

Industry Seminar – 6 December 2013

Consumer Protection – The Way Forward

Rosemary Stevens, Assistant Director, Conduct Unit

Introduction – Jeremy Quick

Thank you Dale and good day everybody.

I am going to speak for a few minutes before handing over to Rose.

The current household savings in the UK is 4% of income. What that means is that for every pound earned, 4 pence is set aside for savings. This ratio is volatile and there are many factors that influence it. However we all would recognise here today that people need to save more, not least giving the fact that we all expect to live longer.

One reason that people are not saving enough is that they lack confidence in the financial industry to deliver products that they believe to be good-value. Some of that lack of confidence may be based on expectations around unrealistic returns, but some of it is due to historic weaknesses in both the design and delivery of in particular long-term savings products.

The media might have us believe these weaknesses are due to a few unscrupulous people or firms. I dare say in some cases that this is true. But there are deeper structural reasons that need to be addressed such as perverse sales incentivisation, a disjoint between issuance and distribution, long-term financial volatility, financial illiteracy, tax and so on.

These issues are not going to be dealt with overnight and the ability of Guernsey as a jurisdiction to address all of them is limited. Nevertheless, some issues can be addressed locally not least around the sale of long-term life products; as witnessed for example by the government issuance of the Guernsey Financial Advice Standards.

The problem of a low household savings rate needs to be addressed co-operatively. The public need to re-discover the concept of caveat emptor. The industry needs to sell financial products professionally and transparently. The authorities need to encourage financial literacy and to provide firm but fair regulation. The solution has to be trilateral.

Apart for long-term savings products, the people of Guernsey depend on local financial services as part of their everyday life. They need to operate bank accounts and buy general insurance. Effective and responsive regulation on conduct is also important here.

It is in this context that the Commission has set up the Conduct Unit. Much of the work of the Commission is wholesale and may therefore appear sometimes remote to local people.

The Conduct Unit is primarily for local people and is designed as a one-stop shop covering all aspects of consumer issues regardless of provider or intermediary. It will therefore over time begin to feature more centrally in the discussion of financial services to Guernsey people.

The Conduct Unit is an exciting development and the Commission is very keen to hear how both the public and the industry would like to see it develop. This is the theme of Rose's presentation to whom I will now hand you over.

Thanks you for your time.

Rosemary Stevens – Conduct Unit

Good morning ladies and gentlemen and welcome to the Conduct Unit's first appearance at the annual industry update. For those of you who don't know me, I am Rosemary Stevens, the Assistant Director heading up the Conduct Unit.

Slide – The Common Good

In his address yesterday, William Mason described in practical terms what the common good would look like if the Commission is successful, in Guernsey, in taking the balanced approach to regulation. The practical measures to which William referred consist of:

- Financial stability and good quality controls on financial crime
- A fair degree of consumer protection
- Easily understood good quality rules
- Good quality interaction between the Commission and licensees.

The Conduct Unit has a part to play in each of these, however during our session today I will concentrate on the second measure – a fair degree of consumer protection.

The intention to create the Conduct Unit was announced by the Commission in June as part of the changes to its internal structure to help increase its effectiveness. The Conduct Unit has since been established to take a Commission-wide lead on conduct supervision and policy, in particular the implementation of Guernsey Financial Advice Standards, which I shall refer to hereafter under the acronym of GFAS.

Slide – The Conduct Unit

The Conduct Unit consists of a team of four people under the direction of Jeremy Quick, Director of Banking and Insurance Supervision and Policy Division and line management of Caroline Bradley, Deputy Director, Insurance. The team's background is primarily in the supervision of licensees in the insurance and fiduciary sectors. However the creation of the Conduct Unit has enabled the team to look to consumer matters in all sectors and help ensure that a Commission-wide approach is developed.

During our session today I will talk more about GFAS and how its successful implementation will form part of the overarching objective for the Conduct Unit to help ensure that the Commission can continue to act to defend the Bailiwick's consumers from the inappropriate sale of ill-advised financial products. I will refer to this trait as the practice of mis-selling.

I will then move on to look at some of the Commission's findings from the thematic on-site visits that have been carried out by the Conduct Unit together with some detail of other supervisory and policy work and initiatives we have undertaken.

I will then focus on how the creation of the Conduct Unit has addressed objectives for 2013 before finishing off with details of our plans for 2014 and beyond.

Finally, there will be an opportunity for questions at the end of the presentation.

Slide – Background to GFAS

Those of you who attended the Insurance Division presentation in October 2011 will have heard the Commission talk about the FSA's Retail Distribution Review and how this was the main policy issue affecting the audience in that year. In view of the significance of this issue, it is not surprising that this continues to be high on today's agenda. In the intervening period the Commerce and Employment Department issued a consultation paper in 2012.

Slide – GFAS - 2013

In March this year Commerce and Employment Department issued its feedback paper on the consultation and requested the Commission to implement GFAS with commencement to be effective from 1 January 2015.

To this end the Commission issued a consultation paper in September asking for responses on the changes to rules and codes proposed by the Commission that were seen to achieve the desired objectives. The consultation period ended in November.

Slide – Future milestones for GFAS

The Commission will shortly be issuing a feedback paper summarising the responses that have been received. However in the interim, I would like to thank those who took the trouble to respond to the consultation paper and give a brief overview of responses.

We received 25 representations – the majority from licensees that would be affected by the proposed changes. We also received representations from professional bodies with members that will be affected, training bodies, an industry body and 2 responses from others who are not directly affected. Thank you all for your support in this process and the helpful manner in which you have laid out your representations.

Slide – Enhanced qualification standards

The representations were primarily in respect of the qualifications set out in the table in Appendix A of the consultation paper, and as a result of which, the Commission will be extending the contents of the table to include relevant higher level qualifications – i.e. those at a level above FCA level 4 – and include lower level and historic level 4 qualifications which may be supplemented by gap fill to reach the proposed standard.

Working with industry to help ascertain training requirements for relevant financial advisers and long term authorised insurance representatives – which I will refer to collectively as financial advisers - the Commission has asked for details to try to establish a comprehensive list of those that are affected by the proposals.

The information that we have received indicates that the vast majority of insurance intermediaries and their long term authorised insurance representatives have been proactive in trying to ensure relevant level 4 qualifications will be held with 13 being qualified and 21 having already embarked on gap fill qualifications. This compares favourably with the impact assessment survey carried out two years ago when only 3 of the practising long term authorised insurance representatives held a proposed FCA level 4 qualification with a further 3 undertaking study.

Slide – On-site Supervision

I will now provide you with some feedback on the on-site visits to insurance intermediaries and investment licensees that have been carried out by the Conduct Unit in relation to advice provided to retail clients. These thematic visits focussed on an assessment of the extent to which the Licensee was complying, or otherwise, with the relevant rules and codes.

In July 2012 the Commission carried out 8 on-site visits focussing on the provision of advice to the retail clients of insurance intermediaries. These findings were summarised in last year's industry presentation and then, in January, the Commission wrote to the sector, setting out its expectations in this respect. For those of you who have not seen this letter, a copy will be appended to my presentation today when this is published on our website.

The Conduct Unit carried out 8 visits in October this year, 2 of which were follow up visits to licensees that had been visited in July last year and has this week visited another 4 licensees; 1 of these having likewise had a previous visit. These visits again focussed on the provision of advice to retail clients.

Slide – On-site Sales Practices

Our visits were not a tick box exercise simply to identify whether the Licensee has procedures in place which it follows to ensure – for example - the existence of a fact find with all boxes completed, client signature on this fact find, the assessment of a client's attitude to risk, the completion of a peer review and issue of a recommendation letter. Nor did we just check to see that the client file had been reviewed by compliance. We were looking to see whether the financial adviser acted in the best interest of the client in a fair

and transparent manner. To establish this we placed emphasis on good judgement and considered questions, such as:

- Did the financial adviser find a suitable product for the client that meets the client's circumstances and attitude to risk?
- Did the financial adviser consider the affordability of the product and the client's capacity for loss?
- Was the client given time to consider the recommendation or was the recommendation letter merely a confirmation of a decision?

Slide – On-site Sales Practices (continued)

We also considered the effectiveness of peer and compliance reviews by considering questions, such as:

- What evidence exists to show that the peer reviewer challenged the financial adviser's recommendation?
- Did compliance reviews identify any trends in relation to products, client attitude to risk, market research etc. and if so, what was done about this?
- How has the Licensee considered whether its financial advisers are complying with the requirements of the relevant code or rules?

Our visits have identified instances of good practice - those licensees where the Commission's messages have been considered and changes made to develop a more client-focussed approach to their business. We have found that most licensees are heading in the right direction. We will write early in the New Year, after we have assimilated the findings from all 12 thematic visits, with a summary of our findings, and I would encourage you to review your culture and procedures in the light of GFAS and our letter.

I also want to mention that we have come across some instances where financial advisers and licensees are falling short of the Commission's expectations and the requirements of the relevant code and rules and where the risk of mis-selling taking place is not being adequately addressed by the business despite guidance from the Commission.

Where visits fall into this latter category and, if there is sufficient concern that retail clients are at risk from the advice that is being given by the licensee, the Conduct Unit, will make a recommendation for enforcement action against the licensee to be considered. Enforcement action may also be considered in cases where the licensee has failed to introduce procedures to comply with regulatory requirements in spite of remediation.

We have been particularly concerned by instances where clients who have clearly stated that they have little or no capacity for loss, and the investment represents a substantial amount of their savings, have been recommended to invest in products where return of capital is not guaranteed and, by instances, where the adviser has failed to identify if the client is able to withstand loss on their investment whilst not knowing the extent of that person's wealth or circumstances. We have also come across instances where the client has been aged or in failing health and, in spite of these factors, the client has been recommended to take out a long term product which incurs substantial penalties for early surrender.

Slide – Mis-selling risk factors

This slide illustrates factors which could give rise to mis-selling. Firstly, the opportunity to mis-sell must exist, there will also be an incentive, or pressure, to do so and finally the person doing the mis-selling will be able to rationalise the action they are taking. Each of these factors should be considered and addressed by you, as licensees, to ensure that they are controlled and the area of overlap is minimised.

I also want to mention a tip given by a local businessman some 2 years ago which has stuck with me and I believe is relevant to today. This tip is “An island community never forgets. If you want to take chances in business and it all goes wrong, if you were in the UK you could disappear. You can’t do that in Guernsey. The islands are too small and you’ve got to be able to hold your head up and still be able to talk to people if things go wrong”.

Slide – Other supervisory and policy work

The Conduct Unit has become the Commission’s point of contact with the Commerce and Employment Department in relation to the proposed establishment of the Channel Islands Financial Services Ombudsman Scheme, which was approved by the States last week. The Unit will be carrying on the work in this area previously co-ordinated by the Commission’s Policy and International Affairs team. We will look to develop a memorandum of understanding with the Ombudsman to ensure, amongst others, that matters of a regulatory nature identified by the Ombudsman can be referred to the Commission for review and action where appropriate.

In September, I attended an open evening at the Citizen’s Advice Bureau. During the coming year the Conduct Unit will look to enhance this relationship to ensure that the Commission has an understanding of the issues arising from financial services business that cause referral to the bureau and assess whether these are matters requiring its attention on a licensee or sector basis.

The Conduct Unit, again with the interests of Guernsey residents at heart, has sought to establish whether there is a potential risk of financial exclusion of customers who have been asked to close their current accounts at the local branch of a UK bank. As part of this exercise the Unit has also considered the extension of the current account switch service from the UK to Guernsey and the effectiveness of this service at those banks where it has been introduced. We have worked closely with the Commission’s banking team on both these matters and I would like to convey my thanks to the local retail banks for providing the requested information in a helpful and timely manner.

The Conduct Unit has started to consider fair treatment for consumers in respect of the charges levied on pension savings in locally-administered schemes. Concern in this area has been highlighted through recent comment by the UK Government that someone who saves £100 a month, over a typical working lifetime of 46 years, could lose almost £170,000 from their pension pot with a 1% charge and over £230,000 with a 1.5% charge.

Although pensions are not a product that is regulated within the Bailiwick, the giving of advice in relation to that pension by financial advisers is supervised by the Commission. It

is important that the introduction of GFAS enables consumers to fully understand the effect of charges so that they are able to make an informed choice on any recommendation put to them by their financial adviser.

Slide – Delivery on 2013 Key Objectives

Finally, I would like to revisit certain of the Key 2013 Objectives that were set, at that time, for the Insurance Division and which have been undertaken initially by that division and latterly by the Conduct Unit. I will also touch on the Conduct Unit's objectives for 2014.

The relevant 2013 objectives were to:

- Undertake appropriate supervisory visits and associated work
- Continue to maintain and enhance relationships with other regulatory authorities
- Plan implementation of the Guernsey Financial Advice Standards
- Undertake a thematic study of sales practices amongst insurance intermediaries

I am pleased to confirm that these 2013 objectives have been met and that our thematic study extended to retail sales practices of investment licensees as well.

Slide – 2014 Key Objectives

In 2014 we will continue to plan for and implement GFAS, setting and amending relevant rules and codes as appropriate through continued consultation and liaison with industry and other interested parties.

In this year's Annual Report, the Commission identified the need to devise effective regulation and implement appropriate supervision for business conducted through the internet. The internet's reach cannot be underestimated nor can the inherent threat of misconduct through mis-selling through the internet. To mitigate this threat, the Conduct Unit will be extending the reach of financial services education and information available to the person in the street through the development and improvement of the consumer information its website.

The consumer pages will provide an easy to understand overview of what it means if a business is regulated by the Commission and explain the difference if a business is only registered with the Commission. We will also clarify that being registered in Guernsey does not necessarily mean that the Commission supervises that business. We will provide easy access to terminology and links to trade bodies with a working relationship with the Commission and other bodies such the Citizens Advice Bureau and, in due course, to the Ombudsman.

Importantly, the Money Advice Service has agreed that we can make reference to them through our website. However, we appreciate that many of the Money Advice Service web pages and articles, being specific to the UK, will not be relevant to Bailiwick residents and so we will provide links to pages that are relevant and will be helpful to Bailiwick consumers.

We will develop the relationship with the Ombudsman.

We intend to review codes, rules and guidance relevant to the interaction of regulated financial services businesses with the consumer. Where our review recommends revisions are made, we will engage with interested parties, through the establishment of a working party if appropriate, in order to determine the way forward.

We will continue to hold seminars with insurance intermediaries and, extend these seminars to other licensees, to address matters of conduct within a sector that have come to the attention of the Conduct Unit.

Slide – Other Supervisory Activity

We will continue with our thematic work. We have had a couple of ideas for topics that we could cover but we have yet to decide which to proceed with. We would welcome your views on topics, you believe, would add the most value and provide the most benefit, not only to the retail consumer, but also to the way in which you conduct your business.

As I am sure you will appreciate, the creation of the Conduct Unit is a recent initiative by the Commission and likewise all the team are new to their roles. In these first few months we have sought to determine the direction for the Conduct Unit but I would be very interested to hear your thoughts on this subject. I would welcome your input on where you believe we could do a more effective job in protecting the consumer and I would be happy to meet with anyone with ideas as to how this can be taken forward.

Above all, we will listen to what you have to say, working with you to enhance the regulatory framework underpinning your business, to facilitate you being able to meet consumer expectations that the financial services and products they receive, from you, meet their needs and, that these financial services and products have been provided by financial advisers and firms they can trust. By working together for the Common Good I am certain that we will all, together, protect the consumer enabling your business to meet their expectations and flourish.

Thank you for listening.

Jeremy Quick
Director of Insurance

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7 January 2013

Dear Enter Recipients name

Sales Practices

This letter is being sent to all Guernsey long-term insurance intermediary licensees.

As I mentioned in my November 2012 Industry Presentation's speech, in the second half of 2012 the Commission conducted a series of on-site visits around sales practices. This included the issuance of on-site reports by the Commission and, in the event, the adoption by several licensees of remedial action plans.

As the attached short report illustrates, the Commission uncovered several instances of weak implementation of systems and controls around sales practices. The Commission will, in the second half of 2013, undertake another series of on-site visits. In the event that further material failings are uncovered, the Commission will be obliged to consider enforcement sanctions.

The Commission urges all long-term licensees – whether or not visited in 2012 – to review their current sales practices with the aim of ensuring that they are in line with regulatory requirements. It is important for the Bailiwick and in particular for the reputation of the financial sector amongst the local population that licensees adhere to the appropriate standards.

Yours sincerely

Enc

Guernsey Financial Services Commission Thematic Onsite Visits

The Code of Conduct for Authorised Insurance Representatives (“AIRs”)

Overview

In July 2012, the Insurance Division of the Commission undertook a series of eight onsite visits to specifically assess licensed long-term insurance intermediaries’ compliance (“licensees”) with the Code of Conduct for Authorised Insurance Representatives (“the Code”). During the visits the Commission also considered compliance with certain aspects of the Conduct of Business Rules (“the Rules”). The licensees selected for this purpose ranged from small independent intermediaries to large banking groups.

The Commission engaged RWA Group Limited to conduct the visits alongside Commission staff. The format of the visits comprised interviews with key staff together with a review of a sample of client files and the management of those files in accordance with the licensees’ existing policies and procedures.

Executive Summary

Whilst licensees within the banking groups were generally found to be largely compliant with the Code, the Commission identified some common areas of non compliance by other licensees.

While AIRs were able to demonstrate an understanding of the regulatory requirements of the Code and Rules, the records inspected did not always support the assertions made

Overall, there are areas in which improvement is required as a matter of priority by the licensees based on the findings summarised below.

Findings

1 Suitability of Advice (Section 6 of the Code)

An AIR shall ensure as far as possible that the policy proposed is suitable for the needs and financial position of the prospective policyholder.

There were a number of instances identified where the product recommended to a client may not have been suitable. In some instances it was not possible to establish whether the product recommended was suitable or not due to record management issues, which are discussed further below.

2 Know Your Client (Sections 6 and 28a of the Code)

AIRs shall take all reasonable steps to obtain and record information from the client concerning the personal and financial circumstances of the client necessary to give suitable advice.

Information was obtained by the licensees through the use of a fact find questionnaire. However, the Commission found that the fact find questionnaires were not fully completed, with sections either left blank or struck through without further explanation as to the basis for the omitted information. It was therefore difficult to determine whether the AIR possessed the necessary information upon which to rely when recommending a product to a client, and in some instances the information

missing appeared to have been essential in determining the nature of the products recommended by the AIR.

While in some instances certain sections of the questionnaire may not be applicable or the client unwilling to provide that information, the reasons for missing information should nonetheless be clearly recorded and the client informed that withholding requested information may affect the suitability of the advice given.

3 Attitude to Risk (Sections 6 and 28a of the code)

An integral part of the obligation to obtain information regarding the client's circumstances is an assessment of the client's attitude and tolerance to risk. This is essential in order to provide the client with an appropriate product.

Each licensee has a method for assessing attitude to risk, with most adopting a scoring system based on a series of specific questions, with the result providing a rating on a scale of low to high with various increments. However, some licensees often also had a different method of assessment and definitions of risk, usually within the fact find questionnaire. This led to multiple ambiguous ratings being provided to a client, and in many cases the descriptions used in the written advice were inconsistent with the rating definition provided.

Once a rating had been established, there was little evidence seen to suggest that the licensees were making an assessment as to whether the product selected was suitable or consistent with the risks the client was willing to take.

4 Written Advice (section 28b of the code)

An AIR must provide the client with written advice prior to the inception or any other material change of the policy, which must contain sufficient information for the client to make an informed decision.

In several instances, written advice reviewed simply stated what course of action had been agreed but did not make clear how that action was the result of having taken into account the information obtained from the fact find questionnaire or how the product's risk profile matched that of the client.

To be sufficient, written advice should contain a summary of the client's current position, provide the client with a clear explanation as to the basis for the product recommended and how that recommendation reflects the client's risk profile.

5 Key Facts (Sections 8 and 28d, e, f and g of the code)

AIRs must use their best endeavours to explain the principal terms of any contract of insurance recommended, including but not limited to possible surrender values over the term of the policy, possible penalties of early surrender, full details, conditions or limitations of any guarantees and any cooling off period.

In some instances, AIRs appeared to rely heavily upon the product provider's literature to explain to the client the characteristics, principal terms, capital guarantees, surrender penalties and other key information required by the Code. The Commission did not consider this to satisfy the Code's requirements.

Whilst it is not necessary to duplicate the Key Facts document, an AIR is expected to draw the client's attention in the written advice it prepares for the client to that

information which may affect the client's decision, in particular that information required by sections 28d, e, f and g of the Code.

6 Policy Surrender, Cancellation and Lapses (Section 27b of the code)

In the event that an AIR is recommending a client to surrender, convert, cancel or lapse an existing policy, the AIR must be able to evidence the action is in the best interests of the client.

In the majority of cases, the AIR did not provide justification within the written advice for the surrender of an existing product and in some cases the written advice only noted that a policy had been surrendered.

7 Training and Competency (Sections 18, 19 and 20 of the Rules)

Licensees must create and implement a training and competence scheme for all AIRs appropriate to the nature and scale of the licensee's business. The scheme should ensure that AIRs are fully aware of and conversant with the products and services provided and the advantages and disadvantages for clients of purchasing those products.

Licensees, in conjunction with its AIRs, must maintain a training log in respect of each AIR.

The Commission found that improvements could be made in the Training and Competence regimes for AIRs. In particular, there was a lack of documentary evidence to support the regimes that licensees described as being in place.

8 Records Management and Retention

Licensees are also reminded that section 3 of the Rules requires them to ensure that each AIR complies with the Code and section 9 requires them to ensure that detailed records of information received from and provided to a client are maintained.