

# COMPLIANCE RULES



**Welcome** to the third issue of *Compliance Rules*. This issue begins with an article from Steve White who describes the key ingredients of a possible market solution on transparency, disclosure and conflicts of interest for commercial insurance buyers.

### A possible industry solution

The Financial Services Authority's discussion paper 08/2 (DP08/2) made reference to work being led by BIBA on a possible industry solution. Despite the tone of DP08/2, the FSA has always maintained that it would prefer the industry to agree a solution itself, rather than write more rules.

Once it became clear that the FSA was not going away and that the choice was either more rules or an industry solution, BIBA and its London Market Brokers' Committee (LMBC) committed themselves to designing a solution that would achieve buy-in from both the market and the regulator. This has been done by regular dialogue with members – via an email questionnaire and regional compliance forums.

### How might the model look?

The model BIBA has been working on is still based on the principle that

the commercial customer receives a clear and accurate disclosure of the intermediary's commissions, should they request this.

However, the model does go on to address several key components of transparency – areas of concern raised by the FSA in DP08/2:

- 1. Status** – it is often unclear to commercial customers the capacity in which the intermediary is working, especially where a binder or a managing general agent is involved. The model will look to assist firms in giving greater clarity to customers.
- 2. Breadth of choice** – the FSA's market failure analysis in 2007 identified that commercial customers often overestimate how much searching of the market is undertaken by the intermediary on their behalf. The model will look to assist firms in giving greater clarity to customers.
- 3. Conflicts of interest** – the model will look to pull together some of the guidance BIBA has previously issued on how to identify and manage conflicts, how to create an internal conflicts management policy, and

on management information and culture.

- 4. Transparency** – the model will look to achieve a position where the intermediary is confident that the commercial customer has the right to request information on the intermediary's remuneration. It will consider how TOBAs and oral disclosure can be used to achieve this.
- 5. Disclosure** – the model will address what should be disclosed, including the treatment of contingents and work transfer arrangements, and will provide template wordings to assist in the standardisation of the disclosure, when requested.

The model will address each of these issues in more detail, but this outline should give members an understanding of what is being designed. At the time of writing (late July), both the Association of British Insurers and the Institute of Insurance Brokers are actively supporting the development of an industry solution. Clearly, as this issue develops, BIBA will keep its members fully updated.



## REGULATORY ROUND-UP

### FSA's progress report on TCF says firms must try harder

The Financial Services Authority (FSA) has told firms that they will have to step up their efforts considerably if they are to meet the end of December 2008 deadline for consistently treating their customers fairly.

Findings from the FSA's latest review of a sample of 96 relationship-managed firms showed that only a minority (13 per cent) of those assessed met the March 2008 interim deadline for ensuring that they have appropriate management information or measures in place to test whether they are treating their customers fairly. However, the FSA was confident that with "substantial continuing effort" approximately 80 per cent of the same sample was still capable of meeting the December deadline.

The report contains examples of good and poor practice some of which will be relevant to all firms.

[www.fsa.gov.uk/pubs/other/tcf\\_progress.pdf](http://www.fsa.gov.uk/pubs/other/tcf_progress.pdf)

The FSA reminded firms of what they will need to do in order to meet the December deadline:

- demonstrate that senior management has instilled a culture within the firm 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 by firms, corrected and learned from
- be appropriately and accurately measuring performance against all customer fairness issues materially relevant to their business, and be 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.

The FSA has also included some early lessons emerging from the enhanced supervisory strategy for small firms

which are worth looking at in annexes 1 and 2. The regulator does not plan to publish the results of the enhanced strategy before the end of Q4 2008.

The FSA's website also contains further information on its regional assessment programme and how firms may prepare for it.

[www.fsa.gov.uk/pages/Doing/small\\_firms/general/tcf/assessments/index.shtml](http://www.fsa.gov.uk/pages/Doing/small_firms/general/tcf/assessments/index.shtml)

Separately, the FSA asked firms how well their appointed representatives were doing on the treating customers fairly front. All principal firms must put appropriate controls in place and management information to allow them to be confident that their appointed representatives are treating their customers fairly.

[www.fsa.gov.uk/pubs/other/factsheet\\_appointed\\_reps.pdf](http://www.fsa.gov.uk/pubs/other/factsheet_appointed_reps.pdf)

The £735,000 fine which the FSA recently slapped on Hastings Insurance Services Ltd for failing to treat its customers fairly in relation to cancelling around 4,550 incorrectly priced motor policies was an interesting case. The FSA found that the way in which the policies were cancelled and the service that Hastings gave to its customers following the cancellation, showed the firm focused on the financial cost to itself and did not properly consider the alternatives, or the detrimental effect on customers – a salutary TCF lesson for all.

[www.fsa.gov.uk/pubs/final/hastings.pdf](http://www.fsa.gov.uk/pubs/final/hastings.pdf)

### Financial stability and depositor protection under the microscope

The near collapse of Northern Rock last year and the continuing global credit crunch has resulted in a stronger focus on financial stability and depositor protection in the UK.

The Treasury, Bank of England and the FSA (the tripartite authorities) have a joint role to play in ensuring that the UK's financial system remains resilient and able to cope with turbulence in the markets both at home and abroad. They are also keen to ensure that consumers have a responsive compensation system in which they can have confidence should a bank get into difficulties.

These concerns have led to the publication of a series of consultation documents aimed at introducing reforms to ensure that the regulators are better co-ordinated, have the necessary tools to deal with a bank's

failure, and that consumers are adequately and swiftly compensated in the event of a collapse.

Two consultation documents were published in July which build on proposals first published in January for strengthening the framework for financial stability and depositor protection. The first, entitled *Financial stability and depositor protection: further consultation* explains the tripartite authorities' plans going forward, providing a response to issues raised in the earlier consultation and seeks views on some key outstanding questions.

The second consultation paper puts forward the concept of a special resolution regime (SRR) which is designed to reduce the impact of a failing bank on the UK's financial systems. The paper proposes legislative changes to introduce a new insolvency procedure for banks based on existing liquidation provisions, to provide for the winding up of a failed bank and to facilitate rapid Financial Services Compensation Scheme payments to eligible claimants. The latter measure could well have repercussions for general insurance intermediaries as contributors to the FSCS.

A third consultation document, also published in July, follows on in this series and consults on changes to the disclosure and transparency rules (this should not be confused with discussions going on in the commercial insurance market at the moment). The FSA's consultation paper 08/13 proposes that financial institutions in receipt of liquidity support from a central bank will have a legitimate interest for delaying the public disclosure of such support.

The documents can be accessed at the following links:

[www.hm-treasury.gov.uk/media/E/1/consult\\_depositorprotection010708.pdf](http://www.hm-treasury.gov.uk/media/E/1/consult_depositorprotection010708.pdf)

[www.hm-treasury.gov.uk/media/1/1/consult\\_finstab\\_specialresolution220708.pdf](http://www.hm-treasury.gov.uk/media/1/1/consult_finstab_specialresolution220708.pdf)

[www.fsa.gov.uk/pubs/cp/cp08\\_13.pdf](http://www.fsa.gov.uk/pubs/cp/cp08_13.pdf)

### FSA tackles unfairness in 'consequential loss' exclusions

The FSA's unfair contract terms team has issued a statement regarding the use of terms which exclude 'consequential loss' in general insurance contracts. The FSA is concerned that firms using such terms

may not be meeting their obligations under the *Unfair Terms in Consumer Contracts Regulations 1999* (UTICC) to ensure that they express any written term of a standard-form consumer contract in plain and intelligible language.

The regulator is urging firms to reconsider their usage of these terms and how they might express their meaning in a more understandable language.

The statement highlights the risk to firms of having unfair terms in their consumer contracts and provides several examples of terms which exclude consequential loss without using that particular terminology.

The examples are illustrative only and are not directive or prescriptive. [www.fsa.gov.uk/pubs/other/consequential\\_loss.pdf](http://www.fsa.gov.uk/pubs/other/consequential_loss.pdf)

### Lloyd's modernisation reforms continue apace

The Treasury has laid before Parliament its final proposals to amend legislation relating to the operation and governance of Lloyd's of London. The legislative reform order to amend the Lloyd's Act 1982 contains eight major proposals including the removal on the restriction requiring managing agents generally to accept business only from a Lloyd's broker; and removal of the divestment provisions (which prohibit prescribed associations between Lloyd's brokers and managing agents).

### Regulator appoints new MD for retail markets

Jon Pain has been appointed managing director of retail markets at the FSA.

He will have overall responsibility for regulating firms or groups whose business is predominantly with retail consumers, including the approximately 17,000 smaller firms undertaking insurance broking, investment and mortgage advice.

He will also be responsible for the main consumer-facing functions, such as the financial capability programme and the FSA consumer contact centre. Pain has 30 years' experience in UK financial services, most recently as managing director of Cheltenham & Gloucester.

### Passporting queries solved

"Do we need a passport?" is a question regularly heard on the phones at BIBA House. BIBA's compliance team has put together a brief fact sheet designed to help members

understand what is required of them from a regulatory perspective as far as undertaking activities elsewhere in Europe is concerned.

[www.biba.org.uk/BrokerContentDetails.aspx?ContentID=1064](http://www.biba.org.uk/BrokerContentDetails.aspx?ContentID=1064)

### Early birds get discounts in travel application process

The FSA has opened the application process for firms wishing to become directly authorised to sell connected travel insurance once regulation begins on 1 January 2009.

Firms have until 30 September 2008 to submit an application if they are to take advantage of a 30 per cent discount in the usual fee payable.

Further information on the process can be found at the link below:

[www.fsa.gov.uk/pages/Doing/small\\_firms/travel/authorised/index.shtml](http://www.fsa.gov.uk/pages/Doing/small_firms/travel/authorised/index.shtml)

### Compensation Sourcebook amendments for EEA branches of UK insurers

The FSA has amended the *Compensation Sourcebook* to extend coverage of the Financial Services Compensation Scheme (FSCS) regarding business written through EEA branches of UK insurers. Policy statement PS08/8 contains final rules and may be accessed at the link below:

[www.fsa.gov.uk/pubs/policy/ps08\\_08.pdf](http://www.fsa.gov.uk/pubs/policy/ps08_08.pdf)

The FSA had proposed in consultation paper CP08/9 extending the scope of the FSCS so that EEA risks written under long-term or general insurance policies issued through EEA branches of UK insurers are treated in the same way as UK risks written under such policies regarding eligibility for the FSCS.

The rule change took effect on 25 July and applies to insurers declared in default on or after that date in respect of policies issued on or after 1 December 2001.

### FOS publishes policy statements on transparency and accessibility

The Financial Ombudsman Service (FOS) has published two policy statements setting out decisions of principle made by its board during summer 2008 on transparency and accessibility issues after a review, including an independent report by Lord Hunt of Wirral.

[www.financial-ombudsman.org.uk/publications/policy\\_statements.html](http://www.financial-ombudsman.org.uk/publications/policy_statements.html)

### FSCS payouts top £1bn since scheme's creation

The Financial Services Compensation Scheme (FSCS) made payments amounting to more than £82m, including almost £46m for general insurance claims, according to its *Annual Report and Accounts* for 2007/08. This brought the total paid out in compensation by the FSCS since its creation in 2001 to £1.04bn.

The total number of claims received was 16,490, a reduction of 33 per cent on 2006/07, with 269 firms declared in default during the year. The FSCS made more than 9,450 payments for insurance claims and completed close to 22,000 other claims during the year.

The scheme received 110 new claims relating to insurance mediation (the A19 contribution group), compared to 35 in 2006/07, an increase of more than 214 per cent. Seventy claims were completed during the year, compared to 100 in 2006/07, a reduction of 30 per cent. Offers of compensation were made in 91 per cent of decisions with the average compensation payment around £1,350.

[www.fscs.org.uk/files/documents/pdfs/trudqkhicznndl.pdf](http://www.fscs.org.uk/files/documents/pdfs/trudqkhicznndl.pdf)

### Look out for GABRIEL

The FSA will make electronic reporting mandatory for most regulated firms during the remainder of 2008. A new reporting system named GABRIEL (Gathering Better Regulatory Information Electronically) has been developed as part of this process; it will replace the majority of the FSA's legacy reporting systems, including the Early Reporting System (ERS) and the Firms Online (FoL) Regulatory Reporting system. Most general insurance intermediaries fall into the third phase of the project and should hear shortly, if they have not already heard, from the FSA as to how they will be affected by the changes.

### Consultation on deregulating retail freight forwarding insurance closing soon

There are just days to go until the HM Treasury consultation seeking views and evidence on the Government's intention to remove the retail insurance activities of freight forwarders and storage firms from the scope of FSA regulation closes. Members have until 12 September to submit their comments.

[www.hm-treasury.gov.uk/media/F/4/consult\\_freight190607.pdf](http://www.hm-treasury.gov.uk/media/F/4/consult_freight190607.pdf)



### Compliance reforms

This year marks the culmination of two major work streams for the Financial Services Authority – reform of the Insurance Conduct of Business rules and TCF. The beginning of 2008 saw the introduction of the new *Insurance Conduct of Business Sourcebook* (ICOBS), while firms have until the end of December to ensure that they are consistently treating their customers fairly and be able to demonstrate compliance.

It has meant a busy time for the partners in BIBA's Compliance Initiative which has been offering compliance facilities to members at commercially attractive terms for five years now.

Branko Ltd and RWA Compliance Services Ltd provide the facility and are able to offer members health checks on their firms, audits and training programmes. They are also happy to discuss bespoke compliance requirements with members, for more details see the BIBA website.

*Compliance Rules caught up with Branko Bjelobaba, founder of Branko Ltd, and Jim Dart, compliance director at RWA, and asked them what had been keeping them occupied during visits to members this year...*

### TCF – coming to a place near you!

Members will have been living on Mars if they have failed to notice the high level of activity being undertaken by the FSA to validate TCF now that one of the deadlines has passed.

The regulator has already been to Northern Ireland and the North West and Birmingham/the West Midlands follow in September. Then it will be the turn of the South West towards the end of the year. Firms selling protection products or payment protection insurance WILL be assessed. Firms that only sell general insurance will not be automatically assessed but it appears that a number will be randomly selected.

So what will happen? The FSA will host roadshows at a number of venues in advance of the regional assessments. These are very useful and are fully interactive – providing firms with a great opportunity to pick up good ideas and learn even more about what the FSA wants done. Please do take the time to attend – it shows that a firm is taking TCF seriously and is actively engaging with the regulator.

What happens when a firm is selected for an assessment? The

FSA is currently using one of four assessment tools: on-site mini-visits, questionnaires, regional assessment centres (the firm goes to see them) and telephone assessments (they will call at an agreed time). Firms will be asked to send the FSA a copy of their TCF gap analysis in advance, a diagram of the firm's structure, and if used, a copy of the most recent compliance consultant's report.

The assessment will look at the relationship the firm has with its staff, how it communicates TCF to them and what controls are in place to demonstrate delivery of fair outcomes. For the March 2008 deadline, firms had to assess how the outcomes were being delivered within their organisation and then produce evidence/management information to establish that that outcome had been/was being met. Towards the end of the year, firms need to embed TCF fully in their operations.

*Branko Bjelobaba, Branko Ltd*

### ICOBS – changes now effective

It was surprising to see just how many brokers had still to implement the ICOBS rule changes during my visits earlier this year, particularly because they generally involved a reduction in prescription. All firms should by now have completed those changes as the transitional arrangements expired on 5th July 2008.

The continuing move to principle-based regulation forms the background to the review and the FSA has made an effort to remove as much of the 'gold-plating' as possible, while still meeting the requirements of the Insurance Mediation Directive (IMD) and Distance Marketing Directive (DMD). This means that, for telephone sales of most general insurance policies, the 'scripting' will be shorter, including removal of the regulatory status declaration at point of sale.

One of the main changes is the reclassification of customers from 'retail' and 'commercial' to 'consumers' and 'commercial customers'. This may not seem much of a difference, but it is, in effect, a reversion to pre-FSA rules, as 'consumers' are personal lines policyholders, with 'commercial customers' exactly what it says on the tin! In particular, mixed-use policies, that were previously required to be treated as retail, are now commercial, although as before, if there is any

doubt, the customer should be treated as a consumer. A further impact of this change may be the need to review the classification assigned to customers, or individual policies, on the firm's computer system to ensure that they are handled properly and that reporting is accurate.


Perhaps slightly harder to understand, in the light of increased attention to TCF, is the removal of the requirement to invite renewal to consumers 21 days in advance, in favour of a general 'in good time' rule for all business.

Sales of general insurance products now have separate rules to pure protection contracts, such as term assurance, and protection policies, such as PPI, which reflects the FSA's view that such products represent a higher risk to consumers.

Another main change is the introduction of an 'eligibility' requirement under which the intermediary must ensure that the policyholder will be entitled to claim under the policy, and point out any areas where they will not. This is fairly obvious under a PPI policy where, for example, a self-employed person may be ineligible to claim under the unemployment section, but may be harder to see on most insurance products.

*Jim Dart, RWA Consulting*

### 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



**Steve White**  
(whites@biba.org.uk)  
on 020 7397 0222

or



**Vanessa Young**  
(youngv@biba.org.uk)  
on 020 7397 0233

BIBA House,  
14 Bevis Marks,  
London, EC3A 7NT



**Mixed Sources**

Product group from well-managed forests, and other controlled sources  
www.fsc.org Cert no. TT-COC-002444  
© 1996 Forest Stewardship Council