

February Newsletter  
Issue 2/2010

### Editorial

In the past most small firms did not need to apply for controlled functions other than the governing functions and any director that held a important position such as head of a business unit did not need to apply for a significant management controlled function since the FSA viewed that management role as being included in the director controlled function.

The rationale being that the director was directly responsible, and was sufficiently close to what was going on, not to have to significantly rely on others. However the FSA has now changed its stance to say that certain functions are of sufficient importance and require particular skills, which need to be recognised and identified. Therefore if the FSA's new proposals become rules smaller firms will have to identify those individuals and get them approved.

**Firms also need to make sure that if there are those individuals that have significant influence on the Board but in the past have not held a controlled function** then these individuals will have to be considered for approved person status.

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

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## **Effective corporate governance (Significant influence controlled functions and the Walker review)**

The FSA has produced a CP entitled 'Effective corporate governance (Significant influence controlled functions and the Walker review)'. The FSA has recognised that there is further work to be done to ensure that it has the necessary regulatory foundations in place to support its efforts to deliver effective governance, and this CP seeks to address these gaps.

The CP sets out a number of different proposals:

- a new framework of classification of controlled functions ;
- other changes to the approved persons regime, including the scope and definition of some controlled functions;
- some guidance on its expectations in relation to non-executive directors; and
- risk governance guidance and its plans for other implementing measures in support of Sir David Walker's recommendations.

The FSA has identified a number of roles that it expects to be carried out within the governing functions. Therefore it does not expect to see an increase in the number of approved persons. These include the finance function, risk function and internal audit function. It also includes the parent entity Significant Influence Function which covers those who exert significant influence from the position of the firm's holding company.

This means that for those that are carrying out one of these roles as part of the governing functions (for example finance director) they will now have to apply for the finance

function in addition to the governing function should these proposals be agreed.

Also under the current rules an individual approved for one of the governing functions is not currently required to also apply for approval as CF28 (systems and controls function) or CF29 (significant management function), even though they may be performing that controlled function within the responsibilities of their governing function role.

The FSA is proposing to maintain this approach for CF29. However for CF28 the FSA believes that there are likely to be specific technical competences required that are distinct from those required of the governing functions. Therefore for those holding governing functions it is proposed that CF28 will need to be an additional function.

The FSA is also considering the proposal for a protection of assets controlled function, which will be considered in a separate CP.

## **FSA issues financial resources letter**

The FSA has recently issued one of its 'Dear CEO' letters to all insurance intermediaries to note its concerns that firms are not paying sufficient attention to threats to the financial viability of their firms. As a result the firms are not taking steps to guard against such threats or to develop management plans for the materialisation of those threats.

The FSA specifically notes examples where a firm failed to make adequate provision to meet its obligations in relation to additional pension contributions; and a firm relying on inter company debts to demonstrate compliance with the FSA's financial resource requirements.

The FSA is requiring the boards of firms to satisfy themselves that they have adequate financial resource in line with Threshold Condition 4. This should consider matters such as intra

group debts and other liabilities including contingent liabilities. Firms need to note the difference between meeting the minimum capital requirements (as set out in MIPRU) and having adequate financial resources (as in TC4), which may mean them having additional capital above the required minimum. The issue of having 'adequate' against the 'prescribed minimum' should also be considered in relation to how much PI cover a firm purchases.

The FSA notes "Where we consider that a firm is unable to demonstrate compliance with Threshold Condition 4, we will first look for it to take immediate steps to strengthen its financial position and may seek to restrict all or part of its regulated activities until such time as the position is addressed to our satisfaction. In severe cases we will also consider Enforcement action."

## **Director banned by FSA for Client Money failings**

The FSA has banned the director of a Manchester based mortgage and general insurance firm from holding senior positions in the financial services industry after his failure to comply with client money rules resulted in the loss of approximately £85,000 of his customers' money.

Matthew Sixsmith was the director of Bridgewater House UK, which dealt mainly in the sub prime mortgage market, but also arranged life and critical illness insurance in connection with those mortgages.

When Bridgewater sold an insurance policy, it would charge its customers two years' insurance premiums upfront, and then add this amount to the mortgage. The firm agreed with its customers that it would hold this money and then pay the insurance premiums to insurers on their behalf.

However, Sixsmith failed to separate his customers' money from that of the firm, and used only one bank account under the name of Bridgewater to administer both his business and the

premium payments customers had entrusted to him. As a result, when Sixsmith's firm ceased trading in September last year, approximately £85,000 of customers' money was lost.

As Bridgewater's sole director, it was also Sixsmith's responsibility to ensure that any insurance premiums that customers had lodged with the firm were passed on to the insurers when payments became due. However, approximately 700 policies lapsed because, until May 2008, Sixsmith kept no record of when these payments should begin or end for each of the firm's customers and therefore he failed to ensure that premiums were paid when due.

Margaret Cole, director, enforcement said:

"Sixsmith was incompetent and his actions posed serious risks to customers who trusted him with their money and expected him to pass that money on to insurers.

"Individuals who look after client money must act in accordance with the rules. Where they fail to comply, we will not hesitate to take enforcement action against them."

## **FSA announces annual funding requirement for 2010/11**

The FSA has announced its proposed annual funding requirement for 2010/11. The budget reflects the FSA's determination to continue delivering intensive supervision and the substantial international regulatory reform agenda. It will require an increase of 9.9% in overall funding.

It is proceeding with its strategic review proposals for a new minimum fee and a move to straight line recovery for variable periodic fees above the minimum fee. The changes are:

- A minimum fee that will be the same for all firms and based on recovering minimum specified

regulatory costs – for 2010/11 this will be £1,000 for each firm.

- Firms that pay a variable periodic fee on top of the minimum fee, this variable element will increase in direct proportion to the size of firm - this will ensure that fees for the largest firms reflect the greater regulatory engagement they receive (straight line recovery).

The proposed fee rates will result in substantial changes in fees levied for 2010/11. Overall, 40% of firms will see an increase and 60% a decrease in their fees. Generally, smaller to medium size firms will pay less fees in 2010/11 as more of their annual funding requirement is being recovered from larger firms than in previous years.

The FSA has set up a fees calculator for firms to estimate what their fees will be under the new proposals which can be found at:

[http://feecalc.fsa.gov.uk/FeeCalc.asp?fy=2009\\_2010&sc=StrategicReview](http://feecalc.fsa.gov.uk/FeeCalc.asp?fy=2009_2010&sc=StrategicReview).

So what does this mean? General insurance intermediaries will see their minimum fee increase from £450 to £1,000. For those that pay the minimum fee this represents an increase of 122.2%. Apparently the £1,000 new minimum fee replaces an unequal range of minimum fees which were levied for each fee-block the firm was in. This gave rise to differences where the amounts did not reflect the risk to their objectives and the type of regulated business undertaken. The FSA believes the new minimum fee addresses the current differences and makes the minimum fee regime fairer, transparent and simpler.

However these figures are proposed figures. Therefore you do have the opportunity to give your views on these proposals - the closing date for comments is 11 March 2010.