Section 5

Other laws and regulations relevant to advising clients

Introduction

In addition to the legislation already described, the interests of financial services customers are safeguarded by aspects of a range of other laws and regulations. Some of these relate closely to financial services, while others are aimed more broadly at the rights of consumers in general.

Section 5 covers part K2 of the Syllabus for Unit 2, showing how a range of non-tax laws and regulatory schemes affect different aspects of financial services including consumer credit, pensions and advertising.

5.1 Consumer Credit Act 1974

The purpose of the Consumer Credit Act 1974 is to regulate, supervise and control certain types of lending to individuals, and to provide borrowers with protection from unscrupulous lenders. The provisions of the Act are regulated by the Office of Fair Trading (not the FSA).

There are many types of lender in the market for financial services, ranging from large multinational banks to individual moneylenders. The Act sets out standards by which all lenders must conduct their business. It includes a number of safeguards under which potential borrowers must be made aware of the nature and conditions of a loan, and of their rights and their obligations.

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The Act affects most aspects of a bank's lending activities, including personal loans and revolving credit such as credit cards. Not all loans are covered by the Act.

- With effect from April 2008, the previous limit of £25,000 has been removed, and all loans are regulated by the consumer credit regulations, *unless they are exempt* (see below).
- Loans for the purchase of a private dwelling are exempt and further loans for the improvement or repair of a private dwelling are also exempt, provided that they are from the same lender as the original mortgage loan. Loans raised on the security of a dwelling but used for other purposes are not exempt.

The main elements of the Act's provisions are as follows.

- Suppliers of loans and credit as defined in the Act must be licensed by the Office of Fair Trading.
- Clients must receive a copy of the loan agreement for their own records.
- Prospective borrowers have a cooling-off period during which they can review the terms of the loan and, if they wish, decide not to proceed with the transaction. This applies to all loans regulated by the Act, unless the loan agreement is signed on the lender's premises.
- Undesirable marketing practices are forbidden: for instance, advertisements must not make misleading claims.
- Credit reference agencies must, on request, disclose information held about individuals and must correct it if it is shown to be inaccurate.

One of the Act's most significant innovations was a system for comparing the price of lending. This is the *annual percentage rate (APR),* which must be quoted for all regulated loans. The APR represents a measure of the total cost of borrowing and its aim is to allow a fair comparison, between different lenders, of the overall cost of borrowing.

The calculation of the APR is specified under the terms of the Consumer Credit Act 1974 and it takes account of two main factors:

- *the interest rate* – whether it is charged on a daily, monthly or annual basis;
- the *additional costs and fees* charged when arranging the loan, eg an application fee.

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The result is that the APR is higher than the actual rate being charged on the loan.

5.1.1 Changes to consumer credit legislation

The government has carried out a three-year review of consumer credit law, which led to the decision to reform the Consumer Credit Act 1974 in order to better protect consumers and to create a fairer and more competitive credit market. It aims to make improvements in three broad areas, described by the Department of Trade and Industry as follows:

- to enhance consumer rights and redress. Consumers will be able to challenge unfair lending and will have access to more effective options for resolving disputes;
- to improve the regulation of consumer credit businesses by ensuring fair practices and through 'targeted action to drive out rogues';
- to make regulation more appropriate for all kinds of consumer credit transaction. The plan is to extend protection to all consumer credit and to create a fairer regime for business.

This reform is being implemented through primary and secondary legislation. The primary legislation is in the form of the Consumer Credit Act 2006. Parts of the Act, including the decision to use the Financial Ombudsman Service (see Section 3.2) to arbitrate on disputes, came into force in April 2007, with the main licensing regime and transparency requirements being implemented a year later in April 2008. Prior to this, however, a number of pieces of secondary legislation came into force.

- *The Consumer Credit (Advertisements) Regulations 2004* relate to the form and content of advertisements for credit. They replace the old distinction between simple, intermediate and full-credit advertisements, and establish a single list of items of information that must be included in all credit advertisements. They also introduce new provisions relating to the calculation and presentation of APR in advertisements, including a requirement to display the APR more prominently than other financial information. Other requirements of the regulations are that:
  - all advertising must be in plain English and must be easily read or clearly heard;
  - the name of the advertiser must be included;

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  - the ***typical*** APR must be displayed, meaning that at least two-thirds of those responding to the advert would qualify for it;
  - if a loan is to be a secured loan, the advertisement must state clearly the nature of the required security.

- *The Consumer Credit (Agreements) (Amendments) Regulations 2004* seek to make the agreements signed by customers clearer and easier to understand, by making some changes to content and layout.
- *The Consumer Credit (Disclosure of Information) Regulations 2004* specify what information must be disclosed to prospective borrowers, and the way in which it must be disclosed.
- *The Consumer Credit (Early Settlement) Regulations 2004* confirm the entitlement of borrowers, under regulated credit agreements, to a rebate when all or part of the debt is repaid earlier than when it is due. They also change the calculation method for such rebates.

5.2 Unfair contract terms

5.2.1 Supply of Goods and Services Act 1982

The Supply of Goods and Services Act 1982 applies to all contracts (except those entered into before 1995) involving the supply of services, including those for the supply of financial services. Its terms mean that, in the absence of anything specific, the following provisions are automatically deemed to be included in all such contracts.

- The service will be performed with reasonable care.
- The work will be done within a reasonable time.
- A reasonable charge will be made.

5.2.2 The Unfair Terms in Consumer Contracts Regulations 1999

The Unfair Terms in Consumer Contracts Regulations 1999 apply to any term in a contract between a supplier of goods and services and a consumer, where the supplier is acting on behalf of their business and the contract has not been negotiated on an individual basis. The Office of Fair Trading is responsible for considering any complaint brought about because of the regulations.

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A contract that has been drafted in advance and which does not offer the consumer an opportunity to influence the terms of the contract is regarded as one that has not been individually negotiated and will therefore fall under the terms of the regulations. Contracts for the sale of land, tenancy agreements and mortgages can fall under the remit of the regulations where the supplier is not an individual and is acting in the course of business: a person selling his own home would be excluded from the regulations but the legislation would cover a builder selling new houses.

The main areas covered by the regulations are as follows.

5.2.2.1 Fairness

The main requirements are that all terms in regulated contracts should:

- be fair;
- adhere to the requirement of good faith (see Section 5.2.2.3);
- not cause a significant imbalance in respect of the rights and obligations of the various parties to the contract to the detriment of the consumer.

5.2.2.2 Plain language

The written terms of a contract should be expressed in clear, easily understood language. If there is any doubt about the meaning of a written term, then the interpretation most favourable to the customer will be adopted.

5.2.2.3 Good faith

A term that causes a significant imbalance between the rights and obligations of the various parties to the contract to the detriment of the consumer will be deemed to be in breach of good faith.

It should be noted that any part of a contract that defines the main subject matter of the contract does not fall under the regulations, as long as it meets the plain language requirement. So, for instance, in the case of house purchase, the regulations cannot be used to determine whether the price being charged for a property is fair.

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Examples of unfair terms might be:

- a term that allows the supplier to terminate the contract on a discretionary basis without the consumer being offered the same facility;
- a term that allows the supplier to terminate a contract without reasonable notice;
- a term that limits the consumer's rights to take legal action against the supplier.

If an element of a contract is found to be unfair, the whole contract is not necessarily invalidated. The contract may be allowed to continue if it is can do so without the unfair term. The term that is deemed to be unfair will not be binding on the consumer.

5.3 Rules regarding occupational pension schemes

The regulation of occupational pension schemes remains quite separate from the regulation of other financial services, separate even from the regulation of private pension arrangements such as personal pensions and stakeholder pensions. Nevertheless, financial advisers should clearly have a good knowledge of matters relating to occupational schemes, in order to be able to advise, for instance, individuals who are members of such schemes or employers who may be considering establishing a scheme.

5.3.1 Pensions Act 2004

The Pensions Act 1995 introduced changes to several aspects of pension provision and supervision, not least of which related to concern about the security of occupational pensions. Public confidence in occupational pension scheme security had been severely dented by the Maxwell affair, where pensioners' funds were used to meet the companies' general obligations. The government sought to restore confidence with measures designed to prevent fraud and to improve the administration of occupational schemes.

The later Pensions Act 2004 was, in part, a response to the worsening pensions crisis in the UK. Two particularly important elements of the 2004 Act are the establishment of the Pension Protection Fund (see Section 5.3.1.2) and the transfer of regulatory responsibility for occupational pension schemes from the Occupational Pensions Regulatory Authority (OPRA) to the newly created Pensions Regulator.

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5.3.1.1 Pensions Regulator

The Pensions Regulator has wider powers than its predecessor and will take a proactive and risk-focused approach to regulation. Its mission statement is that it will work 'to improve confidence in work-based pensions by protecting the benefits of scheme members and encouraging high standards and good practice in running pension schemes'.

Like the FSA, the Pensions Regulator has a set of statutory objectives:

- to protect the benefits of members of work-based pension schemes. Work-based schemes mean all occupational schemes, and also any stakeholder and personal pension schemes where employees have direct payment arrangements;
- to promote good administration of work-based pension schemes;
- to reduce the risk of situations arising that may lead to claims for compensation from the Pension Protection Fund.

The **Pensions Regulator** aims to identify and prevent potential problems rather than to deal with problems that have arisen. It will do so by assessing the risks that may prevent it from meeting its statutory objectives. These risks might include inadequate funding, inaccurate record keeping, lack of knowledge or understanding by the trustees, or even dishonesty or fraud. The Pensions Regulator will consider the combined effect of two factors related to each risk: the *likelihood* of the event occurring and the impact of the event on the scheme and its members. Schemes that are judged to have a higher risk profile will be more closely monitored than those with lower risk. This is similar to the principles and process adopted by the FSA.

The Regulator has a range of powers that enable it to protect the security of members' benefits.

The Regulator's powers fall broadly into three categories:

- *investigating schemes* in order to identify and monitor risks. All schemes must make regular returns to the regulator. In addition, trustees or scheme managers must give notification of any changes to important information, such as the types of benefit being provided by the scheme. The Regulator also demands to be informed quickly if the scheme discovers that it cannot meet the funding requirements, so that remedial action can be taken at an early stage;

- *putting things right,* which can include:
  - requiring specific action to be taken to improve matters within a certain time;
  - recovering unpaid contributions from an employer who does not pay them to the scheme within the required period (by the 19th day of the month following that in which they were deducted from the member's salary);
  - disqualifying trustees who are not considered fit and proper persons;
  - imposing fines or even prosecuting certain offences in the criminal courts.
- *acting against avoidance,* ie preventing employers from deliberately avoiding their pensions obligations and so leaving the Pension Protection Fund to cover their pension liabilities. The main actions the Regulator can take are issuing:
  - *contribution notices,* requiring the employer to make good the amount of the debt either to the scheme or to the Pension Protection Fund; or
  - *financial support directions,* which require financial support to be put in place for an underfunded scheme.

The Pensions Act 2004 requires the Pensions Regulator to issue voluntary codes of practice on a range of subjects. The codes provide practical guidelines for trustees, employers, administrators and others on complying with pensions legislation, and set out the expected standards of conduct.

The Act also introduces new requirements for trustees to have a sufficient knowledge and understanding of pension and trust law, and of scheme funding and investment. Trustees also must be familiar with the trust deed and other important documents such as the scheme rules and the statement of investment principles. These requirements came into force in April 2006.

5.3.1.2 Pension Protection Fund (PPF)

The Pensions Act 2004 established the Pension Protection Fund (PPF) to protect members of private sector final salary (defined-benefit) pension schemes whose firms become insolvent with insufficient funds to maintain full benefits for all the members.

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In addition to this responsibility, the PPF also assumes the existing responsibilities of the Pensions Compensation Board, which compensates members of both defined-benefit and defined-contribution (money-purchase) schemes in cases of fraud and misappropriation.

The PPF will ensure that, where a company with an eligible defined-benefit scheme becomes insolvent, with an insufficiently funded scheme, members of that scheme will still receive the core of the benefits to which they are entitled. The PPF will provide compensation of:

- ♦ 100% for existing pensioners including ill-health retirement and survivors' benefits;
- ♦ 90% for pre-retirement members, subject to an overall benefit cap.

To ensure that PPF compensation retains its value over time, pensions in payment will be increased in line with the retail price index (RPI) up to a maximum of 2.5%.

Compensation will be funded in two ways: firstly, by taking over the assets of pension schemes with insolvent employers, and secondly, by means of a *levy* on all private sector defined-benefit schemes and the defined-benefit element of hybrid schemes.

The levy is split into five parts:

- ♦ a *pension protection levy based on risk factors,* including under-funding, credit rating and investment strategy. Eventually, this is expected to constitute at least 80% of the total amount collected by the PPF;
- ♦ a *pension protection levy based on scheme factors,* such as the numbers of active and retired members;
- ♦ an *administration levy,* covering the set-up cost and ongoing costs of the PPF;
- ♦ a *PPF Ombudsman levy,* covering the costs of the PPF Ombudsman;
- ♦ a *fraud compensation levy,* replacing the Pensions Compensation Board levy.

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5.4 EU directives

As mentioned in Section 1.1, directives issued by the European Union are binding, *as to the result to be achieved,* upon each member state to which they are addressed. What this means is that the *objectives* of the directive have to be achieved but the choice as to exactly how they are achieved is left to national authorities in each state. As a result, much of the UK regulation about financial services is derived from European directives. Some examples are given below.

5.4.1 Banking

A significant EU directive issued in March 2000 (known as the *Second Banking Directive*) consolidated the earlier directives that gave institutions the freedom to establish and pursue the business of credit institutions (banks, building societies and similar organisations) throughout the European Union. It describes:

- what constitutes a credit institution: 'an undertaking whose business is to receive deposits or other funds from the public and to grant credits for its own account';
- the minimum funding (and other) requirements for an institution to be authorised as a credit institution;
- the way in which institutions can become authorised (through their home state's appropriate regulatory authority, ie the FSA in the UK);
- the activities that an authorised credit institution can carry out, including acceptance of deposits, lending of various kinds including mortgages, leasing, money transmission, trading in money markets, portfolio management and safe custody services.

5.4.2 Investment

The 1993 Directive on Investment Services in the Securities Field, commonly known as the Investment Services Directive (ISD), came into force at the beginning of 1996. Its aim was to enable investment firms to operate in different European states in much the same way as other directives have broadened the markets for banks and for the insurance industry, by providing direct access to well-regulated markets across the EU.

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In the same way as with credit institutions, firms that provide certain specified investment services must first be authorised in their own home state. They can then operate in the other member states without requiring further authorisation from the authorities in those other states.

In order to obtain and retain authorisation in their home state, investment firms must comply with certain prudential rules drawn up by the authorities in the home state. The general nature of these prudential rules was first specified in the ISD and later incorporated in a subsequent directive that replaced it (MiFID, see below). They include, for example, requirements that investment firms must have:

- sound administrative and accounting procedures;
- adequate controls to safeguard electronically held data;
- adequate internal control mechanisms, including rules about personal transactions by their employees.

5.4.2.1 Markets in Financial Instruments Directive (MiFID)

The ISD has been revised by a new directive, the Markets in Financial Instruments Directive (MiFID). A firm that is subject to MiFID has the right to operate throughout the EEA on the basis of a single authorisation in its home state. The aim of the directive is to make cross-border activity easier to conduct by imposing a single set of rules across the EEA. Firms affected will include securities and futures firms, banks conducting securities business, recognised investment exchanges and alternative trading systems. MiFID does not apply to life assurance, pensions or mortgage business.

MiFID applies to certain types of investment activity when they involve specified financial instruments. The types of investment activity covered by MiFID include:

- receipt and transmission of orders from investors;
- execution of such orders on behalf of customers;
- investment advice;
- discretionary portfolio management (on a client-by-client basis) in accordance with mandates given by investors;
- underwriting the issue of any of the specified financial instruments.

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However, there is an important exemption from MiFID for firms that meet the following requirements. UK firms are exempt from MiFID if they:

a) do not hold client money or securities; and

b) restrict their business to transmitting orders for transferable securities and collective investment schemes and to giving advice on such investments;

c) transmit orders only to authorised credit institutions (such as banks), investment trust companies, collective investment schemes and MiFID investment firms (such as stockbrokers).

In broad terms, this should exempt advisers that do not hold client money and do not advise on or arrange complex investments such as derivatives.

However, any firm making use of the exemption will not be able to engage in cross-border business.

The specified financial instruments include:

- transferable securities, such as stocks and shares;
- units in collective investment undertakings, such as unit trusts;
- money market instruments;
- financial futures contracts;
- forward interest rate agreements;
- interest rate, currency and equity swaps;
- options to acquire or dispose of the instruments mentioned in this list, including options on currency and on interest rates.

Life assurance, pensions and mortgages are outside the scope of MiFID.

Because it is expected that most financial advisers will be exempt from MiFID, this text will refer to non-MiFID situations, unless otherwise stated.

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5.4.3 Insurance

The two main objectives of a European single market for insurance are:

- to provide all EU citizens with access to the widest possible range of insurance products, while ensuring the highest standards of legal and financial protection; and
- to enable an insurance company authorised in any of the member states to pursue its activities throughout the EU.

In setting out to achieve these objectives, the EU has always dealt with life assurance and non-life insurance separately, in order to take account of their different characteristics and also in acknowledgment of the close ties that life assurance has with the long-term savings industry.

5.4.3.1 Life assurance

The first directive relevant specifically to life assurance was adopted in 1979 with the aim of setting out how the right of establishment included in the Treaty of Rome might be put into effect for life assurance companies. The 1979 Life Directive defined life assurance as including the following categories:

- life assurance (ie policies payable on survival of a specified term, on death, on survival of a term or earlier death, on death within a specified term, on birth, or on marriage);
- annuities;
- personal injury, incapacity for employment and accidental death, when underwritten in addition to life assurance;
- permanent health insurance.

The second Life Directive, issued in 1990, laid down special rules relating to the freedom to provide cross-frontier services in the life assurance field. It covers individual policies and group life, but not group pension funds.

Arrangements for regulation and supervision of insurance policies fall into two categories, depending on the reason why the applicant is taking out the policy.

- If the policy is being taken out wholly on the applicant's own initiative, the regulations that apply are those of the country in which the insurance company is established. Applicants who take out a life policy with an insurer established in a different state are required to sign a

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declaration confirming that they are aware that the regulatory rules of the other country will apply.

- If the applicant requires the insurance because of a specific rule of the state in which they reside, then regulation and supervision is by that state, in order to guarantee that the appropriate cover is provided.

In 1992, the third Life Directive – sometimes also known as the *Life Framework Directive* – was adopted. Like all EU directives, its provisions had to be incorporated into the legislation of all the member states. In the UK, for example, its provisions were incorporated into insurance legislation (based largely on the Insurance Companies Act 1982) through the Insurance Companies (Third Insurance Directive) Regulations 1994.

In order to obtain authorisation, a company must:

- limit its business activities to insurance only;
- submit a scheme of operation in a format specified in the Directive;
- be run by technically qualified persons of good repute;
- possess the minimum guarantee fund;
- notify the identities of shareholders and the amounts of their shareholdings.

The financial supervision of an insurer is the responsibility of its home state; this supervision includes valuation of assets and liabilities, and the consequent verification of solvency. Local legislation may apply, in the states where the insurance is sold, in relation to advertising, marketing and contract matters. Similarly, any premium taxes applied are those of the state in which the insurance is sold (at present, in the UK, insurance premium tax applies to general insurance but not to life assurance).

The directive requires the harmonisation of national laws where this is necessary for its principles to work smoothly throughout the EU. These principles include:

- the choice, valuation, diversification and location of assets used to support the company's liabilities. Earlier rules requiring assets to be located in the state in which the business was transacted were removed in line with other measures designed to increase the freedom of capital movements;
- the actuarial principles applied in the calculation of assets and liabilities.

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Policyholders must be able to withdraw from the contract within a 'cooling-off' period of between 14 and 30 days from the time when they are informed that the contract has been made. This rule is reflected in the UK through the issuing to customers, by the insurance company, of a *statutory cancellation notice*. Customers then have 14 days in which to return the notice to the company and cancel the policy with a refund of any premium paid.

Policyholders must also be provided with clear and accurate information about the essential characteristics of the products offered to them, to assist them in choosing an appropriate product. This requirement is met in the UK by the issue of a *key features document* (see Section 1.7.5.6).

In 2002, a fourth Life Directive was issued: the previous three Life Directives (and certain other directives) were repealed and replaced by this single directive that covers all aspects of life assurance. It is largely a consolidation directive, bringing together the provisions of earlier directives concerning the concept of a single licence and harmonising local rules on authorisation and the regulation that is required to make the single-licence system work.

5.4.3.2 General insurance

In 1988, the Second Non-Life Council Directive laid down rules for cross-frontier non-life insurance that balance the needs of freedom of service and consumer protection. This allowed companies to supply insurance in another member state without having to establish a branch or subsidiary in the other state.

The Third Non-Life Council Directive, issued in 1992, completed the process and now any insurance company whose head office is in one of the member states can establish branches, and carry on non-life insurance business, in any other state. That activity will be under the supervision of the competent authorities of the member state in which the insurance company's head office is situated.

Authorisation to carry out insurance business under the terms of this directive is granted for a particular class of insurance (or even, sometimes, for some of the risks relating to a particular class). Companies can, of course, be authorised for two or more classes. General insurance risks are classified into a large number of categories, including: accident; sickness; land vehicles; railway rolling stock; ships; aircraft; property; and a range of types of liability.

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In some cases, authorisation can be given for more than one class together: the accident and sickness classes can be authorised as 'accident and health insurance'. There are, however, specific rules on compulsory insurances against accidents at work, such as employers' liability insurance in the UK.

5.4.3.3 Insurance intermediaries

As well as ensuring that insurance companies can operate throughout the community, the EU also wants to ensure that retail markets in insurance are accessible and secure. To this end, a *Directive on Insurance Mediation* came into force in January 2003, the purpose of which is to establish the freedom for insurance intermediaries to provide services in all states throughout the EU. It was felt that, prior to the development of this directive, the liberalisation of the insurance sector had benefited the wholesale market (large industrial and commercial risks) to the detriment of the retail market (insurance for private individuals). The 2003 directive replaces an earlier (1977) directive, that first introduced plans to give insurance brokers and agents the freedom to operate across the community, and a 1992 recommendation from the European Commission about qualifications to be required of insurance intermediaries. It is now the sole European statute governing insurance intermediaries.

Insurance mediation is defined in the directive as 'the activities of introducing, proposing or carrying out other work preparatory to the conclusion of contracts of insurance, or of concluding such contracts, or of assisting in the administration and performance of such contracts, in particular in the event of a claim'. When an employee of the insurance company, or someone acting under the responsibility of the insurance company (a tied agent), carries out such activities, they are not included in the definition of insurance mediation.

The directive establishes a system of registration for all independent insurance (and reinsurance) intermediaries. They must be registered with a competent authority in their home state: independent financial advisers based in the UK who are selling life assurance or general insurance must be registered with the FSA, but tied agents are authorised by the company to which they are tied and do not have to be authorised directly by the FSA.

Registration is subject to strict requirements regarding professionalism and competence; intermediaries must have the necessary general, commercial and professional knowledge and skills. Exactly what this means depends on the relevant national authority, but it will almost certainly include a requirement for appropriate training and a specified level of qualification, and possibly a programme of continuing professional development. In the UK, the FSA have

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set out their requirements in considerable detail in their *Training and Competence sourcebook*.

Insurance intermediaries are also required to be 'of good repute'. Again, local interpretations of this may vary, but minimum requirements are that an intermediary must not have been:

- convicted of a serious criminal offence relating to crimes against property or other financial crimes; or
- declared bankrupt.

The directive also requires that insurance intermediaries should hold professional indemnity insurance of at least €1m per case and €1.5m in total per annum. The whole question of professional indemnity insurance in the UK has become very difficult in recent years: problems such as the 'pensions mis-selling scandal', and the failure of some mortgage-related endowments to provide sufficient funds to repay policyholders' loans, have made professional indemnity insurance more difficult to obtain and more expensive.

Rules are also included to protect clients' funds, including the requirement to keep client money in strictly segregated accounts. This is backed up by a requirement for intermediaries to have financial capacity of an amount equal to at least 4% of premiums received per annum, subject to a minimum of €15,000.

The regulations specify in some detail what information an intermediary must give to a customer. In relation to the intermediary, the following information must be supplied:

- name and address;
- details of registration and means of verifying the registration;
- whether the intermediary has any holding of more than 10% of the voting rights or capital of an insurance company;
- conversely, whether any insurance company has a holding of more than 10% of the voting rights or capital of the intermediary;
- details of internal complaints procedures and of external arbitrators (eg ombudsman bureaux) to which the customer could complain;
- whether the intermediary is independent or tied to one or more insurance companies.

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In relation to the advice offered and products recommended:

- ♦ independent intermediaries must base their advice on analysis of a sufficiently large number of contracts available on the market to enable them to recommend, in accordance with professional criteria, a product that is adequate to meet the customer's needs;
- ♦ the intermediary must give the customer – based on the information supplied by the customer – an assessment of the customer's needs and a summary of the underlying reasons for the recommendation of a particular product. This requirement is satisfied in the UK, for instance, by the use of a confidential client questionnaire, or factfind, to obtain the necessary information, and by the issue of a 'reason why letter' to justify the specific recommendation.

All information provided by an intermediary to a customer must be set out in a clear and accurate manner, and must be comprehensible to the customer.

The requirements of this directive are closely reflected by rules in the FSA's Conduct of Business sourcebook.

5.5 CAT standards

The government has long been concerned that many financial products are:

- ♦ too complex for financially unsophisticated customers to understand; and/or
- ♦ too expensive in terms of the charges levied by the product providers.

They have tried to counteract this by introducing a set of **charges, access and terms standards (CAT standards)** intended to help less knowledgeable investors choose a suitable deal.

Originally, CAT standards were applicable to ISAs (at the product provider's discretion) but, following the introduction of the 'Sandler suite' of simplified products (see Section 1.7.6), CAT standards for new ISAs have been withdrawn.

CAT standards for mortgages remain in force. These are standards that *can* be applied to mortgage products, although lenders are not obliged to offer CAT-standard mortgages and there is no guarantee by either the government or the

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lender that a CAT-standard mortgage will be the most suitable product for a particular borrower.

CAT-standard mortgages are likely to appeal to borrowers who wish to have clearly stated limits on charges. Examples of the limits set on charges and other costs are that:

- the variable interest rate must be no more than 2% above Bank of England base rate, and must be adjusted within one calendar month after the base rate is reduced;
- interest must be calculated on a daily basis;
- arrangement fees cannot be charged on variable-rate loans and no more than £150 can be charged for fixed-rate or capped-rate loans;
- maximum early redemption charges apply to fixed-rate and capped-rate loans;
- no separate charge can be made for mortgage indemnity guarantees;
- all other fees must be disclosed in cash terms before the customer makes any commitment.

Other rules relating to access and terms include:

- normal lending criteria must apply;
- the customer can choose on which day of the month to pay;
- all advertising and paperwork must be clear and straightforward;
- purchase of related products cannot be made a condition of the offer.

5.6 Advertising standards

In addition to abiding by the rules laid down in industry-specific regulations, advertisements for financial services and financial products must meet the standards laid down in the British Code of Advertising under the supervision of the **Advertising Standards Authority (ASA)**.

The ASA was set up in 1962 and is an independent self-regulatory body, which administers the British Codes of Advertising and Sales Promotion, the Radio Advertising Standards Code and the Television Advertising Standards Code.

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It covers virtually all advertisements, ie those that appear in:

- the national and regional press, magazines and free newspapers;
- posters, hoardings and transport sites;
- direct mail leaflets, brochures, catalogues and circulars;
- cinema commercials, videos, CD-ROMs and the Internet;
- pack promotions, competitions and prize draws;
- television and radio programmes.

The ASA can take action against individuals and organisations whose advertising contravenes the code. The first step is usually to discuss the offending advertisement with the advertiser and – if an acceptable explanation is not given – to require that the advertisement is changed or withdrawn.

A number of sanctions are used against offenders, ranging from the adverse publicity generated by its adjudications to legal proceedings in the case of persistent or deliberate offenders. This legal action is available through a referral of the advertiser, agency or publisher to the Office of Fair Trading.

The Advertising Code requires that advertisements should be prepared with a sense of responsibility to consumers and society, and should respect the generally accepted principles of fair competition in business. Specifically, the code requires that all advertisements should be:

- *legal*, ie containing nothing that breaks the law, or incites anyone to do so, and omits nothing that the law requires;
- *decent*, ie containing nothing that is likely to cause serious or widespread offence, judged by current prevailing standards of decency. Account is taken of the context of the advertisement, the medium used and the likely audience. Particular care should be taken with sensitive issues such as race, religion, sex or disability;
- *honest*, ie not exploiting the credulity, lack of knowledge or inexperience of consumers;
- *truthful*, ie not misleading by inaccuracy, ambiguity, exaggeration, omission or any other means.

Advertisers are permitted to express opinions, including opinions about the desirability of their products, provided that it is clear that it is opinion and not a statement of fact. Assertions or comparisons that go beyond subjective opinion must be able to be objectively substantiated.

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5.7 The Banking Code

The Banking Code was drawn up by the British Bankers Association and the Building Societies Association, and came into effect in March 1992.

It is a ***voluntary*** code of practice but almost all banks and building societies subscribe to the code. The aim of the code is to set out good standards of banking practice. It is not considered to be *best* practice: subscribers can, if they wish, adopt different standards if they believe them to be better than those in the code.

The code relates to dealings with personal customers, which covers private individuals, executors and trustees, but not clubs, societies, companies, sole traders or partnerships. A separate Business Banking Code covers small businesses with a turnover of up to £1 million. Both codes are reviewed every two years by an independent body – the Banking Code Standards Board – and updated versions of the codes came into force on 1 March 2005. The Banking Code Standards Board also checks on compliance with the code and, if it receives complaints about non-compliance, it takes the matter up with the bank or building society concerned.

The Banking Code covers the following products and services:

- current accounts, including basic bank accounts;
- deposit and savings accounts;
- cash mini-ISAs, TESSA-only ISAs and cash-deposit Child Trust Funds;
- card services and cash machines;
- loans and overdrafts, but not mortgages;
- payment systems;
- foreign exchange transactions.

The standards of the code are set out in a series of key commitments that apply to the conduct of business for banking products and services. These commitments specify that banks and other organisations that subscribe to the code will:

- make sure that advertising and promotional literature is clear and not misleading and that the customer is given clear information about products and services;

- when a customer has chosen an account or service, give clear information about how the account or service works, its terms and conditions and the interest rates that apply to it;
- help the customer to use his/her account or service by sending him/her regular statements (where appropriate) and keep the customer informed about changes to the interest rates, charges or terms and conditions;
- deal quickly and sympathetically with things that go wrong and consider all cases of financial difficulty sympathetically and positively;
- treat all customers' personal information as private and confidential, and operate secure and reliable banking and payment systems;
- publicise the code, have copies available and make sure that the organisation's staff are trained to put it into practice.

The Banking Code covers the following areas of business operation:

- new customers, products and services, including:
  - the need for clarity of information given to customers, eg product features;
  - information required from customers for proof of identity;
- interest rates, including:
  - details of how changes to interest rates will be communicated;
- charges, including:
  - when and how customers will be informed about new or increased charges;
  - rules about charges for cash machine withdrawals;
- terms and conditions, including:
  - details of how changes to terms and conditions will be communicated;
  - the requirement for these to be, for example, fair and set out clearly in plain language;

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- changing accounts, including:
  - procedures for moving or closing accounts (these must be free of charge);
  - the supply of information to other banks when customers decide to change;
  - branch closure procedures;
- advertising and marketing, including:
  - that these should be clear, fair, reasonable and not misleading;
  - that personal details will not be passed to other companies for marketing purposes;
  - the ability of customers to choose not be contacted for marketing purposes;
- running an account – including practical matters relating to:
  - statements (eg frequency of issue);
  - cheques (eg how to treat unpaid or out-of-date cheques);
  - direct debits and standing orders;
  - new rules about dealing with dormant accounts;
- cards and PINs, including:
  - that information must be supplied clearly in a 'summary box' when new cards are issued;
  - the fact that customers can reduce credit limits or opt out of increases;
- personal information – that it will be kept confidential unless:
  - disclosure is required by law or public duty;
  - it is in the institution's interest (but not for marketing purposes);
  - the customer's permission is given;
- protection of accounts, including:
  - that the bank must co-operate to ensure reliable, safe banking and payment systems;
  - setting out the customer's responsibilities (eg checking statements, keeping cards safe);

- borrowing money, including:
  - assessing the customer's ability to repay before granting loans;
  - the need to give an explanation if credit is refused;
  - advising guarantors to seek independent legal advice;
  - rules about when customer information can be given to credit reference agencies;
- dealing with financial difficulties, including:
  - treating situations of financial difficulties sympathetically and positively;
  - doing everything possible to assist in overcoming difficulties;
- complaints, including:
  - explaining to customers how they can complain and what to do if they are not satisfied;
  - dealing with complaints within a specific timescale.

Some of the requirements described in the code are open to interpretation – for instance, different banks may give different meanings to certain technical terminology. The code suggests that a 'common sense' approach should be applied in cases of doubt.

An independent review of the personal and business Banking Codes began in November 2006.

5.8 Competition Commission

The Competition Commission is an independent public body whose aim is to ensure healthy competition between companies in the UK, based on the premise that the existence of healthy competition leads individual companies to charge reasonable prices and to supply a good quality product. It replaced the Monopolies Commission in 1999 as a result of the Competition Act 1998.

It investigates issues of concern which are referred to it by other authorities. Many of the referrals are from the Office of Fair Trading, but it also deals with concerns raised by the regulators of the utility companies and other public service organisations such as transport and postal services.

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The areas of concern addressed by the Competition Commission fall into three main areas:

- ♦ *mergers*: where a merger or takeover will result in one company having more than 25% of market share;
- ♦ *markets*: where there is a danger of competition being restricted in a particular market;
- ♦ *regulation*: where the major regulated industries (financial services is clearly one of them) may not be operating fairly.

If the Commission's investigations determine that a particular situation has a significantly damaging impact on competition (or would do if it went ahead), it has sweeping powers to implement appropriate remedies. It can, for instance, prevent a merger from taking place, or require a company to sell off a part of its business.

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Test your knowledge and understanding with these questions

Take a break before using these questions to assess your learning across Section 5. Review the text if necessary.

Answers can be found at the end of this unit.

1. A customer borrows £30,000, secured against his main private property and uses it to fund a lavish wedding for his daughter. Is the loan regulated by the Consumer Credit Act 1974?
2. What do the Consumer Credit (Advertisements) Regulations 2004 say about the way that the APR is mentioned in a written advertisement?
3. Under what circumstances is a contract not governed by the Unfair Terms in Consumer Contracts Regulations 1999?
4. What are the conditions that, in the absence of anything specific, are – under the terms of the Supply of Goods and Services Act 1982 – automatically deemed to be included in all contracts?
5. The Pensions Regulator has jurisdiction over work-based pension schemes. What constitutes 'work-based' schemes?
6. What levels of compensation are provided by the Pension Protection Fund?
7. What are the two main elements of the pension protection levy, by which the Pension Protection Fund is funded?
8. What are the most common forms of credit institution in the UK?
9. What are the four categories of business defined by European life assurance directives?

10. A UK insurance company provides insurance in France. The insurance is a type that is compulsory under French law. Which regulatory authorities are responsible for regulating that insurance business?

11. What activities are included under the EU definition of 'insurance mediation'?

12. Insurance intermediaries are required by EU law to be of 'good repute'. What does this mean?

13. What is the maximum arrangement fee that can be charged for a CAT-standard discounted variable-rate mortgage?

    (a) None.

    (b) £100.

    (c) £150.

14. Under the terms of the Banking Code, how will banks treat customers who are experiencing financial difficulties?

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Answers

1. Yes. From 6 April 2008, the previous £25,000 limit no longer applies.

2. The APR must be displayed more prominently than other financial information.

3. When the contract has been negotiated on an individual basis between the business and the customer.

4. The service will be performed with reasonable care, the work will be done within a reasonable time, and a reasonable charge will be made.

5. 'Work-based' pension schemes mean all occupational schemes, and also any stakeholder and personal pension schemes, where employees have direct payment arrangements.

6. 100% for existing pensioners and 90% for pre-retirement members, subject to an overall benefit cap.

7. An element based on risk factors, such as under-funding, credit rating and investment strategy. A pension protection levy based on scheme factors, such as the numbers of active and retired members.

8. Banks and building societies.

9.
   - Life assurance (ie policies payable on: survival of a specified term; death; survival of a term or earlier death; death within a specified term; birth; marriage).
   - Annuities.
   - Permanent health insurance.
   - Personal injury, incapacity for employment and accidental death, when underwritten in addition to life assurance.

10. The French regulatory authorities.

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11. Introducing, proposing or other work preparatory to the taking out of insurance policies, or assisting in the administration and performance of policies, particularly claims.

12. They must not have been convicted of a serious criminal offence relating to crimes against property or other financial crimes, or declared bankrupt.

13. (a) None.

14. Sympathetically and positively.

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