

May Newsletter  
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## Editorial

If we didn't know already from Hector Sants speech there is a clear expectation that senior management need to get a grip on risk management within their firms and apply the appropriate challenge to information that is presented to them. And if they don't the FSA is 'happy' to take more action against those where there is evidence of 'culpable misconduct'.

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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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## **Financial sanctions**

The FSA has recently produced a factsheet specifically aimed at small firms setting out its findings from thematic work on how firms are approaching the financial sanctions regime. However I think that the factsheet is a useful basic guide on the financial sanctions regime.

Financial sanctions orders prohibit a firm from carrying out transactions with a firm or organisation. HM Treasury (HMT) maintains a list of targets and there are 50 individuals and 20 UK entities on the current list. A breach of a financial sanctions order may be a criminal offence and therefore firms need to have systems and controls in place relating to financial sanctions as part of the FSA's requirements on financial crime.

The FSA's thematic work concluded that there were inadequacies in firms' systems and controls to reduce the risk of a breach of UK financial sanctions. These inadequacies applied to all sizes of firms across all financial sectors and small firms need to improve their awareness of the UK financial sanctions regime. Firms should not confuse HMT's financial sanctions regime with anti-money laundering procedures.

The FSA has noted that it is good practice to check:

- 1) existing clients against HMT's list;
- 2) all new customers prior to providing any services;
- 3) updates to the HMT list; and
- 4) any changes to a client's details.

For further information follow the link:

<http://www.fsa.gov.uk/smallfirms/resources/pdfs/Sanctions.pdf>

## **'On the grapevine'**

On the FSA website there is a section called 'On the grapevine' that is designed to clarify or explain any perceptions that may be circling the market. This month their comment is

***"When we report other firms we never hear anything more. It seems that nothing happens after that."***

The FSA notes that it receives a great deal of useful information from firms about the activities of other firms. These reports can be anything from the suggestion of poor practice right through to reports of fraudulent behaviour.

All the information received is taken seriously and is logged and recorded. It may mean additional action is taken and the issue is escalated for investigation to a case officer. Alternatively the information may be used to build up a picture of a firm or the way things are being done in a particular area or part of the industry. Where the FSA believes a firm is behaving in a non-compliant way it will take action. Where it suspects criminal or fraudulent activity it is likely to take legal action. Sometimes it will refer cases to another law enforcement agency.

Any action is normally kept confidential until enforcement action is taken or it is published as part of the results of a wider investigation.

## **The regulator's role in judging competence – a speech by Hector Sants**

In May Hector Sants gave a speech to the Securities and Investment Institute Conference. Whilst this was not directly linked to the insurance industry I believe that there are always clues in the speeches made by the FSA to provide information about the issues that it is interested in and the direction that it is heading.

The speech focussed on the shortcomings exposed by the current financial crisis in the governance and risk management of regulated firms. It noted that amongst other things some of the management decisions revealed a degree of incompetence and there was a lack of challenge from Boards.

The FSA retains the fundamental view that senior management carry primary responsibility for their actions and their resulting consequences and this responsibility should be shared with non-executive directors (NED's), shareholders and auditors. However in the current crisis it noted that there have been indicators that some NED's have struggled to fulfil their role of providing strong independent oversight of the executive management. In the future it will be working to ensure that NED's have the relevant expertise with a willingness to challenge and avoid the 'herd mentality'. The FSA is now interviewing applicants for key functions in an authorised firm to check that amongst other things that they have a clear understanding of the nature of the risks and that they can ask the right questions.

All financial services firms need an effective risk management function with clear independent reporting lines to the Risk Committee and effective risk managers need to have appropriate stature in an organisation which in Mr Sants' opinion will only happen if there is a Board director solely responsible for risk. The aim is for management to create a culture of challenge without creating conflict and meet the challenge to 'have the necessary resolve to restrain the overbearing CEO'. However the FSA will be taking more action against senior management where there is evidence of culpable misconduct.

To ensure that the FSA is practicing what it is preaching supervisors are undertaking an internal regulatory testing regime. Also the FSA is ensuring that it has the right mix between professional regulators and market practitioners.

His closing points were that the structure of governance in financial companies needs a radical overhaul, as does the attitudes and conduct of the individuals who conduct the governance. Governance arrangements need to foster challenge without conflict.

### **Controls within networks**

The FSA has set out some key areas for principals of smaller networks and a list of questions to help spot potential risks. Network principals are responsible for the sales their appointed representatives make and they need to be satisfied that their appointed representatives are offering sound advice and treating customers fairly. (Interestingly enough some of these points would apply to a firm monitoring

the practices that are going on within it.) Here are some points:

1) Firms can get evidence of whether this is happening through their compliance monitoring. This could include, for example:

- observed sales and advice sessions between appointed representatives' staff and customers; and
- file reviews.

2) Having a clear reporting structure within a firm, so that it and the appointed representatives know who is responsible for what, will help the monitoring process. Firms should make sure that between them and the appointed representatives there are:

- clear reporting lines;
- clear information flows; and
- defined roles and responsibilities.

3) Firms should also produce and make use of management information to help identify trends and manage risks to the network, its appointed representatives and its customers.

### **Insurance Risk Management: The path to Solvency II**

For those of you that are following the saga of insurance companies' preparation to meet the requirements of the Solvency II regime the FSA has issued a feedback (09/1) statement on discussion paper DP08/4. For those that aren't aware the implementation date for Solvency II is definitely set at 31 October 2012. If firms wish to view the document please click on the following link:

[http://www.fsa.gov.uk/pubs/discussion/fs09\\_01.pdf](http://www.fsa.gov.uk/pubs/discussion/fs09_01.pdf)