number of questions to be tabled in the House by other supportive MPs.

## The future of regulation

The independent research commissioned by BIBA was launched at Westminster on 21 March to an audience of politicians, civil servants, media and members. The research marked a significant step in

our quest to demonstrate that the current FSA has been inappropriate, disproportionate and overly costly. If you have not seen the research, it can be found within the media centre section of the BIBA website at [www.biba.org.uk](http://www.biba.org.uk).

Since launching the research, we have met with Clive Adamson the new Director of Supervision at the FSA and with HM Treasury's Financial Regulation Strategy team. Both have been keen to discuss the detail of the research and shown a willingness to involve us in discussions about the future. Indeed, those who attended the Regulation Forum at the recent 2011 BIBA Conference in Manchester will have heard the FSA's Charles Roe confirm that such discussions are ongoing.

## BIBA's regional compliance forums

Each BIBA region runs regular informal compliance forums. These allow those people involved in day-to-day compliance to meet and discuss topical compliance issues in a non-competitive environment. They are very popular, so if you are not involved and would like to be, please either contact the Regional Executive for your region (details can be found on the BIBA website), or Steve or Vanessa.

## REGULATORY ROUND-UP

### BIBA's response to Treasury consultation on future regulation

BIBA reiterated its call for a more proportionate and appropriate system of regulation for insurance brokers in its response to the HM Treasury consultation paper *A new approach to regulation – building a stronger system*. Members can find a copy of BIBA's response at: [www.biba.org.uk/PDFfiles/HMTConDocResponse0411.pdf](http://www.biba.org.uk/PDFfiles/HMTConDocResponse0411.pdf)

### Bribery Act set for July introduction

The UK Bribery Act 2010 will come into force on 1 July 2011, following publication of the Ministry of Justice's (MOJ) final guidance on adequate procedures. The new Act modernises UK bribery law and is part of a global effort to eradicate corrupt practices, and will apply to all UK businesses and citizens worldwide, and to companies with a UK presence, even if they are based overseas.

BIBA has prepared a guide for members on the Act in conjunction with commercial law firm Beachcroft LLP which can be found on our website.

[www.biba.org.uk/PDFfiles/BIBABriberyActguidance2011.pdf](http://www.biba.org.uk/PDFfiles/BIBABriberyActguidance2011.pdf)  
- BIBA guidance

[www.justice.gov.uk/guidance/docs/bribery-act-2010-guidance.pdf](http://www.justice.gov.uk/guidance/docs/bribery-act-2010-guidance.pdf)  
- MoJ guidance on adequate procedures

### Insurance Mediation Directive revision

The European Commission is currently revisiting the EU Insurance Mediation Directive (IMD) and the work on possible revisions to the legislation is progressing apace. BIBA as members of the European Federation of Insurance Intermediaries

(BIPAR) has been actively involved with the review discussions and responding to any calls for information from the Commission. BIPAR has made a formal response to the Commission's consultation paper on the IMD revision which BIBA fully supports. This response can be found at: [www.biba.org.uk/PDFfiles/BIPARIMDRevisionresponse.pdf](http://www.biba.org.uk/PDFfiles/BIPARIMDRevisionresponse.pdf)

The Commission has also published a summary of the 125 responses received to the consultation paper, which can be found at: [www.biba.org.uk/PDFfiles/summaryofresponsesen0511.pdf](http://www.biba.org.uk/PDFfiles/summaryofresponsesen0511.pdf)

### FOS annual review of complaints shows further PPI increases

The Financial Ombudsman Service (FOS) has published its latest annual review providing an overview of consumer complaints which it has handled during the financial year from April 2010 to March 2011.

The review shows that the FOS handled a record 206,121 new cases for the financial year, up 26% on the previous year. Payment protection insurance (PPI) complaints rocketed during the year with 51% of the new cases relating to the sale of the product.

[www.financial-ombudsman.org.uk/publications/ar11/ar11.pdf](http://www.financial-ombudsman.org.uk/publications/ar11/ar11.pdf)

### Law Commissions' recommendations for consumer insurance law changes progress

The Government has decided to take forward proposed reforms based on the recommendations made by the English and Scottish Law Commissions in their 2009 report 'Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation'. The Consumer Insurance (Disclosure and Representations) Bill was introduced in the House of Lords during May.

The Bill replaces the

requirement for consumers to volunteer information about everything which a 'prudent insurer' would consider relevant with the requirement that insurers ask particular questions to obtain specific information about the customer. More importantly for BIBA members, the Bill establishes a statutory code to determine for whom an intermediary (an agent or broker) acts when arranging insurance.

[www.publications.parliament.uk/pa/bills/lbill/2010-2012/0068/2012068.pdf](http://www.publications.parliament.uk/pa/bills/lbill/2010-2012/0068/2012068.pdf) - Bill's wording

[services.parliament.uk/bills/2010-11/consumerinsurance/disclosureandrepresentations.html](http://services.parliament.uk/bills/2010-11/consumerinsurance/disclosureandrepresentations.html) - follow progress of Bill.

### FSA reveals financial risks and its priorities in 2011/12

The FSA published its Prudential Risk Outlook (PRO) for 2011, which sets out its assessment of macro economic and financial trends as a context for its micro-prudential regulation and supervision of firms. The analysis supporting the PRO helps inform how the FSA sets priorities and uses its resources.

Those priorities and the resulting resource requirements are detailed in the FSA's Business Plan for 2011/12. The FSA said its business plan has been created against a backdrop of considerable change, particularly with regards to the restructuring of financial services regulation in the UK and its own transition into two new regulators which is due to occur at the end of 2012 or in early 2013. Until then the regulator plans to continue delivering on its statutory objectives and implementing the major initiatives that are already underway.

The FSA said that the 2011/12 business year would be difficult and it would have to ensure that

it is operating effectively as a supervisor as well as taking forward key policy initiatives. The FSA's annual funding requirement (AFR) for 2011/12 is £500.5m, up from £454.7m in 2010/11, a gross increase of 10.1% in overall funding.

[www.fsa.gov.uk/pubs/other/pro.pdf](http://www.fsa.gov.uk/pubs/other/pro.pdf)

[www.fsa.gov.uk/pubs/plan/pb2011\\_12.pdf](http://www.fsa.gov.uk/pubs/plan/pb2011_12.pdf)

### FSCS announces 2011/12 budget

The FSCS has now confirmed its budget for its 2011/12 financial year. The FSCS announced an increase in the budget for the insurance intermediary sub-class from £61m last year to £69.5m for 2011/12. Although the FSCS expects volumes of PPI claims to continue increasing, it does not expect that increase to be as steep as it initially believed, and has revised its claims assumptions downwards from the 20,000 announced in the Plan and Budget to 13,400 and the cost down from £93.5m to the final figure of £69.5m.

[www.biba.org.uk/PDFfiles/FSCSLevyrelease0411.pdf](http://www.biba.org.uk/PDFfiles/FSCSLevyrelease0411.pdf)

### FSA confirms fees and levies for 2011/12

The FSA has confirmed its fee and levy requirements for the 2011/12 financial year in Policy Statement PS11/07. Members can find PS11/07 on the FSA website at:

[www.fsa.gov.uk/pubs/policy/ps11\\_07.pdf](http://www.fsa.gov.uk/pubs/policy/ps11_07.pdf)

The FSA has also published an accompanying newsletter which can be found on their website at:

[www.fsa.gov.uk/pubs/policy/ps11\\_07\\_newsletter.pdf](http://www.fsa.gov.uk/pubs/policy/ps11_07_newsletter.pdf)

The Policy Statement also gives feedback on a proposal presented for discussion in CP10/24 Regulatory fees and levies – policy proposals 2011/12 (October 2010) on establishing a new fee-block for funding client money and assets regulation.

The FSA has made available a final 2011/12 fee calculator on its website at: [www.fsa.gov.uk/pages/Doing/Regulated/Fees/calculator/index.shtml](http://www.fsa.gov.uk/pages/Doing/Regulated/Fees/calculator/index.shtml)

The FSA has also introduced a new application called 'Online Invoicing' which gives firms access to their fees account via a web browser. The phased rollout of this application is now well underway and the FSA is in the process of inviting all firms to register. [www.fsa.gov.uk/Pages/Doing/Regulated/Fees/pilot/index.shtml](http://www.fsa.gov.uk/Pages/Doing/Regulated/Fees/pilot/index.shtml)

## BIBA responds in product intervention debate

BIBA has formally responded to Discussion Paper DP11/1 on product intervention as a regulatory tool. Concerns were expressed that under the proposed new approach the FSA could look at the product design process too narrowly and miss the wider picture with regard to developing issues that could impact consumers detrimentally.

BIBA argues in its response that the introduction of more rules should be as a last resort as this could negatively affect product innovation in the industry and be overly-intrusive. Instead, efforts should be concentrated on identifying and improving the specific areas where the current regulatory regime is not working rather than the current all encompassing debate on product intervention which the discussion paper appears to be encouraging. [www.biba.org.uk/PDFfiles/responsesFSADP11.pdf](http://www.biba.org.uk/PDFfiles/responsesFSADP11.pdf)

## Call for judicial review on PPI complaints handling measures rejected

The High Court has dismissed the British Bankers' Association's (BBA) and Nemo Personal Finance Ltd's legal challenge to the Financial Services Authority's payment

protection insurance (PPI) complaints handling measures.

The BBA had requested a judicial review of the way in which the industry should handle complaints about PPI sales, as set out in the FSA's policy statement 10/12. The BBA objected to the additional requirements in PS 10/12 arguing that they effectively applied new standards to past sales.

## FSA sends 'Dear CEO' letter on regulatory transition

The FSA has sent a 'Dear CEO' letter to larger firms, setting out further details of the transitional arrangements in creating the new regulatory architecture. The first milestone on this journey was an internal reorganisation to help the FSA evolve into the proposed new structure. This sees the FSA replace its Supervision and Risk business units with a Prudential Business Unit (PBU) and a Conduct Business Unit (CBU). [www.biba.org.uk/PDFfiles/FSADearCEOTransitional0411.pdf](http://www.biba.org.uk/PDFfiles/FSADearCEOTransitional0411.pdf)

## BIBA research into the cost of regulation and the contribution of brokers

Members can access BIBA's research on *The contribution of insurance brokers to the UK economy* by London Economics and *The Future regulation for insurance brokers* by Charles Rivers Associates at the following links: [www.biba.org.uk/PDFfiles/LONDONECONOMICSFINAL.PDF](http://www.biba.org.uk/PDFfiles/LONDONECONOMICSFINAL.PDF)

[www.biba.org.uk/PDFfiles/CRAFIREPORT.PDF](http://www.biba.org.uk/PDFfiles/CRAFIREPORT.PDF)

## ICO gives website owners one year to comply with EU cookies law

The Information Commissioner's Office (ICO) has given organisations and businesses that run websites aimed at UK consumers one year to 'get their house in order' before enforcement of the new EU cookies law begins.

The EU's Privacy and Electronic Communications

Directive came into force on 26 May 2011 and requires business and organisations to obtain consent from visitors to their websites in order to store and retrieve usage information from users' computers. The most common technique of storing information is widely known as a cookie.

The UK government revised the Privacy and Electronic Communications (EC Directive) Regulations 2003, to address the new EU requirements. The new Privacy and Electronic Communications (EC Directive) (Amendment) Regulations 2011 make clear that UK businesses and organisations running websites in the UK will need to get permission from visitors to their websites before storing cookies on users' hard drives.

The ICO has been charged with regulating the new rules for websites aimed at UK consumers. Guidance on how the ICO will enforce the new rules is available at: [www.ico.gov.uk/~media/documents/library/Privacy\\_and\\_electronic/Practical\\_application/enforcing\\_the\\_revised\\_privacy\\_and\\_electronic\\_communication\\_regulations\\_v1.pdf](http://www.ico.gov.uk/~media/documents/library/Privacy_and_electronic/Practical_application/enforcing_the_revised_privacy_and_electronic_communication_regulations_v1.pdf)

## FSA confirms new consumer complaint handling rules (CP11/10)

The FSA has confirmed new complaints handling rules as part of a package of measures to drive up standards within the industry. Consultation Paper CP11/10 provides feedback to Consultation Paper CP10/21, which related to consumer complaints and Financial Ombudsman Service (FOS) award limits and also includes final rules. The new rules include:

- Abolition of the 'two-stage' complaints handling rule to make sure firms resolve complaints fairly and do not dismiss them the first time, requiring persistence from the customer to pursue the complaint (takes effect on 1 July 2012);
- Requiring firms to identify

a senior individual responsible for complaints handling (takes effect on 1 September 2011);

- Additional guidance to help firms understand the processes they might need in place to meet FSA requirements on root cause analysis (takes effect on 1 September 2011); and
- Further guidance requiring firms to take account of ombudsman decisions and previous customer complaints (takes effect on 1 September 2011).

Consultation paper CP11/10 also confirms an increase to the limit on awards made by the FOS from £100,000 to £150,000, with an effective date of 1 January 2012.

The paper also launches a consultation on an amendment to the definition of 'eligible complainant' to allow consumers who are wrongly pursued for a debt by a debt owning firm to complain to the FOS. Comments about the consultation paper should be submitted to the FSA by 31 August 2011. [www.fsa.gov.uk/pubs/cp/cp11\\_10.pdf](http://www.fsa.gov.uk/pubs/cp/cp11_10.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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# CLIENT MONEY AUDIT REQUIREMENTS FOR INSURANCE BROKERS – KEY DEVELOPMENTS TO ENHANCE QUALITY AND CONSISTENCY

Client money is a key area of focus for the FSA and one which regulation continues to strengthen following the economic crisis.

The FSA's client money risk team (or client assets unit) identified numerous cases of non-compliance with the rules including a number of material failings within the auditor's report during firm visits.

This led to the Bank of England and the FSA setting up a joint working group in September 2010 and the release of Consultation Paper CP10/20 - 'Improving the auditor's report on client assets'. The consultation paper set out proposals to improve the quality and consistency of the auditor's report on client assets which in turn would increase their value as a supervisory tool to the FSA.

The external auditor's client money audit report forms a major component in the FSA's supervision of insurance brokers and intermediaries' handling of client monies. Consequently, the FSA's CP10/20, and its subsequent Policy Statement PS11/5 which provides feedback and sets out new requirements for firms and their external auditors, will have implications for certain firms in the broking sector and needs to be prepared for.

### Current audit requirements for insurance brokers

An auditor must be appointed where the following applies:

- Operation of a non-statutory trust account; and / or
- Operation of a statutory trust account that holds at least £30,000 (at any one time).

It is the responsibility of the broker to assess, on a continuing basis, if it is exempt or appoint an auditor where this is required.

The audit should be performed over the relevant financial period. Auditors have four months from the end of the audit period covered to provide

the audit report.

Under SUP 3 of the FSA Handbook, the auditor is required to report whether, in their opinion:

- (1) The firm has maintained systems adequate to enable it to comply with the rules in CASS 5.1 to 5.8 (except CASS 5.2 – holding money as an agent of the insurer) throughout the period since the last report was made;
- (2) The firm was in compliance with the CASS 5 rules (except CASS 5.2) at the date at which the report is made;
- (3) If there has been a secondary pooling event (see 'Client Bank Accounts' section below) during the period, the firm has complied with CASS 5.6.

Failings in the auditor's report has not so much been the *what* is to be audited or *when*, but the *how*. Client money is a complex area and remains challenging for both brokers and auditors in terms of understanding the rules, how these are applied in practice and also identifying the relevant systems and controls to audit. As such, the quality and consistency of the auditor's report has been variable and, in some cases, has failed to identify key deficiencies in a firm's compliance with the client money rules and associated systems and controls.

### Key developments

After the release of PS11/5, the main developments to the auditor's report are as follows:

- Requirements to be clearly set out for the auditor's report for firms who hold client money and for 'limited' reports where firms claim not to hold client money.
- The Auditing Practices Board (APB) to develop and release guidance (the APB has established a Client Asset sub-committee to steer this project).
- Development of a template

to be used for the auditor's report.

- The auditor's report to include a separate template schedule identifying the specific breaches noted.
- Management to provide comments in the template schedule of the actions taken and/or mitigating factors associated with each breach identified.
- The auditor's report to be signed in the name of the audit partner and not the audit firm.

### Main considerations for brokers

While PS11/5 is applicable to audit activity, there are a number of important implications for brokers:

- (1) Risk to audit firms is higher as a result of the new requirements. This is likely to result in more detailed client money audit work, particularly if the CASS 5 rules change. As such, it is likely that client money audit fees charged by audit firms will increase.
- (2) It is expected that management satisfy themselves as to the competence of the auditor for client money audit work. Therefore brokers should ask for details as to the level of experience, knowledge, and training of the client money audit team (at the very least this will ensure value is being obtained for the cost of the client money audit).
- (3) In light of (2) it should be remembered that compliance with client money rules is the responsibility of firms and not auditors, and that any enforcement action as a result of failure will in the first instance be against the firm and the approved persons. Therefore the accuracy of the auditor's report is crucial since firms place reliance upon it.

- (4) Firms should determine what other assurance of client money is required because an annual audit at the end of a financial year is not sufficient given that issues can occur during the year. Compliance monitoring, internal audit and any other assurance activities as applicable should play a key role throughout the financial year.

In summary, the client money audit is crucial as it allows management to satisfy themselves that the client money rules are being complied with, and therefore client monies are being adequately protected as required by Principle 10 of the FSA Handbook. Client money is a key FSA area and recent fines and other enforcement actions against firms and directors as a result of failures further highlight the importance in achieving compliance with this critical and high risk regulatory area.



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