

April Newsletter
Issue 4/2010

Editorial

The FSA has been busy this month issuing newsletters for the insurance industry. By the time you read this it will also have made a couple of presentations to LIIBA on amongst other things what is coming up for the rest of 2010. Not sure if this is what we would call a 'charm offensive' but we will report back in our next issue. It's good to get information straight from the horses mouth but not sure if it's necessarily going to help us in what we do.

In this issue:

- Enhancing the Client Asset Sourcebook
- Royal Assent for Financial Services Act
- Changes to the RMAR
- Brokers Errors and Omissions Insurance – managing agents reporting
- FSA General Insurance newsletter
- FSA approach to corporate governance
- FSA Smaller Wholesale Insurance Intermediaries newsletter

Further information on the issues in this newsletter, or any other issues which concern your business, can be obtained from

Chris Keene on
020 7369 5375 /
07775 610006

Enhancing the Client Asset Sourcebook

In March the FSA issued a consultation paper entitled 'Enhancing the Client Asset Sourcebook'. In producing this document the FSA has taken into account the issues highlighted by a number of insolvency appointments, including Lehman Brothers. The focus of this paper is to consider proposals which will protect clients and consider market stability, in the event of a firm's insolvency.

HOWEVER for those of you who were hoping that the CASS rules for insurance intermediaries were long overdue for a change you will have to wait a little longer. This consultation does not apply to insurance intermediaries and you will have to wait until the first quarter 2011 for CASS 5 to be reviewed. This will include proposing the introduction of a new CASS 5 controlled function.

Royal Assent for Financial Services Act

The Financial Services Act 2010 has received Royal Assent resulting in a number of changes to the FSA's objectives, powers and duties. The main changes are as follows:

- **Financial stability:** The new financial stability objective for the FSA includes a duty for the FSA to determine and review its financial stability strategy, in consultation with the Treasury;
- **Consumer education:** The FSA is also required to establish a new consumer financial education body. When this body is fully operational, it will assume the FSA's current responsibilities in relation to financial education.
- **Enforcement powers:** Changes include the power to suspend individuals, and firms, along with the ability to fine those who are carrying out a role that needs FSA approval without the necessary approval being in place. The time limit to issue

a warning notice against an individual increases from two years to three years from the time the FSA first becomes aware of the misconduct;

- **Remuneration:** The FSA will have the power to specify that remuneration agreements in breach of its remuneration rules are void;
- **Consumer redress scheme:** This would give the FSA the power to impose a consumer redress scheme. It will come into effect only by order of the Treasury.

Whilst these issues might seem miles away from the FSA rules it is worth remembering that this is the primary legislation that effectively sets the framework by which the FSA can make its rules.

Changes to the RMAR – section A (Balance Sheet)

As we know under Threshold Condition 4 (TC4) firms are required to have adequate resources in relation to the specific regulated activities that they seek to carry on. During the last 18 months the FSA has carried out work as part of its wholesale insurance intermediaries' supervision activities in relation to TC4. This has confirmed that some insurance intermediaries do not pay sufficient attention to risks such as amounts owed by fellow group undertakings.

The FSA is proposing two amendments to the RMAR:

- 1) It is proposing an additional data element to section A (balance sheet) to inform it which insurance intermediaries include in their current assets amounts owed by directors, group undertakings, or undertakings in which the company has a participating interest. Under this proposal, insurance intermediaries must enter the total of such amounts falling due within one year as a memorandum item. In accordance with generally accepted accounting

practice, and other entries in RMA-A, the baseline date for the proposed new memorandum field will be the firm's reporting period end.

- 2) Secondly the FSA is also proposing an additional data element to section A (balance sheet) to inform it which insurance intermediaries include shares in group undertakings as part of their investments, where such investments are held as current assets. Under this proposal, insurance intermediaries must enter details of such amounts as a memorandum item.

The FSA believes that its supervisory effectiveness would be improved if insurance intermediaries reported these items in their RMAR submission. This in turn would make it easier for the FSA to identify associated risks and target its supervisory resource more effectively.

Broker Errors and Omissions Insurance – managing agents reporting

Lloyd's has highlighted the issue of certain managing agents underwriting the E&O insurance of Lloyd's brokers that also present business to those managing agents. It recognises that as a result of the existence of this ongoing business arrangement there is a perceived conflict of interest which could arise either at the point of underwriting or when claims are being determined.

In order for Lloyd's to more effectively monitor this particular type of business and the extent to which it is being written, Lloyd's is now requiring managing agents to disclose any intention to underwrite broker E&O in respect of brokers which also place business with their syndicates in their business plans.

As a result of XCS acting as a claims agreement party and the claims peer review process Lloyd's is satisfied that any conflict of interest which exists at

the point when a claim is being determined can be appropriately managed. However Lloyd's would like to receive a greater level of information about material claims (£500,000 in aggregate or more). Lloyd's is also requiring managing agents to disclose any intention to underwrite broker E&O in respect of brokers which also place business with their syndicates in their business plans.

Whilst there is no direct impact on insurance intermediaries it is worth noting the approach Lloyd's is taking, which presumably has been instigated somewhere down the line by the FSA's (and also perhaps Europe's) strong line on managing conflicts of interest. This approach is evidence of the importance that the FSA gives to conflicts management, so insurance intermediaries also need to be diligent in ensuring that they have processes in place for conflicts management.

FSA General Insurance newsletter

The FSA has issued a newsletter that is aimed at the whole of the general insurance community ie insurers and intermediaries. For intermediaries there is nothing that we haven't seen already: the relevant topics are Threshold Condition 4 (TC4) and Client Money and assets and related issues so don't get too excited. However the Enforcement section does show something interesting. Under the heading 'Recent enforcement cases' the FSA highlights a client money case that was finalized in 2008 - who says the FSA isn't on the ball! The link to the general insurance newsletter is shown below:

http://www.fsa.gov.uk/pubs/newsletters/gi_apr10.pdf

FSA's approach to corporate governance

At the risk of playing the same record the FSA has made another speech about Corporate Governance. Without going into too much detail

the FSA wants to see two key features within firms:

- 1) that good culture and behaviours in firms is being driven by senior management; and
- 2) that good culture and behaviours are being reinforced by effective corporate governance and the role of the boards.

FSA Smaller Wholesale Insurance Intermediaries Newsletter

The FSA has also issued another newsletter for wholesale insurance intermediaries. This is the first issue so presumably we can assume that this will be the first of many in its attempt to get its messages out to wholesale insurance intermediaries. As per the General Insurance newsletter it mentions (in not much detail) Client Money and TC4. However it also notes common failings that it has encountered when reviewing control and oversight arrangements during ARROW risk assessments. The common failings it notes are as follows:

- 1) lack of independent challenge within the Board;
- 2) key decisions taken outside of Board meetings; and
- 3) complicated structures where it is not always clear where the division of responsibility lies.

Apparently it has also encountered problems with Approved Persons not always being fully aware of their responsibilities. It notes "Regardless of their size, we expect firms to have appropriate and robust control arrangements in place, so senior management has full oversight over the business. You should review your control arrangements to ensure that these requirements are met."

And for those of you that weren't already aware "Financial crime remains our focus" for 2010.