

COMPLIANCE RULES



Welcome to the first edition of *Compliance Rules* for 2009. We are delighted with the feedback we have received, but do not intend to rest on our laurels – if you can think of ways of improving BIBA's newsletter, please contact us.

In this issue, we bring you our usual centrespread round-up of BIBA's regulation updates, together with a back-page article by Jonathan Clark, Director of Claims at the Financial Services Compensation Scheme (FSCS), who seeks to explain how the scheme pays out compensation and how brokers can help getting claims paid. We begin, however, with Steve White, BIBA's Head of Compliance and Training, who will set the regulatory scene for 2009.

What to look out for in 2009 – commission disclosure

The Financial Services Authority (FSA) set out its decision not to mandate commission disclosure in the commercial market in Feedback Statement FS08/7. Hopefully this will be followed by the granting of Industry Guidance status to the industry solution that BIBA has led the development of in the first quarter of 2009.

Once confirmed, we have promised the FSA a range of support activity which will include issuing a 'helpful hints' document to our members, running training courses

around the UK, updating the *BIBA Compliance Manual*, publishing a special edition of *Compliance Rules*, and instigating and writing press articles to place in various commercial customer trade publications. Our activities, however, will not extend to policing, measuring or enforcing the guidance – after all, we are a trade association, not a quasi-regulator.

Effects of the economic crisis

The global credit crisis will have a knock-on effect for regulators and these are likely to manifest themselves in a number of ways.

First, the attention of supervisors will undoubtedly switch away from 'less critical' areas and their focus will be much more on prudential matters – capital adequacy and liquidity. Second, with many large financial institutions trading globally, there will be much greater and more visible co-operation between regulators when it comes to prudential regulation of the major groups. Third, moves to regulate the credit rating agencies will gather in pace as the lessons learned in the run-up to the current crisis are converted into actions.

The whole debate about compensation arrangements and how these are funded will resurface as the financial markets begin to stabilise.

The BIBA Manifesto 2009

The *Manifesto* establishes BIBA's lobbying agenda for the coming year. In respect of regulatory issues, the *Manifesto* sets out the following:

Financial Services

Compensation Scheme – UK insurance intermediaries could be subject to a levy to contribute towards compensating the customers of failed banks. The UK is the only EU member state where such a practice exists. We believe this to be unfair and will work to seek a review of the funding model.

Better regulation – we will continue to work with the FSA and the Treasury and maintain our working relationships with the Financial Ombudsman Service, the FSCS, the Better Regulation Executive and the FSA's Small Business Practitioner Panel to achieve better, more cost-effective regulation.

Principle-based regulation – we will support Government and regulatory initiatives to develop more appropriate and proportionate regulation in the insurance sector.

Level playing field – we will work with BIPAR (the European Federation of Insurance Intermediaries) and the WFII (World Federation of Insurance Intermediaries) to achieve a level playing field for brokers both in the UK and in Europe.

The best insurance is a BIBA broker

www.biba.org.uk

Member helpline:
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BIBA

REGULATORY ROUND-UP

FSA decides against mandatory commission disclosure for commercial customers

BIBA has welcomed the FSA's decision not to mandate the disclosure of commission in the commercial insurance sector, preferring instead to give firms the opportunity to address its concerns in this area by means of an industry solution.

The FSA said in Feedback Statement FS08/7, entitled *Transparency disclosure and conflicts of interest in the commercial insurance market*, that industry guidance has real potential to lead to a change in the market and for its desired customer outcomes to be achieved. The regulator added that if intermediaries adopt and adhere to the guidance, it would neither be necessary nor proportionate for it to make rules to achieve the outcomes.

BIBA has been working closely on the development of an industry solution in conjunction with the Association of British Insurers (ABI), the International Underwriting Association, the Lloyd's Market Association, the London & International Insurance Brokers' Association and the Institute of Insurance Brokers. An industry solution is believed to be the most appropriate method of achieving the regulator's desired outcomes for commercial customers.

The industry solution has been submitted to the FSA's formal industry guidance process. It is hoped that guidance status will be confirmed in the first quarter of 2009.

The FSA will keep the situation under review. It will assess progress as to whether customers are receiving sufficiently clear and comparable information about their intermediaries' services, capacity and remuneration in 2010/11.

www.fsa.gov.uk/pubs/discussion/fs08_07.pdf

Changes to PII limits on the horizon

Members must not forget the changes to the professional indemnity insurance (PII) requirements for intermediaries which came into effect on 1 March 2009.

Article 4(7) of the Insurance Mediation Directive requires that PII limits be reviewed every five years to keep them in line with movements in the European Index of Consumer Prices.

The FSA's board made the changes at its meeting in January, which result in the minimum limits of indemnity rising to: €1,120,200 for a single claim (currently €1,000,000); and €1,680,300 in aggregate (currently €1,500,000) or, if higher, 10 per cent of annual income up to £30 million.

The new limits of indemnity apply to a PII policy or a comparable guarantee agreement, commenced, renewed or extended with effect on or after 1 March 2009. Any other existing non-annual arrangements must be aligned with the new limits of indemnity before 1 March 2010.

www.fsa.gov.uk/pubs/handbook/hb_notice84.pdf

Regulator sets down financial risk outlook for the coming year

The FSA has published its *Financial Risk Outlook (FRO)* for 2009 outlining the main risks facing firms, consumers and the regulatory system in the economic downturn.

The FRO's conclusions are a major element in the FSA's priority-setting arrangements which were set out in its business plan published on 12 February 2009.

The challenges include banks adjusting their business models to operate successfully in difficult conditions in financial markets and in the real economy. Firms are also reminded of the importance of treating customers facing difficulties with fairness.

Members can find a copy of the FSA's FRO at the link

below and would be well served finding the time to read its contents.

www.fsa.gov.uk/pubs/plan/financial_risk_outlook_2009.pdf

SYCS changes due in April

Members are reminded of changes to the *Senior Management Arrangements, Systems and Controls Sourcebook (SYSC)* which will come into force on 1 April 2009. The changes apply to all firms not subject to the Markets in Financial Instruments or Capital Requirements Directives, except for insurers.

Currently, mortgage and insurance intermediaries and IFAs are subject to SYSC 2 – senior management arrangements – and SYSC 3 – systems and controls. The FSA will apply the 'common platform' (SYSC chapters 4 to 10) to these firms instead of the requirements in SYSC chapters 2 and 3 from the beginning of April.

This will mean some new requirements – such as on outsourcing and managing conflicts of interest – but the FSA expects that apart from these, firms that comply with their existing provisions in SYSC 2 and 3 now will not need to change their behaviour when moving to the 'common platform'.

www.fsa.gov.uk/smallfirms/good_practice/managing_your_business/systems_changes.shtml

Non-executive directors vital to TCF

Sarah Wilson, Director, Treating Customers Fairly, FSA, highlighted the important part that non-executive directors (NEDs) play in ensuring financial service firms serve their customers well. Wilson focused on three aspects of the non-executive director's role, namely business strategy and its governance, risk management and oversight, and reward setting out their relationship to the fair treatment of customers. Wilson made her comments

at a recent ABI workshop. www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0205_sw.shtml

No need for telephone call taping technology

BIBA is reminding members that they do not need to buy costly telephone technology in order to comply with the FSA's rules designed to combat market abuse which come into force in March 2009.

A number of our members have been targeted by technology providers telling them that they fall within the scope of the new rules and consequently should be recording certain telephone conversations. General insurance intermediaries are not subject to these rules and have no need to buy-in extra telephone services.

Debate on consumer responsibility re-opened

The FSA is hoping to provoke a debate on the nature of consumer responsibilities and how consumers can be encouraged to better understand and protect their own interests when engaging with the financial services industry.

Discussion Paper DP08/5 explores how the FSA currently takes account of its responsibilities in carrying out its activities and some ideas of what a 'better' world might look like. It also considers current obstructions to achieving improvements in consumer understanding. The concept of caveat emptor – or buyer beware – firmly underpins the document.

The FSA has no power to impose responsibilities on consumers, but is required by law to consider the general principle that consumers should take responsibility for their decisions when setting its consumer protection agenda.

Comments about the paper should be submitted to the FSA by 19 June 2009.

www.fsa.gov.uk/pubs/discussion/dp08_05.pdf

Competition Commission publishes remedies for PPI in final report

The Competition Commission has published its final report into the Payment Protection Insurance (PPI) market, setting out the measures it has decided are necessary to introduce competition between suppliers. A full copy of the report can be found at the link below:

www.competition-commission.org.uk/rep_pub/reports/2009/fulltext/542.pdf

The Commission has concluded that businesses that offer PPI alongside credit face little or no competition when selling PPI to their credit customers. The following raft of measures will be introduced in order to encourage competition in the market:

- a ban on the sale of PPI during the sale of the credit product and for seven days afterwards
- a prohibition on single-premium policies
- credit providers will have to give personal PPI quotes annual statements
- measures to ensure that improved information is available to consumers to make it easier for them to compare and search for products and switch policies at a later point.

The Commission expects that the measures will come into force during 2010, with the information remedies in place by April 2010 and other measures by October 2010, each to coincide with Government common commencement dates for new legislation and regulation.

Separately, the FSA issued a clarification of its ICOBS requirements following publication of the final report from the Competition Commission's market investigation into the supply of PPI.

The FSA also sent a 'Dear CEO' letter to all firms still selling single premium PPI with unsecured personal

loans, asking them to withdraw the product by no later than 29 May 2009.

www.fsa.gov.uk/pages/Library/Other_publications/Miscellaneous/2009/icobs.shtml

FOS budgets for record complaints in 2009/10

The Financial Ombudsman Service (FOS) has published its corporate plan and proposed budget for the next financial year, 2009/10. The Ombudsman has budgeted to receive a record 165,000 complaints from consumers in the next financial year, compared with 115,000 complaints for 2008/09. Motor insurance complaints are expected to rise by a staggering 57 per cent to 11,000 cases.

This 44 per cent rise in complaints will involve an increase in operating costs from £62.7m (forecast for 2008/09) to £92.5m (in 2009/10). This includes the cost of 300 additional adjudicators needed to help resolve the additional complaints that are expected.

The average cost of handling a case, taking all overheads into account, is expected to rise by 2.8 per cent to £559 in 2009/10. Operating costs are to be met mainly by an increased case fee – from £450 to £500 – paid by those financial firms that have four or more disputes referred to the FOS during the year. It is proposed that the first three cases should continue to be free for each firm covered by the Ombudsman.

www.financial-ombudsman.org.uk/news/updates/corporate_plan_and_09-10_budget.html

Revision to FSCS for speedier compensation payments

The FSA has set proposals for speeding-up the pay-out of compensation to make it possible for customers to receive back their money within seven days if a bank collapses.

Consultation Paper CP09/3

aims to simplify eligibility for deposit compensation to include all private individuals and small entities. It also recommends that eligible depositors receive a compensation pay-out on a gross basis, which would ignore any debts the depositor has with the same firm, in an attempt to allow the quick processing of claims. Deposit-taking firms would also be required to hold up-to-date information about customers and would proactively have to tell consumers which trading names are covered by a particular authorisation.

The paper also includes proposals detailing how the FSA aims to increase the awareness and understanding of the FSCS among consumers. This would involve a wider strategic programme including an advertising campaign designed to raise consumer awareness of compensation arrangements, plus requiring deposit takers to make prescribed disclosures providing information about the existence of the FSCS and its basic coverage.

Comments on CP09/3 should be submitted to the FSA by 6 April 2009. www.fsa.gov.uk/pubs/cp/cp09_03.pdf

Approved persons' regime extension proposed

The FSA has proposed changes to the scope of the approved persons' regime which will enable it to extend its scrutiny of senior management competence at firms. Consultation Paper CP08/25 clarifies the FSA's expectations of those individuals within firms that perform a 'significant influence' function, and in particular, those who are responsible for corporate governance.

Proposals put forward in the paper include:

- extending the definition of the existing CF1 (director) and CF2 (non-executive director) controlled functions to include

certain individuals in parent companies to which an authorised firm is accountable

- clarifying the role of non-executive directors to make clear that the FSA will, in future, look at non-executives more closely where it believes they should have intervened more actively with a firm's management

- extending the definition of CF29 (significant management function) to include all proprietary traders where they can exert a significant influence over a firm
- amending the application of the approved persons regime to UK branches of overseas firms based outside the EEA
- extending the rule obliging firms to provide references for applicants of the CF30 (customer function) to all controlled functions if requested to do so.

The consultation period on this document closes 31 March 2009. The final rules will be published in a policy statement in the second quarter of 2009. The consultation paper can be accessed at the link below: www.fsa.gov.uk/pubs/cp/cp08_25.pdf

Regulator clarifies its use of firm-commissioned reports

The FSA has proposed a small change to the *Enforcement Guide* (EG) in order to clarify its expectations in relation to reports which firms commission from their legal or other advisers.

Consultation Paper CP09/5 provides firms with guidance on the FSA's approach to using firm-commissioned reports in anticipation of possible enforcement action. Firms often choose to commission internal reports from lawyers or accountants in response to supervisory concerns.

Feedback on the consultation and a revised text for EG will be published at the beginning of April 2009. www.fsa.gov.uk/pubs/cp/cp09_05.pdf

The need for a compensation scheme has never been greater

Jonathan Clark, Director of Claims at the Financial Services Compensation Scheme, talks about how claims are paid and how the insurance industry can help to get claims paid.

Since the FSCS was set up in 2001 we have helped hundreds of thousands of people and have paid out several billions of pounds in compensation. Our role is to provide compensation to consumers of financial products or services when authorised firms are not able to meet claims made against them. The existence of a compensation safety net protects individuals, leading to greater confidence in their dealings with regulated firms and the financial system.

The FSCS does not maintain a large standing fund to meet claims when needed. Rather, the FSCS raises levies each year to enable us to meet the anticipated costs of compensation and management costs of eligible claims. Any fund balances held from the previous year's levy are reflected in the funding requirements for the coming year. FSCS makes recoveries from firms in default or third parties, wherever reasonably possible and cost-effective, which are offset against future levies.

As a fund of last resort, it is only when a firm goes out of business and is no longer trading that the FSCS steps in to help. Before the FSCS can consider claims against that firm it has to be satisfied that the firm has insufficient assets to pay claims. At this point we declare the firm "in default". The scheme evaluates all claims on a case-by-case basis and can award compensation when there is a legal liability against the firm. The general aim is to put the consumer back in the position they would have

been had the firm not been declared in default.

Since January 2005, FSCS has dealt with more than 300 insurance intermediary related claims. The total compensation cost for these claims has come to just over £300,000. The types of claims have varied significantly from a simple return of premium to assessing a claim for which no policy was in place. We have not yet seen advice claims for consumers relating to insurance.

We hope BIBA's members do not have to deal with us, but if you do, here are some aspects to bear in mind:

Declaring firms in default

Firms will always be fully aware that they are about to be declared in default. Before this happens, the firm's financial position is fully assessed and they should be in correspondence with FSCS. Most intermediary insurance firms that have been declared in default to date have been smaller firms. We try to work closely with the firm or its insolvency practitioner when determining a default.

Settling claims

We have several approach bases for resolving claims. The most common approach is to return premiums; this is a fairly straightforward process when we can see cover was not placed.

More complex claims arise if cover was not arranged for a claimant and a claim is made against a policy following an accident, in which case we assess that claim against the cover that would have been in place had the insurance been properly arranged. For example, if a broker had negligently not placed car insurance for an individual and that individual crashed into a fence claiming a loss, we would review the insurance policy that they had (or would have) elected to buy. If that policy would have provided cover, then we can uphold the claim.

How to help us reach a decision

If we receive good quality data from the firm declared in default it makes it a lot easier to evaluate and process claims. Cooperation from any successor firm that acquires the business in default is also invaluable.

Recent high-profile defaults in the financial world have happened outside the insurance area in the banking world. We have made compensation payments of more than £18bn, largely under the Banking (Special Provisions) Act. These payments have been in response to the defaults of Bradford and Bingley; Heritable Bank; Kaupthing, Singer and Friedlander; Landsbanki (Icesave) and London Scottish Bank plc. At the moment, FSCS anticipates the interest costs from these failures to be attributed solely to the deposit class and do not anticipate levying them before 31 March 2009 for costs already accruing.

To find out more on this issue, BIBA members can look at the letter published by the FSA, which can be found at: www.fsa.gov.uk/pubs/other/fscs_levies.pdf

Looking forward, among the issues facing the industry is that of payment protection insurance. FSCS has already had claims from firms relating to PPI claims and we are expecting more to follow.

The current compensation limit for advice about and arranging of general insurance products is 100 per cent of the first £2,000 and 90 per cent of the balance, with no upper limit. The FSA recently consulted on the limits for all FSCS sub-schemes in Consultation Paper CP 08/15. The outcome of that consultation paper is not yet known.

For more information on FSCS log on to www.fscs.org.uk/industry.

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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