



**The Association of Finance Brokers response to:  
CP 07/23 Organisational systems and controls  
– extending the common platform**

**1. Introduction**

This response is submitted on behalf of the Association of Finance Brokers (AFB). The AFB is the trade association representing intermediaries operating in the secured loan (second charge mortgages over residential properties) industry. Our members hold secondary insurance permissions with FSA.

The AFB represents brokers who are responsible for approximately 75% by volume and value of secured loans in the intermediary channel. Intermediaries active in this market act on behalf of the consumer in selecting an appropriate lender and product from within their panel of lenders to meet the individual consumer's loan requirements. Our members also provide access to associated protection products such as payment protection insurance.

We welcome the opportunity to consult on this proposal and are grateful for FSA's time at our meeting on the subject.

**2. Key comments**

**Policy Intention**

Whilst we understand that this consultation is proposed as a part of FSA's move to Principles Based Regulation, we have significant concerns over the broad range of firms potentially affected by one set of SYSC rules.

Whilst one high-level set of principles supplemented by guidance may be appropriate for some areas of the handbook, we are concerned that this apparent drive for 'regulatory purity' may be a step too far in the instance of SYSC. Indeed, for a mortgage or general insurance firm currently subject to SYSC 2 and 3 the revised rules are approximately three times the length of existing provision, merely to facilitate one handbook.

We understand that the revised 'guidance' for mortgage and general insurance firms should not represent an increased regulatory burden from the current

SYSC 2 and 3 requirements. However, what does appear to have been overlooked are the unintended consequences of further changes to regulation. Firms invest considerable time in FSA consultations and policy statements, and even though there may be no direct requirement for action, firms will still invest heavily in assessing their standards to any new requirements. Given the busy regulatory schedule, the proposed transition date of 1<sup>st</sup> October 2008 would fall between TCF deadlines for firms, and could divert attention of firms away from TCF. Notwithstanding this, we feel there are areas where unintended consequences could indeed create extra regulatory obligations for firms, only serving to underline the potential extra work that could be created.

The draft text presents many challenges to the industry. These include the interpretation of the guidance by small firms, and in particular the area of outsourcing.

### **The extension of MiFID**

We feel the CP lacks a rigorous analysis of the benefits to be gained by extending MiFID beyond its current scope. We do not argue that such a move is necessarily inappropriate but suggest that the utility of such a move is unproven. The CP does not present evidence for why such a move benefits firms or their clients, how any benefits will be quantified and over what time-period they will be realised. Given the hectic regulatory schedule it also apparently addresses very little consumer detriment, and we question whether this work is entirely appropriate with current market conditions and TCF as such a significant regulatory challenge.

FSA should consider the comments of DG Markt's Head of Unit, Karel Van Hulle, who has publicly stated his concern about member states "rushing to implement MiFID" and extending it too quickly beyond "narrowly defined boundaries". In his view, MiFID is still a new Directive and he expressed concern about the unintended consequences accrued in too swift an extension into other parts of the market not specified by the Directive.

Our comment would be that the case for extending the common platform is "unproven" and that FSA should conduct a far more rigorous analysis before pressing ahead. This will give firms the comfort of implementing proposals that have been tested. It will also allow FSA to assemble more evidence against which to test the results of the proposals when a post-implementation review (PIR) is held.

### **The role of guidance**

This CP clearly demonstrates the greater emphasis being placed on "guidance". Given the MPBR transition FSA should deliver a communication exercise for smaller firms on the role and regulatory status of the different types of

“guidance”. Firms that have enjoyed the certainty of rules in the past, and who now find those rules expressed as guidance, will need a period of transition.

Further, firms who now find their regulatory agenda widened by the arrival of new “guidance” will benefit from greater clarity about how to approach such matters. Firms will worry that the risk-hurdle has been raised by these proposals and will wish to better understand the supervisory approach that will be taken and how best to respond.

AFB has particular concerns over the interpretation of ‘guidance’ by FSA supervisors. Whilst the policy intention of the use of ‘guidance’ is perhaps best practice, we would actively support FSA in an internal educative exercise to ensure that supervisory staff also view ‘guidance’ in such a manner.

With regard to the specific terminology of the document, AFB questions whether the ‘A’ suffixed statements, referring to a previous ‘rule’ as ‘guidance’ for non-scope firms, can themselves be ‘guidance’. We feel that this potentially creates a situation whether either a ‘rule’ isn’t retracted and FSA is thus guiding firms to breach rules. Alternatively, the draft text illustrates the underlying strength of ‘guidance’ in that it actually has the power to amend and discount ‘rules’, in which case we question whether a ‘rule’ and ‘guidance’ actually differ. We agree that all suffixed statements should bear the same status as either ‘guidance’ or a ‘rule’. We acknowledge FSA’s latest communication with AFB on this point, but continue to feel that the use of ‘guidance’ in this situation only serves to emphasise the lack of clarity over the status of ‘guidance’, and therefore we again request clarification on this issue.

As further evidence of the lack of clarity on the role and status of ‘guidance’ FSA themselves comment in 2.8 that “...benefits would not be justified by costs...so we propose to extend this provision as guidance [only] to non-scope firms”. However, in 3.5 FSA comment that “...is important enough to be extended to non-scope firms as guidance”. AFB believes this highlights the genuine confusion that the role of ‘guidance’ holds, and the need for a communication exercise on such a subject.

AFB also wishes to highlight that we do not as a matter of course issue industry guidance, in the way perhaps MiFID Connect has done. Whilst we understand the reasons for such, we lack the resource, and we caution a regulator against relying on the industry to provide such clarity to certain situations.

## **Controlled Functions**

AFB found the consultation around the areas of apportionment of responsibility confusing. Areas of the draft text (SYSC 4.4) were unclear and appear to be at odds with the policy intention. The consultation itself also appears to suggest that a CF8 (Appointment and Oversight) function requirement should be carried

forward from SYSC 2 to SYSC 4.4. However, for small GI and Mortgage Intermediary firms there is no requirement. We have sought clarification on this point and understand that there is no intention to reintroduce a CF8 function for firms without governing functions, with which we agree. However, the draft text does not reflect this, and should the policy intention change to include the reintroduction of controlled functions for sole traders we would strongly disagree with the change of stance.

### **The role of technology**

FSA invested in technology to help small firms construct their own handbook. AFB supported this move and has found that it has delivered benefits to member firms.

We would encourage FSA to continue to invest in this approach. We have long worried that a desire for “regulatory elegance” would lead to a position where simplicity of approach took precedence over the need of firms for specific and detailed rules and / or guidance.

The drive for simplicity can result in significant unintended consequences and we would counsel FSA to resist any solutions which leave firms more exposed to risk. A complex handbook is not necessarily a bad thing if it provides firms with the information they need to operate a better business – technological solutions can help manage the detail and deliver a specific handbook for firms’ needs.

### **The need for clearer regulatory sign-posting**

AFB supports FSA’s move toward a more principles based regulatory regime. However, firms need help and support from the regulator during this transition – especially when the transition affects such matters as a “down grading” of rules into guidance. Part of the regulator’s duties during this period is to effectively sign-post where changes are proposed and what the impact of those changes will be. We are deeply concerned that CP 07/23 fails this test. The title of the CP fails to convey its meaning, the text’s notation style is dense, and more worryingly, the impact on firms is unclear.

The target audience for the CP appears to be wholesale firms – but its impact will also be felt by retail firms.

### **Outsourcing and compliance**

FSA will be aware that one result of MPBR, is the greater use of compliance consultancies of all shapes and sizes. AFB has found a significant increase in the number of compliance firms wanting to be “approved” by us and would suggest FSA will find a similar clamour (NB AFB does not approve compliance firms).

It is still the case that compliance consultancies vary in quality considerably and many are actually a barrier to firms reaching required standards, as their advice is so poor. One clear outcome of CP 07/23 will be an increase in firms wanting FSA to either regulate compliance providers or publish approved lists of compliance providers. We suggest more could be done in co-operation with, for instance, the Compliance Institute, to drive up standards. An alternative may be for FSA to publish its list of organisations regularly used to undertake “skilled persons reports”.

Further to this, AFB wishes to flag potentially serious concerns relating to outsource and material outsource functions. Within the industry there are notable variations of firms utilising the skills of not only compliance consultants, but also lead generation and mortgage packager operations. These have the potential to represent material outsourcing for some firms. This poses significant questions both in the role of these non-regulated outsource operations, and the extent and interpretation of material outsourcing for both the industry as a whole, but also for each small individual firm.

We fear, having referred to confirmed Industry Guidance published by MiFID Connect, that the provision of sourcing software, a critical and important part of the advice process for many firms, could also represent material outsourcing. The requirement placed on a firm with regard to outsourcing arrangements, including right of access, site visits, assessment of disaster recovery arrangements are simply out of scope for a sole-trader or small firm. The potential problem created by firms examining the existing relationships with just a few main sourcing-software providers is clear and we urge FSA to consider whether the outsourcing chapter should be excluded from the final text.

We also have concerns relating to some broker’s roles as outsource functions of lenders. The process of valuation instruction and payment differs in the second-charge sector and this could filter back through lenders as a problem for AFB members.

### **Transition period**

We would suggest that the requirements laid on firms to meet these proposals will actually require a period of considerable transition. We feel that a 1<sup>st</sup> October date to have implemented the proposals is unrealistic and simply does not allow firms sufficient time.

Even in a benign economic environment the 1<sup>st</sup> October date would be significantly ambitious, given the current market turmoil we feel that a much longer transition period is needed and would recommend 1<sup>st</sup> October 2009. This would underline FSA’s commitment to supporting the market, and to their own TCF priorities.

### **3. Answers to specific questions**

**Q1: Do you agree with our proposal to extend the common platform to non-scope firms predominantly as guidance and disapply SYSC 2 and 3 to them? If not, please tell us why.**

Given our comments above, we would suggest FSA has not proven the case to extend the common platform. This is not to say that we are against the move but have not had a strong case presented as to the costs and benefits of the move, and particularly the priority nature of the work.

We are also concerned about how elongated the handbook is becoming through the addition of so much extra text as guidance. Our comments about the need to allow firms to have certainty are particularly appropriate here.

As per our opening statement, we remain confused by the role and status of 'guidance' and seek clarity from FSA on this.

Given that FSA can support the proposals with a thorough cost / benefit analysis, the remainder of our answers broadly support the move – with caveats as appropriate to each answer.

**Q2: Do you agree with our proposal to extend the common platform provisions on business continuity to non-scope firms as guidance? If not, please tell us why.**

We are broadly in agreement.

**Q3: Do you agree with our proposal not to extend the SYSC 4 accounting requirements to non-scope firms? If not, please tell us why.**

Yes we agree. The current twice-yearly RMAR submissions are sufficient.

**Q4: Do you agree with our proposal to extend this monitoring rule to non-scope firms as guidance only? If not, please tell us why.**

No. This should be excluded altogether as it is unnecessary. The current TCF obligations suffice.

**Q5: Do you agree with our proposal to extend SYSC 4.2.1 to non-scope firms as guidance and disapply the current SYSC 3 provisions?**

Whilst we agree with the alternative provisions, we would again counsel FSA to the advantages of a simple, technology backed system for individual registration

in the mortgage market. This would allow firms a far greater control of recruitment, which would also benefit FSA in accurately assessing those applying for new directly authorised status.

**Q6: Do you agree that we should extend this guidance on segregation of duties to non-scope firms? If not, please tell us why.**

Where applicable, we do not object to this guidance being applied, but it must be proportionate. It should be borne in mind that, for some small firms, it would be impractical and unrealistic for no one individual to be completely free to bind the firm as suggested in Paragraph 3.4.(page 12). Fair and sensible application of the guidance will be key to its success. If the proposals are adopted, non-MiFID firms will see 'guidance' put in place instead of rules. We are concerned about how much weight the 'guidance' will have and any powers of enforcement that may result and seek further clarification.

We also strongly challenge FSA's statement that "we do not think this guidance will result in any change in market behaviours". As described in our summary, firms, regardless of any apparent new or increased regulatory burden, will review this and subsequent documents and will invest considerable time and energy in reviewing procedures against any perceived new standard. This effort and significant cost should not be discounted by FSA.

**Q7: Do you agree with our proposal to extend as guidance the provision that firms ensure relevant persons are aware of the procedures they must follow to discharge their responsibilities? If not, please tell us why.**

Yes.

**Q8: Do you agree with our proposal to extend SYSC 5.1.14 to non-scope firms as guidance? If not, please tell us why.**

The concept is fine but the practicality of following such guidance and its relevance for many smaller retail firms give us cause for concern. Any application of such guidance should, again, be proportionate. We feel that for a small firm, such as a sole-trader, this 'guidance' will be at best confusing, and at worst could create unnecessary and expensive work for firms.

**Q9: Do you agree with our compliance proposals? If not, please tell us why.**

We have voiced serious concerns relating to the increased calls for regulation of compliance consultants in our summary, and echo those sentiments here. We also believe that this CP could have the consequences of driving significant numbers of small firms towards the services of such organisations, at considerable financial cost to the industry.

**Q10: Do you agree with our proposed guidance on internal audit? If not, please tell us why.**

The key is that the internal audit function should be applied 'where appropriate and proportionate'. It must be recognised that setting up an internal audit department which is separate and independent from other functions and activities would not be appropriate or beneficial for many small and even medium-sized firms.

We again highlight our concerns relating to outsource functions for smaller firms. If internal audit were a critical function, as a result of direction from FSA, this could develop into a further costly outsourcing function for many smaller firms. We believe that a more appropriate solution may be to either exclude this from the final text, or to consider production of significant 'good practice' notes aimed specifically at smaller and medium sized firms, which combined with a proactive educative program with supervisors could be sufficient to avoid further significant unintended industry expense.

**Q11: Do you agree with our proposed guidance on risk control? If not, please tell us why.**

The tone of SYSC 3.2.10G is actually quite different to SYSC 7 in that where 'it **may** be appropriate [to set up a separate risk assessment function] (SYSC 3.2.10G) SYSC 7.1.6 R states that a firm **must** [... establish and maintain a risk management function that operates independently etc...]. To say that these two pieces of guidance are substantially the same ignores the impact of the change in regulatory tone, especially on a small retail business. We would fully support a retail firm's right and moreover, its responsibility, to determine how appropriate it would be to set up a separate risk assessment function etc. To say that a firm 'must' do so without making clear just how much weight the Guidance will carry, and at which point in a firm's development its business discretion may be over-ridden by FSA supervision, risks creating ambiguity and confusion post 1<sup>st</sup> October. The unintended consequence could be difficulties for the regulator and firms alike if the impact of this and similar moves on all sectors regulated by FSA, not just wholesale, is not fully thought through.

**Q12: Do you agree with our proposed rule that, where outsourcing a critical or important function, a firm must remain responsible for discharging its regulatory obligations? If not, please tell us why.**

We agree that firms must remain responsible, and although we are not aware of firms being under any illusion that they could discharge regulatory responsibilities (e.g. the fact sheet for small firms *Using a Compliance Consultant* states quite clearly 'You cannot contract out your regulatory obligations ...') do not object to 8.1.6R being applied to non-scope firms.

**Q13 Do you agree with our proposal to apply these SYSC 8 provisions as guidance for non-scope firms? If not, please tell us why.**

We do not agree with the application of the outsourcing rules.

We counsel FSA as to the uncharted territory they could be driving firms towards with regard to outsourcing functions. Whilst we understand that clarity of roles and responsibilities is critical to any sector, the mortgage and to a lesser extent GI sectors enjoy various complementary services which themselves have evolved to differing degrees of regulatory maturity.

For example, many mortgage firms utilise the services of packaging operations. Whilst some firms consider a packager to be merely an outsource function of a lender, others may feel a degree of reliance on them. The outsourcing rules potentially bring to a head the issue of responsibilities, which could further destabilise the industry at a difficult time, and / or create extra cost for firms in assessing existing relationships.

We also feel that there is the potential for lead generation and aggregation companies to fall into the material outsourcing function for some firms. This sector is highly innovative but comparatively young. Putting pressure on the smallest firms presents significant challenges that could see some firms exit sectors of the market, which are currently supported by lead generation firms. We again strongly caution FSA to the unintended consequences of these proposals.

As commented upon in our opening statement, there is clearly potential for mortgage sourcing software to become a critical and important outsource function. The consequences of this, for both 11,500 firms attempting to reassess their existing relationships, and for the three main sourcing software providers are significant.

AFB's sister body, AMI, is currently working with IMLA to develop a mortgage sector specific interpretation of FSA's provider/distributor responsibilities work, and AMI's Packager Taskforce (a formal standing committee within the AFB/AMI/AIFA group of trade bodies) is also developing a voluntary Code of Conduct for packagers. However, these documents themselves are unlikely to be complete before summer which perhaps illustrates the significant amount of work that FSA could unintentionally be thrusting upon industry firms.

**Q14: Do you agree with our proposal to extend the high level record keeping provisions in SYSC 9.1.1R to non-scope firms and disapply the current provisions? If not, please tell us why.**

Firms tend to keep records for far longer than they are obliged to as the lack of an effective statute of limitations, and a legal long-stop, means that they could have to deal with a regulatory complaint at any time.

The professional indemnity insurance industry also imposes record keeping requirements on firms that go beyond those established by the regulator.

The proposed record keeping requirements are unlikely to make much difference to current practice. The role of FOS is perhaps more concerning for firms.

**Q15: Do you agree with our proposal to extend the SYSC 9 guidance on providing records in English to non-scope firms and disapply the existing provisions? If not, please tell us why.**

Yes.

**Q16: Do you agree with our proposal to delete the record-keeping provisions in INPRU (INV) 3, 5 and 13? If not, please tell us why.**

No comments.

**Q17: Do you agree with the modification of the SYSC 10.1.8R requirement for insurance mediation activity?**

We agree that 10.1.8(2)(a) R would be disruptive for insurance business and agree that it should not be a requirement.

**Q18: Do you believe disclosure in a durable medium would be too disruptive to established practice in other areas?**

Our members generally only hold insurance permissions.

**Q19: Do you agree with our proposal on conflicts of interest? If not, please tell us why.**

We are unclear of whether any changes will be made to ICOBS 2.3.1(G) which relates to conflicts of interest. We would appreciate guidance as to whether firms active these sectors now need to consider two separate pieces of guidance on conflicts of interest and whether FSA believe them to be complimentary.

With regard to the overall conflicts of interest rules, we have concerns over the requirements placed on small firms to evidence that they have addressed conflicts of interest. We therefore would welcome further support for smaller firms.

**Q20: Do you agree with our proposal to extend SYSC 10 to non-scope firms that produce investment research? If you do not, please tell us why.**

No comments.

**Q21: Do you agree with our analysis of the impact on section 150 rights of action? If not, please tell us why.**

No comments.

**Q22: Do you agree with our proposal to disapply SYSC 2 and CF8 and to extend SYSC 4.3 to those non-scope firms which have at least one governing function under the approved persons regime? If not, please tell us why.**

Although the proposal aims to give non-MiFID firms greater flexibility, SYSC 4.3.2R(1) involves producing annual written reports on various matters covered in SYSC 6 and 7 which does not currently have to happen.

As highlighted in our opening statement and at our representation with FSA, the policy intention as articulated in the CP, the draft wording and the current situation with small firms that hold no governing or controlled functions at all, appear to contradict each other. We would not support the reintroduction of a CF8 function for firms.

Clearly further consideration of this point needs to be considered. AFB would be more than happy to offer further input on this policy area with FSA.

SYSC 4.4.1R (8) states that the Apportionment of Responsibilities rule applies to sole traders. Further clarification of how a sole trader should interpret the rule would be appreciated.

**Q23: Do you agree that we should continue to allow firms conducting business other than designated investment business to classify clients as eligible counterparties for the purpose of the application of PRIN? If not, please tell us why.**

Our only comment is that where a client is an elective as opposed to a per se eligible counterparty, a firm should evidence clearly that the client has opted to be treated in this way.

**Q24: Do you have any comments on the nature and scale of the costs and benefits arising from our proposals?**

The proposals include clauses stating provisions are to be applied proportionately to firms 'taking into account the nature, size and complexity of

their activities'. This is a welcome stance in theory. However, definitions of 'proportionate' may differ between sections of the industry and the regulator. Costs may be incurred debating this issue and regulatory uncertainty at this point in the economic cycle will not be welcomed by firms who were warned by FSA to 'brace themselves' in this year's Financial Risk Outlook.

We wish to see firms being given the benefit of the doubt and being supported where they are clearly attempting to interpret Guidance responsibly and with TCF consumer outcomes in mind.

**Q25: Do you agree with our view that areas not covered here are not material for CBA? If not, can you identify which changes you think will have material impacts and are not covered by our analysis?**

We have no further comments to make here, aside to say that we believe the unintended market impact for firms could be considerable and should not be underestimated. New regulation may not increase regulatory responsibilities but will involve firms reviewing and reassessing systems, and translating what are in the main different rules with which they are not familiar, combined with the concern of the weight held by guidance.

**AFB**  
**March 2008**