

Regulatory Update

August 2003

Index

1.0	Urgent Matters	1
2.0	Changes to the FSA's Handbook in August 2003	1
3.0	Consultation Papers	1
3.1	CP 194 - Amendments to the Training and Competence Sourcebook: including consultation on Competencies for Mortgage Advisers	1
3.2	CP 195 - Enhanced capital requirements and individual capital assessments for life insurers	2
4.0	Discussion Papers	3
4.1	Reducing Money Laundering Risk: Know Your Customer and Anti-Money Laundering Monitoring	3
5.0	Policy Statements and Reports	4
5.1	Consolidated Policy Statement on FSA Fee-Raising Framework (As at July 2003)(including feedback on CP168)	4
5.2	The UCITS Management Directive: Implementing the UCITS Amending Directive (2001/107/EC)	5
6.0	Handbook Development Publications	6
6.1	Handbook Development Notice 42	6
6.2	Retail Market Consultation: A 'Road Map' to future publications	6
7.0	FSA Notices and Part IV Permissions Revoked	7
7.1	FSA Fines Northern Bank Limited £1,250,000 for anti-money laundering failings	7
7.2	Part IV Permissions Revoked	8
8.0	List of FSA Publications Issued in August 2003	9
9.0	Other Matters of Interest	10
9.1	Clarifying "Mis-Selling": A Note by the FSA E-Regulation	10
10.0	Disaster Recovery	11
11.0	FSA Events Update	11

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1.0 Urgent Matters

None.

2.0 Changes to the FSA's Handbook in August 2003

None.

3.0 Consultation Papers

3.1 CP 194 - Amendments to the Training and Competence Sourcebook: including consultation on Competencies for Mortgage Advisers

The FSA is proposing future amendments to the Training and Competence Sourcebook in four main areas; examinations, record keeping, supervision and mortgage examinations. We address these proposals below:

Examinations

The FSA is proposing that the competence of employees is assessed by reference to examinations which are "appropriate", rather than, as is presently the case, by reference to a published list of FSA-approved examinations. Firms will be assisted as to which exams are "appropriate" by referring to an examinations list maintained by The Skills Council for Financial Services* ("SCFS"). An evidential provision in the sourcebook will provide that when a firm is considering which examination an individual should pass as part of its assessment of competence, reference should be made to the list maintained by the SCFS. The list of "approved" exams will be removed from the FSA's sourcebook. We will be notifying our clients when the list of appropriate examinations is published by the SCFS

*The Skills Council for Financial Services is presently in development. It is expected that it will be licensed early in 2004.

Record Keeping

The FSA is proposing that records in relation to Training and Competence need only be kept for three years after an individual ceases to engage in, or oversee, a particular role. There are presently no plans to change the requirements relating to Pension Transfer Specialists whereby Training and Competence records are required to be retained indefinitely.

Supervision

The FSA is proposing to provide additional Guidance regarding the manner in which employees assessed as competent should be supervised in instances where the firm is a sole trader or where there is only one director or partner engaged in an activity. In particular, the FSA is proposing Guidance which would indicate that an employee who is engaging in an activity with or for a private customer may supervise himself if he is a sole trader or is the only director or partner of a firm who carries out an activity with or for such customers. The proposed Guidance may further state that such persons should make “appropriate arrangements” due to the difficulty they might have in assessing their own performance. The FSA has not defined what these appropriate arrangements might be. It can be assumed that these proposals also apply to firms’ who have intermediate customers and market counterparties.

Mortgage Examinations

The Mortgage Examinations section of this CP focuses on the examination modules that could be used as part of the assessment of competence put forward in CP 186.

The consultation period for this Consultation Paper ends on 30 November 2003.

3.2 CP 195 – Enhanced capital requirements and individual capital assessments of life insurers

CP 195 will be of interest to those in the life insurance industry responsible for ensuring their firm’s compliance with the FSA’s prudential requirements. It will also be of interest to analysts and those auditing such firms’ accounts.

Briefly, CP 195 sets out the FSA’s proposals for the Integrated Prudential Sourcebook (“PSB”) for life insurers. The PSB includes rules and guidance on provisioning for liabilities and on capital requirements. The two main proposals contained in this CP are the:

- (i) The proposal to link provisioning and capital requirements more directly to how bonus payments are made to policy holders; and
- (ii) The proposal to require firms’ to self-assess capital appropriate to their individual risk profile, as a complement to the minimum capital requirements for with-profits businesses and other life businesses.

4.0 Discussion Papers

4.1 Reducing Money Laundering Risk: Know Your Customer and Anti-Money Laundering Monitoring

The FSA has published a Discussion Paper ("DP") with the aim of prompting industry wide debate on two important anti-money laundering controls; 'Know Your Customer' ("KYC") and "Monitoring" (i.e. being alert to how a customer is using a firm's products and services and, therefore, to signs of money laundering). This DP has the further objective of helping the FSA decide whether to make changes to the Handbook. It is also hoped that the DP will help industry participants make well-informed risk management decisions.

As regards changes to the Handbook, the DP sets out four possible options. These are:

- (i) To make new specific rules and/or guidance on KYC and/or monitoring (which could include a direct link to the Joint Money Laundering Steering Group (JMLSG) Guidance Notes);
- (ii) To make new high-level rules and/or guidance, to promote better money laundering risk management by firms';
- (iii) To make new rules or to provide guidance, and to rely on the JMLSG Guidance Notes to promote adequate standards in regulated firms'; or
- (iv) To make no decision now and review the position again in two years time.

The FSA has stated that this DP is of relevance to all regulated firms given that each is subject to high-level obligations to take reasonable care to set up and maintain effective systems and controls for countering the risk that they might be used for a purpose connected with financial crime.

Readers may find the Annexes to this DP to be particularly useful. We list these below:

- (i) The Reduction of Financial Crime Objective – section 6 of the Financial Services and Markets Act 2000 (Annex 1)
- (ii) The International and UK Anti-Money Laundering Legal and Regulatory Framework (Annex 2(a))
- (iii) The UK Anti-Money Laundering Institutional Framework (Annex 2(b))
- (iv) Excerpt from the FSA's Handbook of Rules and Guidance (Annex 3)

- (v) Know Your Customer – Statements of Good Practice (Annex 4)
- (vi) Monitoring – Statements of Good Practice (Annex 5)
- (vii) Excerpt from The Proceeds of Crime Act 2002 (Annex 6)
- (viii) Glossary of common anti-money laundering terms (Annex 7)

The deadline for comments on this discussion paper is 30 January 2003

Please contact Terry Douglas at terry.douglas@cclcompliance.com for further advice regarding the possible implications of this DP.

5.0 Policy Statements and Reports

5.1 Consolidated Policy Statement on FSA Fee–Raising Framework (As at July 2003)(including feedback on CP168)

This Policy Statement (“PS”) gives an overview of how the FSA calculates, invoices and collects its fees.

Readers are likely to be particularly interested in Section 8 of this PS; “How we calculate our Fees”. This section details, inter-alia, the discounts that will be granted to firms in fee block A7 that can neither hold nor control client money or assets. Firms in Fee blocks A12 and A13 (i.e. firms whose fees may be wholly or partly determined by the number of approved persons in their employ) will also be interested in the 20% discount on fees for 2002/2003 and 2003/2004.

This PS also confirms that fees levied in 2003/2004 may be collected on a group basis if that is the wish of the group.

CCL can assist firms in establishing whether they have been placed within the correct fee block by the FSA.

For further advice or assistance on this or any or any other matter connected with FSA fees please contact Atma Dhariwal at atma.dhariwal@cclcompliance.com.

5.2 The UCITS Management Directive: Implementing the UCITS Amending Directive (2001/107/EC).

This Policy Statement will be of interest to Operators of Collective Investment Schemes which fall within the scope of the UCITS Directive.

The original UCITS Directive came into effect in 1989 setting out certain minimum conditions that a collective investment scheme ("CIS") needed to meet in order to be sold on a cross-border basis. In order to reduce the limitations imposed by this Directive, the European Commission adopted the UCITS Amending Directive on 21 July 2003. A key component of the Amending Directive is the Management Directive ("MD"). The MD:

- (i) Introduces a new 'passport' similar to that available to relevant firms under the Investment Services Directive ("ISD"), which will allow a manager of a UCITS scheme to carry out cross-border investment services;
- (ii) Imposes certain new financial resource requirements and conduct of business rules on the manager; and
- (iii) Provides for a simplified prospectus to be used as a marketing document for UCITS-compliant CIS throughout the EEA.

This Policy Statement details the FSA's response to comments received during its consultation on implementing the MD.

6.0 Handbook Development Publications

6.1 Handbook Development Notice 42

This newsletter contains:

- (i) Information about recently issued Handbook-related publications;
- (ii) Information about the FSA's E-Regulation programme;
- (iii) Information about the new Client Assets sourcebook;
- (iv) A document clarifying the FSA's position on mis-selling;
- (v) An update timetable for forthcoming FSA publications; and
- (vi) Information about forthcoming conferences and training events.

An extract from a note on mis-selling published by the FSA on 17 July 2003 has been included at Section 9

6.2 Retail Market Consultation: A 'Road Map' to Future Publications

This publication is relevant to firms whose business involves sales or advice to retail consumers of Life Products, Unit Trusts or OEIC's, Pure Protection Products, Mortgages or General Insurance.

It provides:-

- (i) A short explanation of the content of the consultation material published by the FSA in relation to its reforms of the retail market;
- (ii) A provisional timetable for publication of the key papers that affect the retail market; and
- (iii) A "Consultation Road Map" to help readers identify the papers most relevant to them.

CCL will be keeping a close watch on regulatory developments affecting the retail market. For further advice and assistance, please contact Barry Sear at barry.sear@cclcompliance.com

7.0 FSA Notices

7.1 FSA fines Northern Bank Limited £1,250,000 for failing to take reasonable steps to obtain sufficient evidence to be able to verify the identity of its clients.

In January 2002 Northern Bank Limited (“NBL”) conducted a review of its compliance with the client identification requirements set out in the Money Laundering Sourcebook (“ML”). The reviews showed high rates of non-compliance with these requirements. Despite this high rate of non-compliance, and an earlier 2001 review that showed similarly high rates of non-compliance with its own requirements, NBL failed to take effective action to bring about any significant improvement.

The FSA cited the following as being amongst the factors which contributed to it levying a financial penalty against NBL:-

- (i) The failure to NBL to recognise the seriousness of the breaches and to take prompt and effective remedial action;
- (ii) The fact that the breaches had occurred against a background where statutory requirements for firms to have in place anti-money laundering procedures, including procedures to identify their clients, had been in place for over eight years;
- (iii) The fact that the breaches also occurred against a background where NBL’s own earlier testing in 2001 had revealed similarly high rates of non-compliance with its own requirements;
- (iv) The high level of breaches between December 2001 and September 2002;
- (v) The particularly high non-compliance rates with ML found in non-personal accounts where there is an increased risk of actual money laundering taking place; and
- (vi) The serious risk presented to the FSA’s statutory objective to reduce financial crime posed by NBL’s deficiencies.

Please contact Terry Douglas at terry.douglas@cclcompliance.com for further advice regarding money laundering prevention procedures.

CCL strongly encourages recipients of this Regulatory Update to read in its entirety the Final Notice issued to Northern Bank Limited.

7.2 Part IV Permissions Revoked

The FSA has cancelled the permissions granted to R. A Logan and Co. and Reynolds & Dodd pursuant to Part IV of the Act (“the Part IV permission”). There is no connection between these two firms.

8.0 List of FSA Publications Issued in August 2003

	Description	Document Type
1	Enhanced Capital Requirements and individual capital assessments for insurers	Consultation Paper
2	The UCITS Management Directive: Implementing the UCITS Amending Directive (2001/107/EC) – Feedback on CP163 and made text.	Policy Report
3	Reducing money laundering risk – Know Your Customer and anti-money laundering monitoring	Discussion Paper
4	RA Logan & Co	Final Notice
5	Handbook Development (Issue 42)	Handbook Publications
6	Amendments to Training and Competence Sourcebook: including consultation on Competencies for Mortgage Advisers	Consultation Papers
7	The EU Financial Services Action Plan: A guide	Other FSA publications
8	Reynolds and Dodd	Final Notice
9	Northern Bank Limited	Final Notice
10	Handbook Development (Special edition)	Handbook publication
11	Consolidated policy statement on the FSA's fee raising framework – As at July 2003 (including feedback on CP168)	Policy Report

9.0 Other Matters of Interest

9.1 Clarifying “Mis-Selling”: A Note by the FSA

On 17 July the FSA published the final text of its note clarifying mis-selling. The note was prepared in light of industry concerns about the need for clarity about the kind of exposures that can arise for firms where advice is given which leads to claims about “mis-selling” of designated investments. We include key extracts from this note below:-

Suitability

“For the avoidance of doubt, it is the suitability of the recommendation for the consumer, not the investment performance of the product that matters. As long as suitability was established at the time of sale, and the required explanation made of foreseeable risks, then consumer dissatisfaction about investment returns achieved gives no basis for an allegation of mis-selling. Investment performance may be relevant in assessing redress due where mis-selling is shown to have occurred.”

Responsibilities of Senior Management

“A central aspect of the FSA’s regulatory regime is the responsibility of firms senior management to run their business in a way that meets our requirements and hence to decide the systems and controls they need to adopt to ensure that they write good quality business which meets customers’ needs”.

“By leaving boards and senior management to do their job, we realise that they will need to put necessary business systems and controls in place to avoid the risk of regulatory action after the event.”

Enforcement

“Where we contemplate disciplinary action, the Financial Services and Markets Act 2000 contains important process protections for firms such as warning notices and we have added further protections, in particular through the issue of preliminary findings and through setting up the Regulatory Decisions Committee (RDC). The RDC procedures give firms the opportunity to make representations to the Committee before any regulatory decision is made and firms can refer disputed decisions to the Financial Services and Markets Tribunal. This was not a feature of the former PIA regime.”

Record Keeping

"We expect firms to keep a record of the advice given and the reasons for it. Keeping adequate records will both help firms to demonstrate compliance and lessen the need for regulatory attention and intervention."

Retrospection and Reviews of Past Business

"Firms are rightly concerned that they should not be subject to retrospective redefinition of regulatory requirements, which could be coloured by hindsight. Retrospective redefinition is out of the question, given the need for the FSA ultimately to justify any proposed disciplinary action before the Financial Services and Markets Tribunal. The rules and standards to be enforced will continue to be those in place at the time of the sale and not some retrospective reconstruction."

10.0 Disaster Recovery

The power cut affecting a major part of the City on the evening of 28th August will have highlighted the fact that the unthinkable can and does happen.

While this time the disruption was at the end of the day and only lasted for 40 minutes which most firms Uninterrupted Power Supply Units will have covered, what would have happened if it had occurred mid-working day and had lasted for four hours or even four days?

If you would like assistance on reviewing your disaster recovery procedures or wish to have advice on how to implement them, please contact Terry Douglas at terry.Douglas@cclcompliance.com

11.0 FSA Events Update

General Insurance Selling and Administration

The FSA has announced a series of roadshows on General Insurance Selling and Administration. These roadshows, which will be held at various locations throughout the UK in early September, are aimed at general insurance intermediaries who will be regulated by the FSA for the first time in January 2005 when the Insurance Mediation Directive comes into force.

Can We Help?

Should you require any assistance with any of the issues raised in this Regulatory Update or speak to us to find out how we can assist you, please contact us on:

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This Regulatory Update provides information about the consultative documents and publications issued by the FSA which are still current, proposed changes to the Rules and Guidance set out in the FSA's Handbook, actual changes to Rules and Guidance that have occurred in the month of the update, and other matters of relevance to FSA-regulated firms. This Regulatory Notice is intended to provide general summarised guidance only, and no action should be taken in reliance on it without specific reference to the particular FSA document referred to.