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Our ref: WGA/smb

Dear Gavin

CP 174 – Prudential and other requirements for mortgage firms and insurance intermediaries

This is the Consumer Panel's response to CP 174 – Prudential and other requirements for mortgage firms and insurance intermediaries. In this response we have dealt with the issues raised in the paper, rather than with individual questions.

Overall approach

Generally the Panel supports the FSA's approach, although there are some areas on which we would like the FSA to undertake further work.

Safeguards and compensation for consumers

Capital and Professional Indemnity Insurance ("PII")

The Panel agrees that in Chapter 4 of the paper the FSA has correctly identified the main risks to consumers (and to the FSA's objectives) in their dealings with mortgage firms and insurance intermediaries. In Chapter 6 the FSA sets out the requirements it proposes to put in place to safeguard consumers against financial loss. The Panel strongly supports the imposition of a minimum capital requirement and compulsory PII cover, although we think that the figure of £5,000 for firms not holding client assets, and £10,00 for those who do, is too low. We also have doubts about the feasibility of ensuring that these requirements are (and continue to be) met. The FSA has calculated that there are thousands of small firms undertaking mortgage and insurance activities who are not yet authorised and who will, inevitably, be subject to minimal levels of supervision.

Credit unions

The Panel has some concerns about the impact of these requirements on credit unions. The Cost Benefit Analysis in Annex 1 to the paper refers to around five credit unions being involved in mortgage lending and up to about 350 conducting general insurance business. The FSA has also said that it is likely that these firms will leave these particular markets as a result of the FSA's proposals. Given that credit unions provide a valuable service to mainly small groups of consumers, we

thought that the FSA should consider giving some assistance to the credit unions affected to meet the initial additional cost of regulation.

Protecting client money

The Panel supports the FSA's proposals for the use of segregated bank accounts and/or the transfer of risk, whereby client monies held by intermediaries will be treated as being held by the insurance firm. We would like further information on how the FSA intends to ensure the effectiveness of these arrangements in the future.

Financial Services Compensation Scheme ("FSCS")

The Panel is concerned about the level of compensation to be available to customers of general insurance intermediation firms from the FSCS. The FSA proposes that the compensation limit should be the same as the current limit for protected contracts of insurance – 90% of the total claim for the generality and 100% for compulsory classes of insurance. The paper states that the long-standing limit of 90% "is in recognition that the consumer bears some responsibility to buy insurance diligently. By requiring the consumer to bear a small proportion of the claim a disincentive is given to indiscriminate purchasing, for example, irrespective of any consideration of plausibility of price and security." Given the nature of the risks to consumers identified earlier in the paper - including financial failure, negligence and poor internal systems and controls within the firms - it is difficult to envisage circumstances where a customer could possibly be expected to identify these issues. The Panel is therefore requesting a review of existing levels of insurance compensation – including research into the affect of the 90% cap on individual consumers – before the new regime takes effect. In the meantime we strongly support the FSA's proposal that the compensation limit should be the same as the limit for protected contracts of insurance.

In its response to CP160 (Insurance Selling and Administration, High Level Approach to Regulation), the Panel called for a review and revision of the definition of 'small businesses' who are eligible to receive compensation from the FSCS. We have not yet had a response from the FSA.

Mortgages

As we said in our response to CP 146 (The FSA's Approach to Regulating Mortgage Sales), the Panel believes that mortgage lending and administration should be included in the scope of the FSCS.

Cost Benefit Analysis (Annex 1 to the paper) ("CBA")

It is disappointing that the CBA does not attempt to quantify the costs and benefits of the new regime to consumers beyond high level benefits such as PII cover for firms. Nor does the CBA provide any information about the level of increased compliance costs that are likely to be passed on to consumers.

Firms whose principal activity is not a regulated activity

The Panel agrees that there should be a limited set of controlled functions for firms which carry on insurance intermediation as a secondary activity, as it is clear that the majority of staff will be dealing only with the firm's principal business activity. Nevertheless secondary insurance sales (such as sales by travel agents and tour operators) are an area of considerable consumer detriment. The Panel believes that these firms must be subject to an appropriate level of regulation, including the segregation of monies paid by customers to purchase insurance or by the transfer of risk to the insurer.

On a more general point, the term "intermediary" is not always understood by consumers and it would assist those reading Papers produced by the FSA if the meaning was made clear at the outset, eg firms which arrange, advise on or administer insurance policies. We also found that the meaning of the terms "client", "customer" and "consumer" in this paper were not absolutely clear and we thought that consistent use of a single term would have been preferable.

Yours sincerely,



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