

The following Compliance articles are for the week ending 5 June 2009.

## COMMENTARY

### FSA TO PROTECT SALE AND RENT BACK CUSTOMERS

On 3 June, the Financial Services Authority (FSA) published the details of the regime that it aims to introduce on 1 July to tackle immediate problems for customers in the Sale and Rent Back (SRB) market.

This follows the Treasury's announcement the previous day that it is extending the scope of FSA regulation to include SRB, as it considers this to be the most appropriate way of ensuring consumer protection in this market.

This supports the recommendation made last year by the Office of Fair Trading (OFT), following a market study which found that sale and rent back deals had the potential to cause serious harm to homeowners who are often already in a vulnerable position.

A recent FSA survey of 2,006 adults aged 18 and over interviewed across Great Britain found that:

- 42% of those surveyed knew that SRB is currently unregulated meaning that people who currently take part in these schemes do not benefit from the protection afforded by the Financial Ombudsman Service (FOS) if needed
- The majority thought they would be entitled to stay in their home for more than 5 years whereas the typical contract is 6 to 12 months
- The majority (58%) surveyed thought SRB should be regulated

The FSA is taking a two stage approach to regulating the SRB market. An interim regime will be brought in as soon as any statutory changes come into force (expected on 1 July) in order to address the most immediate problems for consumers, followed by a more comprehensive regime which will start on 30 June 2010.

Under the interim regime firms will need to meet FSA threshold conditions including the requirement to have adequate resources and to be run by fit and proper people.

Firms will also have to comply with the Principles for Businesses and meet a number of systems and controls and conduct of business rules.

Firms that are currently unauthorised and that intend to carry on any of the new SRB regulated activities after the commencement of the interim regime will need to apply for interim permission. Similarly, firms that are currently authorised for other activities will need to apply for interim variation of permission.

Firms are encouraged to start preparing now for authorisation and to apply as soon as the interim regime starts.

**Source: FSA Website**

### FSA CONSULTS ON ADDITIONAL GUIDANCE FOR BUILDING SOCIETIES

On 5 June, the FSA consulted on additional guidance to ensure that Building Societies diversifying away from the traditional business model have the risk management systems and skills necessary to operate safely.

Using a combination of existing and new guidance, the FSA expects Building Societies to re-examine their risk management and business models in the areas of liquidity, wholesale funding and lending to ensure they are aligned. This is covered in Consultation Paper (CP) CP09/17.

Societies that demonstrate the necessary risk management systems and skills will have complete flexibility to run their business within the statutory limits set by the Building Societies Act. Those which cannot, the FSA will steer to a simpler business model category and activities they can safely undertake.

Jon Pain, the FSA's retail managing director, said: "Our approach is very simple; the more diversification, the higher the level of management skills and systems and controls the FSA will demand from the firm. This interventionist approach is entirely consistent with our heightened supervision and is designed to challenge and encourage a strong and vibrant building society sector for the future. Building Societies will still be free to innovate and diversify, but not beyond the limits of their risk management skills."

The consultation paper forms part of the FSA's intensive supervisory regime for Building Societies, where supervisors are judging the sustainability of business models and assessing senior management skills.

Building Societies have statutory freedoms to diversify and innovate, but recent experience has shown some building societies diversified without having the requisite skills and systems to manage the risks. The guidance outlined would not limit those freedoms to diversify, but would clearly set out the skills and controls buildings societies need to have to manage more complex business models.

The consultation will close on 5 September 2009.

[Source: FSA Website](#)

### **FSA CONSULTS ON STRENGTHENING LIQUIDITY STANDARDS**

CP09/14 was published on 5 June and sets out the FSA proposals for transitional measures which are intended to aid the implementation of FSA's new liquidity regime on which they consulted through CP08/22 and CP09/13.

The FSA propose a phased approach, differentiated for each class of firm within the scope of the new liquidity regime. This paper directly affects all UK-regulated deposit-takers (Banks and Building Societies), including branches of both European Economic Area (EEA) and other overseas banks operating in the UK.

It is also relevant to non-bank securities firms and small investment firms (including limited licence/limited activity BIPRU investment firms).

CP08/22 set out FSA views on future liquidity regulation within the UK. FSA will require firms to maintain adequate liquidity resources and manage their liquidity risks.

The presumption in the CP08/22 proposals is that every firm must be self-sufficient for liquidity purposes unless prior permission from us allows otherwise.

In developing the transitional proposals they acknowledge that they need to be aware of the potential impact on firms and the need to give them time to prepare for the complete package of liquidity reforms.

Some of the feedback to CP08/22 has raised issues relevant to transitional matters, for example, noting the differences between the classes of firm within the scope of the new liquidity regime, and this has informed the development of the proposals contained in this CP.

The FSA intend to publish a Policy Statement in the third quarter of 2009, setting out the finalised liquidity regime and reporting rules together with the transitional arrangements.

This will consider and incorporate, where appropriate, feedback received to CP08/22 and CP09/13.

As noted in the FSA 2009/10 Business Plan and DP09/02, published alongside The Turner Review in March 2009, they are planning for the new rules and guidance on liquidity risk management, including transitional provisions, to take effect from the fourth quarter of 2009.

[Source: FSA Website](#)

#### **EXTENSION OF SEPARATE DEPOSIT PROTECTION LIMITS**

The FSA has proposed to **extend until December 2010** interim rules which allow separate compensation cover for customers with deposits in two merging building societies.

It also proposes a similar extension for customers of a Building Society which merges with a subsidiary of another Mutual Society and for customers whose deposits are transferred from a failed firm to another deposit taker where they already have an account.

The rules, due to expire on 30 September 2009, were introduced following concerns that customers with savings in two merging societies, or whose deposits were transferred, could find their combined investment exceeded the £50,000 maximum deposit protection limit for the Financial Services Compensation Scheme (FSCS).

Jon Pain, the FSA's retail markets managing director, said: "The interim rules were introduced on a temporary basis to reassure customers involved in particular mergers or transfers. They helped existing savers who wished to keep below the deposit protection limit and also served to reduce withdrawals by savers from successor firms driven purely by compensation considerations. **We now propose to extend the operation of these rules until December 2010**, by which time it should be clear what changes will be made to the EU Deposit Guarantee Schemes Directive. We will then be able to put in place permanent arrangements which will take account of any new EU requirements."

The European Union Deposit Guarantee Schemes Directive (DSGD) has recently been amended to introduce an EU-wide common deposit protection limit of €100,000 from 31 December 2010.

But this amendment will only take effect if the EU Commission reports that such a change would be appropriate and financially viable for all EU Member States.

The Commission's report is due by the end of this year, but even then it may not be clear what the eventual outcome will be. In these circumstances the FSA has decided that an extension to December 2010 is the right course now allowing a permanent decision to be made later when the final DSGD position is known.

The separate compensation arrangements apply only if the new firm formed by a merger, or a firm that takes over deposits from another deposit taker, informs the FSA beforehand that it wishes them to apply and also continues to operate the business of the previous firm under its former name.

Consultation on this aspect ends on 6 July.

CP09/16 also proposes measures on how the FSA would supervise the 'single customer view' (SCV) of deposits covered by the FSCS, if that goes forward.

The FSA consulted on the SCV in CP09/3 published in January 2009. CP09/16 also makes proposals on how the FSCS would treat term deposit accounts when it pays compensation following a default.

Consultation on these proposals will conclude on 4 September 2009.

[Source: FSA Website](#)

### **MARKET WATCH 32 PUBLISHED**

The Markets Division of the FSA has published edition 32 which covers the following topics:

- Applying the MiFID trade publication requirements
- General principles for trade publication
- Practical examples of trade reporting
- Agency trades
- Principle trades (risk trades)
- Combination agency/principle trades
- Deferred publication of large transactions

[Source: FSA Website](#)

### **EXTENSION TO SHORT SELLING DISCLOSURE REGIME**

The FSA has proposed to extend the current disclosure regime for significant net short positions in the stocks of UK financial sector companies, due to expire on 30 June 2009.

Extending the regime will continue to help reduce the potential for abusive behaviour and disorderly markets. They expect in the longer term, the requirements will be replaced by a broader short selling regime for all UK stocks.

As is the case at present, disclosures will only need to be made if a net short position exceeds 0.25% of a company's issued share capital or increases by 0.1% bands above that (e.g. net short position reaches 0.35%, 0.45% and so on).

Sally Dewar, Managing Director of wholesale and markets at the FSA, said: "Keeping the disclosure requirements will continue to enhance transparency and limit the potential for market abuse, while details of a long term regime for short selling are being drawn up. We remain committed to achieving an international consensus that is as wide as possible on our broader short selling regime."

The consultation period on the FSA proposals will close on 12 June to enable any new measures to be put in place before the current regime expires.

[Source: FSA Website](#)

### **FOS REPORTS ROCKETING COMPLAINTS LEVELS**

In its Annual Report published last week, FOS reported record levels on complaints.

52% of its postbags were Payment Protection Insurance (PPI) complaints, up in volume from 10,600 the previous year to 31,000 this year. 25% of the postbags were complaints about credit cards, 7% relate to credit cards, 6% to mortgage endowments and 3% to pensions. 7% relate to other products or types of complaints.

One particularly revealing comment related to the level of complaints being upheld by the Ombudsman – 6 out of each 10 received were upheld.

Bearing in mind that this was after each firm had dealt with the complaints presumably under the DISP rules and had been subjected to a Final Decision Letter before the complainant would be heard by FOS, this indicates that either:

- Firms have got it wrong and are adjudicating complaints overly harshly
- The Ombudsman is using too high a level of adjudication

If the former is the case, firms should be very aware that there are knock-on implications for the TCF regime within their firms. Complaints MI is a key piece of evidence and this should include the outcomes of cases referred to the Ombudsman.

[Source: FOS Website](#)

### **CML COMMENTS ON BANK OF ENGLAND LENDING DATA**

The Council of Mortgage Lenders (CML) commented on the Bank of England lending data of 2 June.

Economist Paul Santer observed:

- House purchase approvals continued to edge up in April, to 43,000 in the month on a seasonally adjusted basis. This is up from 40,000 in March and is the highest level since April last year (when the figure was 55,000, so this April's number still represents a 22% fall year-on-year)
- It looks almost inevitable that May approvals will be higher than a year ago for the first time since early 2007. However, activity remains at extremely low levels on any historic comparison – and weaker than at any point in the early 1990's
- Limited lending capacity and the impact of further job losses are likely to act as a ceiling for how far the improvement can continue, although there could be further modest rises in the coming months

[Source: CML Website](#)

### **WARNING OVER REGULATION “CONTAGION”**

Regulators and Governments must not harm other industries, such as Insurance, as they deal with the banking crisis, warned the Association of British Insurers (ABI) on 3 June.

In its new report, “Restoring Market Confidence”, published ahead of its biennial conference, the ABI says that any changes should tackle the problems that arose in the banking sector, not apply a ‘one size fits all’ set of remedies to the rest of the financial services sector.

The ABI report also argues that regulation must not inhibit the ability of firms to offer competitive products for consumers, or add unnecessary costs to businesses.

The report comes ahead of the deadline for consultations to the Turner Review on June 15, and in the midst of an ambitious regulatory programme covering UK, EU and international initiatives. Some areas of concerns to insurers include:

- Lack of recognition for the advance, sophisticated prudential regulation of UK insurers, and the developments, under Solvency II, of modern, risk assessment modelling across the EU
- Suggestions that remuneration structures designed for bank dealing rooms can be applied to other parts of the financial services sector where business conditions and risk horizons are wholly different

- The cross-subsidy element of the FSCS which has been used to compensate for banking failures and is paid for by other financial services, such as insurers

Stephen Haddrill, the ABI's Director General, said: "Insurance is not banking and should not be regulated in the same way. We need targeted sector-specific changes, and not a lazy adoption of banking rules to other parts of the financial services sector. If this happens, UK-based insurance companies will suffer the damage to profitability, prosperity and innovation for a generation. As a global leader and major UK employer, the consequences of this would be felt throughout the British economy and beyond."

The reports other findings included:

- The case for a Macro-prudential Committee based at the Bank of England

This would identify and act on systemic threats to the economy, in the same way that the Monetary Policy Committee focuses on monetary policy. Chaired by the Governor of the Bank of England, it would focus on the build up of long term risks and could help set capital requirements for the whole financial system.

- Increased transparency of market practices (short selling/hedge funds)

We must avoid regulation of activities not related to the cause of the crisis. For example instead of the protectionist approach of the EU directive on Alternative Investment Funds, a better solution would be the registration of hedge fund managers and targeted prevention of conflicts of interest. This would help prevent problems without damaging enterprise.

- Establish a global, European and national basis for regulation

Better supervision of cross-border groups and more consistent standards for the Single Market could be achieved through an EU body that would act as a supervisor of supervisors. This would need to consider drawing in third country supervisors (such as those in Japan or Australia) to ensure Europe's framework of regulation is outward-facing.

- Encouraging capital investment and the tax regime

A crucial part of restoring confidence in the UK. The Government should consult more openly at the early stages of policy development. It should also look at the tax treatment of debt versus equity and the administrative burden of the tax regime.

- Further measures to help boards to function effectively

Board evaluation would help ensure the necessary skills are in place and thought should be given on how to improve the accountability of directors.

- Executive pay reform must be targeted

The ABI supports the principles behind the FSA's proposed code of practice on remuneration, but calls for the differences in financial sectors to be recognised as the nature of the roles and risks are different.

- High quality financial reporting needed

Investors need transparent accounts, clear from the demands of regulators. This needs to be backed by accounting standard setters being allowed to pursue global standards free from carve outs by the EU or others. The G20 is right to look at the issue of fair value and appropriate risk provision, but this cannot be easily done in the six months set by the G20. The IASB should also be established in international law.

**Source: ABI Website**

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