

November Newsletter
Issue 11/2009

Editorial

The FSA presentations were quite enlightening in certain areas but shocking in others. It is very surprising that the FSA is still finding serious weaknesses in London market firms' client money arrangements but I do wonder whether the firms that showed weaknesses in client money compliance were actually members of LIIBA (or for that matter BIBA). Both trade associations have assisted their membership extensively in complying with the rules. It is also worrying that auditors appear to be confused over when a client money audit needs to be conducted.

In relation to third party payments when conducting your due diligence on any new third party 'introducers' your decision should now include a more risk based approach to decision making and include considerations such as risks associated with doing business in higher risk jurisdictions. Gone are the days of just ticking the boxes on the control sheet!

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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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FSA presentation

In October the FSA gave presentations to members of the London & International Insurance Brokers Association (LIIBA). The aim of the presentations was to give brokers an idea of the work that the FSA had been doing and what was currently on their mind. The sessions were split into three sections:

1) Work with smaller London market firms

They confirmed that their objectives were to establish a greater understanding of these firms, increase their regulatory oversight and raise their profile within this sector. They commenced this in 2008 by sending out a questionnaire to one set of firms covering different aspects of their business. This was followed by the questionnaire sent to a second group of firms in 2009. In total 110 firms were contacted and all but one responded! In the future the aim is to visit some of these firms so be warned. The key findings were:

a) Client money (see also below)

Despite the fact that the client money rules have been in place since January 2005 and London market firms spending ages putting the rules in place it appears that there are some firms that still haven't got it right yet. In particular there is confusion over the client money audit, as well as large differences in the quality of audit reports that are produced.

b) TCF

This remains an important area of focus for the FSA and they will continue to conduct work in this area to test how effective the

procedures are that firms have put in place.

c) Contract certainty

On the basis of their monitoring work they believe that firms may not be monitoring success rates since some firms are reporting rates of less than 50%. They reiterated that firms should be aiming for 90% success and if not reached they should be investigating why not.

2) Financial crime

a) Third party payments

As we know this has been an issue since the beginning of the year after the Aon fine. The FSA were concerned about the due diligence process and the lack of formality involved in some of these arrangements; monitoring of the arrangements lacked independence; and firms were taking a one size fits all approach rather than applying a risk weighting to the process.

b) Data security

The FSA stated that their main focus was around identity theft and the subsequent fraud. They noted that only a limited amount of customer data was needed to be useful to those wishing to commit identity theft and all people are vulnerable, not just those in high income groups. Firms need to ensure that they assess all aspects of their data security, such as office security, disposal of data, and not just concentrating on IT security.

3) Client money

Whilst the FSA has seen progress in this area it noted that there were still some weaknesses including: there was lack of meaningful senior management oversight in this area; in some

circumstances there was a single individual that was responsible for the client money calculation and they possessed all the corporate knowledge; some of the underlying trust paperwork was of poor quality; limited evidence of consideration of asset concentration issues; and weaknesses surrounding the performance of the client money calculations. The FSA is remaining its focus in this area and improvements are expected. It will be issuing a policy bulletin on CASS compliance at the end of 2009.

FSA guidance on data security

Following the HSBC fine and the resultant horror at what the FSA may be enforcing on the market LIIBA sought clarification from the FSA so that brokers could ensure that they were meeting the correct regulatory requirements. What resulted was a two page note on data security. Unfortunately most of what was produced was going back over old ground and regurgitating material that had already been produced by the FSA. However the one point of clarification was their treatment of customer data (personal data) against data of commercial clients.

The guidance noted that the FSA's primary concern is the risk of loss of, and unauthorised access to customer data and this was the cause of the HSBC fine. In relation to data of commercial clients the FSA noted that "it expects firms to treat all data carefully". It is relying on firms to comply with its high level principles of 'conducting business with due skill, care and diligence and 'taking reasonable care to organise and control its affairs ...'. Therefore we now know that if a firm handles any customer data then rigorous protections need to be in place. Where a firm handles data from

commercial clients from a regulatory standpoint there is a less rigorous requirement.

FSA to simplify fees calculation

The FSA has announced proposals to simplify the structure of the fees it levies on regulated firms and to enhance fairness and transparency. It is consulting on a number of measures to ensure that fees continue to be set in a fair way, and to make the basis for calculating fees easier for firms to understand, including:

- Setting a standard 'minimum fee' that all firms will have to pay to cover the basic cost of being regulated;
- Ensuring that 'variable' fees over and above this basic minimum amount increase in direct relation to a firm's size – with the result that fees for the largest firms reflect the greater regulatory engagement they receive.

In February 2010 depending on the outcome of this consultation, the FSA plans to consult on fee levels for 2010/11 using this new fee model.

TCF assessments

As part of the FSA's continuing drive to ensure that the market is continuing to comply with its TCF requirements it has published some more examples of good and poor practice. The focus is on intermediaries dealing with direct clients.

FSA's 'On the grapevine'

The FSA has heard that it is the perception in certain areas that firms think that some firms just go bust and then reinvent themselves. Then nothing seems to happen. The FSA has responded by saying:

"There is plenty happening. We are taking a keen interest in this and we know that firms doing business the proper way want to see an end to this.

We use the phrase "phoenix firms" to describe firms that rise from the "ashes" of another, with the new firm often pretty much identical — the directors have transferred the business almost wholly across, often with the same address, staff and customers.

Of course, there is nothing wrong with a firm closing down in an orderly way and then re-emerging with a new name to start afresh. It is a problem, however, if the old firm is closed down purely to avoid its existing liabilities, with the directors hoping to avoid their obligations to customers, other firms or creditors, and hoping that the FSA will not notice. Be assured we do notice.

Although we can't prevent firms becoming insolvent, we are taking steps to minimise the impact.

- We will refuse the application for authorisation of the new business where the directors of the departing firm will not make reasonable arrangements for claims that arise out of their previous business, or cannot show that they shut down their previous business in an orderly manner
- We will make sure the clients of the old firm are contacted and told about the closure.
- We will refer individuals to the FSA's enforcement team if their actions have actively disadvantaged customers."

Now you know.