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as news

Dear Friends...

After a strange 2002, this past year has been one of recovery for the business. Last year's newsletter mentioned the fact that writing had just become my new product. This year, it took off spectacularly. Five different publishers signed me up commercially to write for their journals, online news services, books and pamphlets. I have just started to contribute to Compliance Online where you will be able to see my commentaries on major regulatory developments on a regular basis.

My website has taken off equally spectacularly. In 2003, hits increased by 43% compared with the previous year. In the autumn, there was a sudden spurt of business from people finding me on the web through search engines.

More importantly, this year I have encountered some impressive businesses and individuals. One intermediary firm which found me on the web asked for advice about how to be the most profitable in its field through being the most compliant. Its business plan stressed the point that by interacting with their customers more effectively and compliantly, they could generate business for those using its services. Profitability and compliance are closely related in the long-term. Communicating that message to senior management within my customer base remains the challenge.

On a lighter note, I discovered a seriously good veggie restaurant in Edinburgh, David Banns. After last year's plug for Thursday night singing at the Golden Eagle pub in London's West End, a number of you have come down there and enjoyed the fish and chips at the excellent Golden Hind round the corner (also convenient for the Wigmore Hall). Finally, for overseas readers and travellers, I found the classy Lausanne: A Short Guide which contains twelve self-guided walks.

Adam Samuel

Life assurance, pensions and investments

Outside the complaints area, I have been most involved in two fields. The first, an old chestnut, is the problem of assessing investment risk. The second is the development of client agreements.

I have long thought that the point-scoring approach to risk profiling is inadequate. A client may have different attitudes to risk, depending on the purpose for which he wants to save or invest. He may be cautious about mortgages and pensions but happy to take chances with money leftover. A recent FSA decision on endowment complaint handling emphasised this.

The adviser must consider the client's risk tolerance. This is whether the client can cope with a possible negative outcome of a particular approach. Some customers cannot or do not want to tolerate certain results. Discovering those limits is vital to protect the adviser if something goes wrong later. Finally, some customers can be satisfied with a wide-range of investment vehicles with different exposures so long as they produce a certain average level of risk exposures. Others do not share that view. The range of permissible investments and funds must be noted as well as the overall sensitivity to risk.

I've done some training sessions this year for the Institute of Financial Planning (IFP) on client agreements. From that and my work on the IFP's disciplinary Committee, I see the Terms of Business as a much more crucial document than before. Increasing numbers of IFAs are moving towards charging by fees. To do this, though, there has to be a document on which every invoice can be based.

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point-scoring approach to risk profiling is inadequate

Life assurance, pensions and investments continued

When a customer queries a charge, a good test of the adviser's decision to bill and client agreement is whether the former can be clearly justified by reference to the latter document. If not, there is a problem.

Successful contract drafting is all about setting out the offer to the customer, his obligations, what will not be provided to him and the regulatory boilerplate. This applies equally outside the financial planning arena. Pension scheme administration is bedevilled by disputes about which of three or more organizations promised to do a particular task. General insurance and mortgage documents suffer from similar problems.

The very antithesis of this mature approach to financial planning is the proposed regime for the marketing of Sandler products. The product specifications are not simple, contrary to expectations. They cannot be sold safely by untrained advisers as the FSA's research shows clearly. The idea that such a salesman can recommend a product without doing proper fact-finding smacks of promoting "bad shoes for poor people". At a time when there is much discussion about improving educational standards in the financial services industry, the idea of allowing these types of sales to occur is grotesque.

Finally, at the end of the year, I encountered another ugly compliance phenomenon previously thought to be consigned to history: the decentralisation of compliance. The FSA condemned a major bank in December for following this approach to money-laundering. It made the obvious point that localised compliance creates conflicts of interest. The decentralised supervision staff are under considerable pressure to certify that everything is fine from those running their regions. Every large life assurer or IFA who has de-centralised compliance has either reversed this process shortly afterwards, been fined or gone out of business and in some cases all three. Don't do it.

Complaint Handling

Endowment complaint handling moved this year in the ugly directions predicted in previous newsletters. I continue to offer a mix of training, opinions, technical answers and face-to-face meetings to predict what the FSA will be saying shortly on the subject.

My traditional complaints customer base, life assurers and nationwide IFAs, has been using me mainly to look at and sometimes train staff to use procedures. However, as the reasons for the FSA's first endowment complaint fine shows, many companies are still trying to cut their costs by wrongly rejecting complaints or by cutting compensation incorrectly. I sometimes have to turn business down as a result. More often, senior managers vetoes the use of training recommended by the staff on the ground. The FSA's approved persons regime has yet to work in this area.

Compliance departments have an unfortunate tendency to focus on technical rule breaches at the expense of quality

In December, I did a talk for Derek Adams's Endowment Forum on joint-liability and endowments. The audience's opinion divided strongly on whether the adviser on an initial non-compliant sale should be liable for a subsequent policy arranged by another firm. If the two companies concerned combine to pay the full amount due to the client, it does not matter. The problem arises where the second one decides not to uphold the complaint. The pension review guidance and law appear to give the same answer. The first adviser must pay the full amount and can claim a contribution from the second firm of about 50% of redress costs generated by the later sale. The suggestion was made at the Forum that endowment complaints and the pension review were quite different. It seems to me that they are increasingly similar. The essential point is that if the first adviser had given good advice and proper disclosure, it could have prevented the second bad sale from occurring. It, rather than the customer, should pay the bill caused by the later transaction.

On endowments, one sees firms failing to compensate clients for the extra cost of new life cover. Some have wrongly deducted the cost of critical illness protection from the redress where similar coverage was included in the missold policy. Some companies reacted to the FSA's purported "lengthening" of the time for bringing endowment complaints to FOS by seeking to reject complaints on the basis that they were time-barred by the 15-year rule in the Limitation Act or the new FSA rule. The FSA confirmed in November that the Act does not apply to regulated complaint handling. It now has to consider whether it is acceptable for firms to reject complaints on the basis of a rule which only applies to the Financial Ombudsman Service and not to firms.

This last point raises a more general point about the FSA's complaints rules. Nobody has a clear idea as to which cases fall within them. There is a list of cases where the Ombudsman may decline jurisdiction which contain grounds such as pricing and underwriting that have traditionally been regarded as falling outside the complaint rules. There are also a significant number of rules whose meaning is unclear.

Compliance

General insurance and mortgages

The impending regulation of mortgage and general insurance sales has created a predictable buzz of activity. There has been much concern about the need to file timely applications for authorisation and variations of permission. The form requires firms to state that they will have a compliant complaints procedure. The current general insurance regulator, GISC regularly reports serious problems with its members' processes in this area. In the last couple of years, I have done work, devising and auditing complaints systems that not only comply with the rules but feedback vital management information. The follow-up training then ensures that the people on the ground know how to use them.

Worryingly, well-known consultants have been trying to persuade firms to seek authorisation when they do not need it. This is usually because the company sells only one company's products in a particular area. Some organizations may even choose to create different companies to service their various providers. The key to all this is for the firms to talk to the insurers with which they do business and fix the nature of their future relationship. A well-drafted contract can co-ordinate everyone's expectations and ensure the sustainability of both businesses.

For some firms, selling more than one company's products for the first time, it will come as a shock that they will have to decide which of their client's products is more suitable for the client. The emphasis on price in the current proposals could leave some insurers with multi-tied agents but no business.

Some brokers expect to be tied and will find that no insurer wants them. More worryingly, without properly negotiated contracts, some appointed representatives could have their appointments terminated soon after regulation arrives, leaving broker firms without a business or authorisation to work as a broker.

The great unknown is the quality of general insurance and mortgage advice. How well do brokers compare the scope of different policies?

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For example, some firms like to exclude cases resolved by the end of the following business day. Unfortunately, the rules do not define "resolved". There are two partial definitions, neither of which cover this issue satisfactorily. Good practice, but not the literal words of the rulebook, would suggest that firms issue a final response letter which mentions the client's right to refer the case to the Ombudsman. If no response is received and the reply was issued by the end of the following business day, such cases can subsequently be excluded from the records. Evidence, though, suggests that huge numbers of complaints are not logged by firms using "different approaches". These are even further away from the literal meaning of the FSA rules. Such variations invalidate most of the regulator's complaints data.

The need to acknowledge within 5 working days requires the firm strictly speaking to post the relevant letter by the same time the following week. However, the FSA has said that it will not be interested in the precise time of posting so long as the letter is posted by the end of that day. On that basis, one firm was breaking the acknowledgement rules a great deal less frequently than it thought.

Compliance departments have an unfortunate tendency to focus on technical rule breaches at the expense of quality. The firm concerned about the timing of its acknowledgements missed the more important point that its final response letters had an illiterate standard paragraph referring clients to the Ombudsman.

There are enough difficulties to justify a committee to amend substantially the wording of DISP. I will happily volunteer to chair it.

I have spent a fair amount of the last eight years teaching firms to write final response letters. The rules here are useful in reminding companies of the need to respond adequately to all the points raised. In all but the simplest case, it makes sense to list these early on in the letter to ensure that a response to each matter can be found subsequently. Firms still all too frequently fail to set out the key facts, thus making it impossible to check the quality of investigation or understand the reasoning behind the letter.

More generally, I have picked up some good customers in relatively new areas for me, small IFAs, general insurance intermediaries and even unit trust administrators. They have proved keen to have complaints properly investigated and to learn the lessons from them even when ultimately my view has been that they should not uphold the complaint. Their constructive approach is heartening.

What is fascinating from the advice and training work that I have done for these customers is what one learns about the underlying businesses and how they can improve their efficiency and approach to clients. Complaints constantly raise issues such as the need to price things clearly, describe services accurately and communicate effectively within the organization. The interesting challenge is to use this information to change the essential nature of the service or product offered to clients and its method of delivery.

Compliance continued

How good are mortgage advisers at distinguishing different types of loan and avoiding the influence of variable procurement fees? We do know that some mortgage lenders continue to be less than fulsome in their disclosure of early termination charges and other costs. Discussion in the press about home income products whose costs cannot be assessed at the point of sale because of market movements brings the "game" into disrepute.

Arguments about product regulation continue to rage. While the financial services industry is shifting its emphasis from sales to advice, no regulator can ignore the outputs of that advice: the products. Some need to be strangled at birth. Precipice bonds are a good example. An apparently guaranteed product ceases to return its capital to investors when a share index to which it is linked drops below a certain level. At that point, the value of the investment goes down by more than the fall in the relevant index. It is difficult to identify any type of customer for whom such an idea would be suitable. If the client does not want the guarantee, he should not be paying for it. If he does want it, the collapse of the promise when it is most needed will be disastrous for him. Instead of banning these products, the FSA merely proposes to amend the rules to make a compliant sale all but impossible. This just clutters up the rulebook.

A chance conversation I had about mortgages led to an interesting idea: compliance profiling products at their launch. The idea is to take a loan or policy, subject it to external scrutiny and then describe the people for whom it is suitable and unsuitable and list the necessary disclosures and processes required for a safe sale. The original feature of the idea is that the document can then be made available to clients and the press. Both can help to scrutinise compliance!

My experience of home income plan complaints is making me increasingly nervous about the return to prominence of these types of product. Advice to borrow in order to invest should have disappeared with the original equity release concepts of the late 80s. Many customers, though, receive worryingly poor value from once-and-for-all releases of control over their equity. Advisers also need to consider the effects of having to sell the property to fund nursing home or other expenses. People who marry customers who have taken out equity releases can find themselves widowed and homeless simultaneously. In this context, the FSA's failure to require advisers to consider the option of selling the property as part of the sales process is worrying. Equally, so, is the complexity of some of the products in this area and the Treasury's failure to regulate equity redemptions.

The new regulatory regime will force firms to change some of their working practices. The new Demands and Needs Statement should make the general insurance advice process more coherent. Firms will also need to learn how to write them, even for execution-only transactions. Surreally, the FSA has not insisted on suitability letters for mortgage advice. Firms do, though, need to keep the justification for their recommendations. In the circumstances, they might as well give the client a copy.

Disputes, Arbitration and Lawyering

The industry could take a "minimalist" approach and use arbitration to resolve disputes rising from particlar incidients

The State of the Nation Conference gave me an opportunity to present a paper about the resolution of disputes within the financial services industry. The positive response from the audience suggests that there is mileage in this idea. The industry could take a "minimalist" approach and use arbitration to resolve disputes that arise after individual well-publicised events. It could then expand the scheme to cover administration problems generally before taking on a fuller range of issues. Otherwise, it could just take a big leap and go for a broad scheme. The initial push, though, still has to be made by the trade bodies or perhaps a company with a major administration problem that affects IFAs. In the meantime, justice within the final services industry remains something of a lottery. E-mail me if you want a copy of the paper.

This year, I became a member of the World Intellectual Property Organization's (WIPO) panel of neutrals for domain name disputes. In May I updated my Hague lecture on arbitration and the European Convention on Human Rights with a new group of students. I have also been working with the Practice Committee of the Chartered Institute of Arbitrators on Guidelines for handling international jurisdiction problems.

A late-night phone call led me to launch a new service: the lawyers' lawyer. A solicitor needed urgent help with a paper on arbitration confidentiality. Using lots of wax at either end of the candle, we produced a competent paper for her to take on the plane to Canada the following day. Since then, I have done a paper for a German law firm on the application of the Unfair Contract Terms Act to an international commercial contract and helped a solicitor out with aspects of switching a pension scheme to a different provider.

Finally, I translate legal documents and articles. I even produce an English version of the bulletin of a worthy charity supporting agricultural development in West Africa for one person: its honorary President, Bishop Desmond Tutu!

All the best for a compliant and dispute-free 2004.