Autumn 2008

MOORE STEPHENS
CHARTERED ACCOUNTANTS

Financial **Insight**

Business partners to the financial services industry

In this issue

Are you TCF?

By December, firms should be able to demonstrate that they are consistently treating their customers fairly.

The FSA has put much emphasis on management behaviours and the fact that Treating Customers Fairly (TCF) must be embedded into firms' values and culture. It is not something that can be looked at once and then forgotten – senior management are responsible for ensuring that TCF is part of the firm's culture. With the December deadline fast approaching, action should be taken now to make sure the documentary evidence the FSA requires; is in place. The FSA has said that they are pushing ahead with this deadline despite the current economic climate. If firms fail to meet this deadline, then penalties will be issued.

Who is affected?

In line with the FSA's risk-based approach to regulation, the focus has been on improving standards for retail customers. However, the FSA has warned wholesale firms not to assume that TCF doesn't apply to them, and they are expected to adopt a risk based approach to TCF which is appropriate to the size and nature of their activties. In summary, TCF applies to all firms that are expected to comply with Principle 6 – *A firm must pay due regard to the interests of its customers and treat them fairly*.

Embedding TCF

By 'embedding' TCF into a firm, the FSA expects to see the following:

- the fair treatment of consumers is established throughout the firm – not just in systems and controls, but in business culture. This includes strategy, training, remuneration and staff behaviours;
- recognition that TCF is a continuous process, rather than a short-term project that can be completed and put to one side. TCF should be built into processes and strategy so it is automatically included in all relevant business decisions (for example, when new products and services are launched);
- adequate management information is available for the firm's management to monitor TCF;
- customers experience improvement in the quality of the six consumer outcomes outlined by the FSA (for example, that products and services are designed to meet the needs of identified consumer groups and targeted accordingly).

Management information

Management information is the key to enabling firms to demonstrate that they are meeting the TCF requirements. Management information is defined as any evidence collected periodically by the firm that shows whether or not the TCF outcomes are being achieved. Management information can be qualitative or quantitative, and some examples include:

- Complaints: Are numbers of complaints measured and trends monitored? How effective are complaint-handling processes? Do firms act on lessons learned from complaints?
- Financial information: Is current information on the firm's financial position and its financial resources requirements available? Have you considered the impact of remuneration strategies on clients?
- Financial promotions: Are you measuring the effectiveness of your sign-off process? Are you ensuring that promotions are clear, fair and not misleading?
- Unfair contract terms: In June the FSA published a report on unfair contract terms, highlighting that fair contract terms are an integral part of firms' obligations to treat customers fairly.
- Remuneration policies: in October 2008, the FSA published a 'Dear CEO' letter to firms on the effectiveness and appropriateness of their remuneration policies. Firms have been asked to review their policies to ensure that no undue risks are taken by firms in order to obtain higher remuneration. This also impacts on TCF.

If you need any help with documenting your TCF policy, then please get in touch.

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New faces

Introducing Samantha Grover and Hayley Turp, new members of the Moore Stephens Financial Sector team.

Both Samantha and Hayley are trainee management accountants whose role is to help clients prepare their accounts, typically on a monthly basis.

Samantha joined the firm in October having previously worked for a small firm in Sevenoaks in Kent. "I was keen to join a larger firm" Samantha explains. "I enjoy my work because every day is different from the last." With a degree in accounting and finance from Greenwich, she is now studying for the ACCA qualification.

A former secretary in Moore Stephens' Wealth Management Division, Hayley began her new accounting role in June. She is currently studying with the Institute of Certified Bookkeepers and plans to begin her ACCA qualification next year. "I love my work" she says. "Being able to go out and help clients is really satisfying."

Samatha Grover

Hayley Turp

Pillar 3 in focus

Pillar 3 introduces substantial new public disclosure requirements relating to risk. Firms need to make sure they understand the level of detail required.

Pillar 3 of the Capital Requirements Directive (CRD) aims to improve market discipline by requiring firms to publish certain details of their risk exposures, capital adequacy and risk management processes. As the FSA explains, "The disclosures are to be made to the market for the benefit of the market".

The exact timing of when firms publish their Pillar 3 disclosures has been left to management's discretion. However, given that inclusion in annual reports is often preferred, many firms with December year ends will be preparing for the publication of their first Pillar 3 disclosures. Also, disclosures should be made on an annual basis at a minimum.

What does Pillar 3 disclosure require?

Firms must publicly disclose information laid down in BIPRU 11.5. The detail required can be highly prescriptive and technical. However, in general terms the disclosures cover the following:

Risk management objectives and policies

Firms must disclose their risk management objectives and policies for each separate category of risk. They should include:

- the strategies and processes to manage those risks;
- the structure and organisation of the relevant risk management function or other appropriate arrangements;
- the scope and nature of risk reporting and measurement systems; and
- the policies for hedging and mitigating risk, and the strategies and processes for monitoring the continuing effectiveness of hedges and mitigants (BIPRU 11.5.1R).

Capital resources

Required disclosures include summary information on the terms and conditions of the main features of all capital resources items and components (BIPRU 11.5.3R).

Compliance

Firms must disclose information regarding compliance with BIPRU 3, 4, 6, 7, 10 and the overall Pillar 2 rules. In particular, they must provide a summary of the approach to assessing the adequacy of internal capital to support current and future activities (BIPRU 11.5.4R).

For more information, see our factsheet, available at www.moorestephens.co.uk/financial, including a suggested format for Pillar 3 disclosures.

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VAT penalty alert

A new regime for VAT penalties comes into force next year.

The current 15% misdeclaration penalty will be replaced with a tiered penalty structure relating to the filer's actions. This will apply to VAT returns for periods starting on or after 1 April 2008 with a filing date on or after 1 April 2009.

Under the new regime, there will be no penalty for an error on a VAT return where reasonable care has been taken. However, penalties can be charged as follows:

- 30% for careless errors;
- 70% for deliberate errors which have not been concealed; and
- 100% for deliberate errors which have been concealed.

Given that there are no useful definitions of what constitutes 'reasonable care' or 'carelessness', appeal cases seem likely before the practical working of the regime is fully understood.

Where an unprompted disclosure is made to Revenue & Customs, the above penalties can be reduced to zero, 20% and 30% respectively. Following a prompted disclosure, perhaps in anticipation of a VAT inspection, the standard penalties may be halved – to 15%, 35% and 50% respectively. While these reduced penalties are welcome, the approach is not as certain or generous as under the current regime, where voluntary disclosure is normally guaranteed to result in no penalty being imposed.

Note that the rules for voluntary disclosures have already changed. Previously only errors with a net value less than £2,000 could be adjusted for on the next VAT return. This limit has been raised to £10,000 or, if higher, 1% of the turnover shown on the VAT return, up to a maximum of £50,000. This is a welcome change, although a penalty of the 'prompted' disclosure type could still be imposed. Businesses may therefore still decide to make a full written disclosure in order to qualify for the lower, 'unprompted' penalty class.

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SYSC warning

Feedback from FSA visits suggests that some firms may need to step up their corporate governance in relation to the Systems and Controls rules in the FSA Handbook.

While many firms may see themselves as complying with the SYSC requirements, they may not always be documenting their procedures and actions properly. In the FSA's eyes, if you are not documenting what you do, you are not doing it.

As a reminder, the overriding purpose of SYSC is:

- to encourage firms' directors and senior managers to take appropriate practical responsibility for their firms' arrangements on matters related to FSA-regulated activities;
- to ensure that firms take reasonable care to organise and control their affairs responsibly and effectively, with adequate risk management systems; and
- to create a common platform of systems and controls that meet the requirements of the Capital Requirements Directive and the Markets in Financial Instruments Directive.

All firms must have put in place robust corporate governance arrangements, including:

- clear organisational structures;
- well defined, transparent and consistent lines of responsibility;
- an effective process to identify, manage, monitor and report the risks the firm may be exposed to; and
- an internal control mechanism that includes sound administrative and accounting procedures.

The systems and controls that management introduce should be proportional to the nature, scale and complexity of the individual business and fully documented. They should also be monitored and evaluated regularly (also documented), and with appropriate measures taken to address any deficiencies.

As part of their systems and controls, firms should establish, implement and maintain adequate risk management policies and procedures, including effective procedures for risk assessment, which are linked to the firm's ICAAP and Pillar 3 disclosures. All such, policies should be periodically reviewed by senior management, and these reviews documented.

Corporate governance over SYSC can be achieved through the introduction of a separate compliance function operating independently from the rest of the business. Larger firms could introduce an internal audit function, again separate and independent from the other functions and activities of the firm.

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Large exposure returns

It is now a requirement that all BIPRU firms complete the FSA008 return on a quarterly basis within 20 business days of the end of the period to which it relates. This is a new requirement for the old investment management firms.

Credit institutions (who have their head office in the EEA or elsewhere) are deemed to be an exempt exposure in accordance with BIPRU 10.6.3 but still need to be included on the FSA008 within the exempt exposures column.

If you are going to lend money to a group company, the exemption within BIPRU 10.7 may be of use. This allows certain firms who are part of a concentration risk group to lend up to 50% of their Tier 1 and 2 capital to a group member providing the conditions within BIPRU 10.7 are met and that at least one months notice is given, in writing, to the FSA in accordance with BIPRU 10.11.1. This is known as the 'treasury concession' and allows the loan to be exempted from the large exposure requirements.

More TCF

As part of their review of firm's compliance with TCF, the FSA has said that small firms must assess the behavioural framework to ensure that senior management has established and maintained the right behaviours to ensure their good intentions actually result in good outcomes for customers. The assessment will look at:

- the relationship the firm's management has with its staff;
- how it communicates TCF to its entire staff (not just advisers); and
- what controls, including management information, it has in place to demonstrate consistent fair treatment of customers.

How would your firm be assessed?

IFRS update

Two new IFRS accounting standards that will be in force and applicable for accounting periods beginning on or after 1 January 2008 are:

- IFRIC 12 – service concession arrangements, which deals with the provision of a public service by an entity using public assets; and
- IFRIC 14 – the limit on a defined benefit asset, minimum funding requirements, which considers the recognition of a refund or a reduction in future contributions by an entity in respect of its defined benefit pension scheme.

Issued between these was IFRIC 13, accounting for customer loyalty programmes. This applies to periods commencing on or after 1 July 2008, although it may be adopted early.

There are few major changes impacting financial statements for the year ending 31 December 2008, but IFRS 8 – operating segments, will be replacing IAS 14, and is applicable for accounting periods beginning on or after 1 January 2009. Comparative information will be required and therefore it is advised that this is obtained during the year ending 31 December 2008.

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If there are any other topics that you would like to be covered in future issues of Financial Insight, or if you have a comment concerning any of the articles please contact one of the partners or e-mail jon.gibbs@moorestephens.com

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Profile: Jeff Lestz and Bob Safford

American entrepreneurs Jeff Lestz and Bob Safford, joint CEOs of Genistar, are on a mission: to help middle income families achieve financial independence.

Jeff and Bob set up Genistar, a third party intermediary, in 2007. "We are not a typical approved financial services company," Bob explains. "We have a unique business model, a unique approach and a unique way of thinking. It's not about money first and foremost. We are passionate about what we do to help middle income British families."

Jeff Lestz and Bob Safford

The approach is working well. "We made a profit in our third month," Jeff says. Over 1,335 people have been recruited by 14 Executive Vice Presidents to train as self-employed associates, with around 400 of these currently FSA registered. "The vast majority of people we hire are previous clients," Bob notes.

Genistar's emphasis is on educating consumers so that they are better able to make intelligent decisions about mortgages, insurance, investments and debt management. "A lot of the things we teach are just common sense," Bob says. Genistar's associates provide education and personalised financial analysis, with an emphasis on putting the client first. Jeff refers to the FSA's Treating Customers Fairly requirement. "That really is what our whole concept is about," he explains. "Just treat people right. Be honest with them and educate them to help make the right decisions. Our mission statement is about helping families become debt free and financially independent."

Though the business is thriving, Bob and Jeff say they probably wouldn't have succeeded in setting it up without the help of the Moore Stephens Financial Services team, led by partner Lorraine Bay. "We were introduced to Lorraine by a friend of Jeff's," Bob explains. "We really connected with her. She is one of the most interesting and knowledgeable accountants I have ever met. We told her what we wanted to do and she told us she thought it could be done."

Working closely with compliance officer Jacquie Collins, Lorraine guided Bob and Jeff through the process of gaining FSA approval, which others had predicted would take two years and cost £500,000. "Actually it took 60 days from when we submitted the paperwork," Bob recalls. "It also cost significantly less than half-a-million!"

Moore Stephens continues to advise the business. "Lorraine is helping to keep us going down the centre of the road," Bob says. "The regulatory side is very onerous, and I couldn't imagine trying to do it without a firm like Moore Stephens."

Loose change

Change in non-financial returns

As you are all now probably aware, GABRIEL is here with the new FSA returns! However, GABRIEL is not just for financial returns.

The FSA is introducing many new returns, including non-financial returns which are all to be collected via GABRIEL. From your firm's profile screen, you should be told what returns are due and when. You should even receive email reminders that the returns are due!

Examples of these returns include the complaints returns, RMAR data, client assets and monies, and the Pillar 2 questionnaire. If you have any questions about the new reporting, please refer to our New FSA forms factsheets, which are available to download on the website, or contact one of our team.

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