

## **GUIDANCE TO MEMBERS OF THE LAW SOCIETY OF NORTHERN IRELAND IN RELATION TO THE SOCIETY'S FINANCIAL SERVICES REGULATIONS 2004**

The current system of investment business regulation which was introduced by the Financial Services and Markets Act on 1 December 2001 will be expanded to include the regulation of mortgages and general insurance business from 31<sup>st</sup> October 2004 and 14<sup>th</sup> January 2005 respectively.

These extended areas of regulation will continue to fall within the Part XX (Designated Professional Bodies) Regime under FSMA 2000 and thus within the regulatory principles provided for in our Solicitors' Financial Services Regulations 2001. As a result, those regulations will be repealed; replaced (where applicable with necessary consequential amendments) and extended to include the new regulated activities by the Solicitors' Financial Services Regulations 2004.

The Solicitors' Financial Services Regulations 2004 fall into three parts, thus:-

**Part I** – the general principles retained from the 2001 Regulations with an extended definition section and consequential amendments at Regulations 10.2, 13 and 14.2 to cover insurance mediation activity.

**Part II** – Insurance Mediation, which details additional information to be provided to clients, including a form of wording to be addressed to clients before providing a service in this category of business. Details of the contents of the demands and needs statements and information relating to your analysis as required are set out.

### **Part III – Regulated Mortgage Activities and long term care insurance.**

These changes come from the Insurance Mediation Directive (EC 92/2002) (the IMD) which requires the regulation of insurance selling and administration by intermediaries (insurance mediation) and from Government policy in relation to mortgage selling and long-term care insurance.

The existing Financial Services Guidelines issued with the 2001 Regulations still apply to financial services business and to long-term care insurance. (Part 1 of the Regulations).

This Guidance on the extended regulations which cover insurance mediation and mortgage work (Parts 2 and 3 of the Regulations) has been approved by the FSA. The extended regulations are concerned with principal areas of change (a) in relation to insurance mediation work; the FSA Register; Regulatory status disclosure; Passporting; and (b) in relation to Mortgage work and the extension of the regulated regime generally. Members are advised to visit - [www.fsa.gov.uk/register/home.do](http://www.fsa.gov.uk/register/home.do)

## **PART 2**

### **INSURANCE MEDIATION**

Article 2(3) of the IMD defines “insurance mediation” as meaning “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 soliciting in the administration and performance of such contracts, in particular in the event of a claim”. There is a parallel and similar definition of “re-insurance mediation”. These definitions are accepted as encompassing the business of insurance brokers and insurance companies, but especially in relation to assisting in the administration and performance of such contract, bring solicitors within their ambit.

The extension to the FSMA 2000 to encompass these activities has been brought about by the FSMA 2000 (Regulated Activities) (Amendment No. 2) Order 2003 with respect to insurance mediation activities with effect from 14<sup>th</sup> January 2005.

We are grateful the Government has agreed to implement regulation of solicitors and other professional firms undertaking insurance mediation activities by extending the existing Part XX regime under FSMA 2000. That is the regime which currently operates to allow the Society as a Designated Professional Body (DPB) to regulate solicitors in Northern Ireland (subject to oversight by the FSA) in relation to business which would otherwise be directly regulated by the FSA provided that such activities are limited in scope and form an integral part of their core professional services for insurance and provided they arise out of or are complementary to those professional services. As such, Northern Ireland solicitors are exempt professional firms (EPFs).

The new regulated activities arising from insurance mediation are:-

- > Dealing as an agent in Contracts of Insurance;
- > Arranging or making arrangements with a view to a person entering into a Contract of Insurance;
- > Assisting in the administration and performance of a Contract of Insurance;
- > Advising on the merits of buying or selling a Contract of Insurance.
- > Government has decided that Exempt Professional Firms (EPFs) can advise on and recommend both commercial and retail non-investment Contracts of Insurance. This is in contrast to the more limited scope under which you can give advice in investment business; and
- > Agreeing to carry on any of the above activities.

Work of Defence solicitors on behalf of insurance companies is not included in the regulated area. Firms are likely to carry on a number of activities which fall within the definition of insurance mediation, including introducing, arranging and advising on the following types of insurance – after-the-event legal expenses insurance, defective title indemnity insurance, buildings insurance, term assurance, missing beneficiary indemnity insurance and unoccupied property insurance.

The exclusions contained in Articles 66 and 67 of the FSMA 2000 (carrying on regulated activities by way of business) Order 2001 (the RAO) which broadly relate to investment business carried on by Exempt Professional Firms in the profession have been disapplied and consequently not available to solicitors who would take up or pursue insurance mediation activity. However, a new exclusion contained in Article 72C (the provision of information about contracts of insurance on an incidental basis) of the RAO may be of some limited assistance to professional firms. The Society has taken the view that this exclusion is potentially of such limited application that it would be imprudent to consider that our members would wish to operate solely within the confines of the exclusion.

### **The FSA Register**

The FSA is obliged by the IMD to maintain an up to date record of inter alia every exempt professional firm which carries on or is proposing to carry on insurance mediation activity pursuant to the Part XX Regime regulated by the Society.

The Society is obliged, as a Designated Professional Body, to provide the FSA with the information it needs to maintain the register relating to Exempt Professional Firms within our membership. This is our responsibility and Regulation 14.2 sets out the information which each firm is required to give the Society before the commencement of the Regulations. Unless otherwise

informed, it shall be assumed that sole practitioners are the responsible persons for IMD work within their practice. Where changes occur in a firm's circumstances or arrangements within, the Society should be informed immediately as we are required to provide updated information to the FSA on a regular basis.

If a firm does not provide the information to the Society we will not be in a position to provide same to the FSA and this firm's name will not appear on the IMD Register. If such firm proposes to carry on insurance mediation activity, they are likely to be breaching the general prohibition within the Financial Services and Markets Act and committing a criminal offence under Section 23 thereof. A firm must therefore ensure that it is included in the FSA Register before undertaking any insurance mediation activity.

Broadly, Exempt Professional Firms may not carry on regulated activities which relate to a contract of insurance in reliance on the Part XX exemption unless the Exempt Professional Firm is included in the record of unauthorised persons carrying on insurance mediation activity to be maintained by the FSA under Article 93 of the Regulated Activities Order.

The Society will be obliged before October 2004 to provide information to the FSA to enable the FSA's register to be established.

We would draw your attention in particular to the demands and needs criteria required by Regulation 16.1 – 16.5; the basis upon which insurance mediation is conducted – Regulation 16.6; the maintenance of records – Regulation 16.7. These and Article 15 reflect the requirements of Articles 12 and 13 of the Directive and provide different regulatory requirements vis-à-vis insurance mediation activities and other financial services.

In this connection, solicitors are reminded that in the albeit unlikely event of your providing insurance mediation activities through the medium of telephone selling, prior information to the customers shall be in accordance with the Distance Marketing of Consumer Financial Services Directive (2002/65/EC). Information as required by Regulation 16.7 must be provided to the customer on paper or other durable medium immediately after the conclusion of the insurance contract.

## **Passporting**

Exempt Professional Firms on the FSA's register are entitled to exercise the EEA right inferred by Article 6 of the IMD to establish a branch or provide services relating to insurance mediation activity in another EEA state. These rights may be of particular interest to solicitors in Northern Ireland who either have branch offices in the Republic of Ireland or who hold Practising Certificates in that jurisdiction. Any firm contemplating the exercise of rights under Article 6 to establish a branch or provide services relating to insurance mediation activity in another EEA state are referred to the relevant extracts from SUP 13 of the FSA handbook (exercise of passport rights by UK firms) copies of which can be obtained from the Society upon request (contact the Deputy Secretary).

Notice of intention to establish a branch or to provide cross-border services in relation to the IMD must be given to the FSA in the required form set out in SUP 13 – such notice is required even if the practice has already been established or is already providing services other than insurance mediation activities.

## **GENERAL**

Although we believe, following the pattern of our Financial Services regime that none of our member firms require direct authorisation by the FSA and will remain within our Part XX regime, you should take cognisance of the FSA's view that professional firms with practices which involve acting for claimants in litigation

against insurance undertakings, where cover is in question, are likely to be seen as to be carrying on the regulated activity of assisting in the administration and performance of a contract of insurance. EPFs whose practices contain a material element of such activity should consider whether they are able to take advantage of the Part XX exemption to avoid any need for authorisation direct with the FSA.

## **PART 3**

### **MORTGAGES**

The extension to the FSMA 2000 has been brought about by the FSA 2000 (Regulated Activities) (Amendment No. 1) Order 2003, with respect to mortgage activities with effect from 31<sup>st</sup> October 2004.

The Order sets out six regulated mortgage activities:-

- “(1) Arranging (bringing about) regulated mortgage contracts;
- (2) Making arrangements with a view to regulated mortgage contracts;
- (3) Advising on a regulated mortgage contracts;
- (4) Entering into a regulated mortgage contract as a lender;
- (5) Administrating a regulated mortgage contract;
- (6) Agreeing to carry on any of the above.”

The regulated activities of advising on, arranging (bringing about) and making arrangements with a view to an administering mortgage contracts are those likely to be relevant to solicitors.

The FSA's own Policy Statement on these matters reads:-

**“Part XX exemption: arranging regulated mortgage contracts**

4.14.4G *Arranging (bringing about) a regulated mortgage contract and making arrangements with a view to a regulated mortgage contract* have not been specified in the Non-Exempt Activities Order. Accordingly, a professional firm may carry on these regulated activities without *authorisation*, provided the other conditions of the *Part XX exemption* are complied with.

**Part XX exemption: advising on regulated mortgage contracts**

4.14.5G *Advising on regulated mortgage contracts* has been specified in the Non-Exempt Activities Order. However, a professional firm is prevented from using the *Part XX exemption to advise on regulated mortgage contracts* only if the advice it gives consists of a recommendation. This will be the case if the recommendation is made to an individual to enter into a regulated mortgage contract with a lender who would, in entering into the contract, carry on the regulated activity of entering into a regulated mortgage contract, irrespective of whether the lender is an *authorised* or *exempt person* or would carry on the activity by way of business. However, a professional firm is allowed to give advice that involves a recommendation of this kind provided the advice endorses a corresponding recommendation given to the borrower by an *authorised person* who has *permission to advise on regulated mortgage contracts* or an *exempt person* whose exemption covers that activity.

**Part XX exemption: entering into and administering a regulated mortgage contract**

4.14.6G *Entering into a regulated mortgage contract and administering a regulated mortgage contract* have both been specified in the Non-Exempt Activities Order. As an exception, a *professional firm* is allowed under the *Part XX exemption* to carry on these *regulated activities* if the firm is acting as a trustee or personal representative. But this is provided that the borrower is a beneficiary under the trust, will or intestacy.”

The Financial Services Authority has confirmed that the majority of activities conducted by solicitors in Northern Ireland are likely to fall within the exclusions. However, members should be careful to avoid attracting the requirements of Chapter 5 of the Mortgage Conduct of Business Source Book (MCOB5 – Pre application Disclosure) which requires the provision or the ensuring of the provision of a “key facts illustration” to the client. MCOB5 is attracted if a firm:-

- “(a) makes a personal recommendation about a particular regulated mortgage contract to a customer; or
- (b) provides information to a customer that is specific to the amount that the customer wants to borrow on a particular regulated mortgage contract, including information provided in response to a request from a customer; or
- (c) provides the means for a customer to make an application to it;

In connection with entering into a regulated mortgage contract provided by a mortgage lender, other than a regulated lifetime

mortgage contract or a variation to an existing regulated mortgage contract.”

These circumstances can arise e.g. where a firm carried on the permitted activity of arranging (4.14.9 above) but is also asked for advice, (4.15.9 above) or where there is confusion between the provision of advice and the provision of financial information. It is suggested that arranging a mortgage with a lender which has only one loan product may be construed as extending into the area of advice – so necessitating compliance with MCOB5

“Regulated mortgage contracts” are those which satisfy the following conditions at the time in which they are entered, namely:-

- (1) the contract is one where a lender provide credit to an individual or trustee (the borrower);
- (2) the obligations of the borrower to repay is secured by a first legal mortgage on land (other than timeshare accommodation) in the United Kingdom; and
- (3) at least 40% of that land is used, or is intended to be used, as or in connection with a dwelling by the borrower (or, where trustees are the borrower by an individual who is a beneficiary of the trust) or by a related person.

Nothing in the regulatory regime precludes solicitors from giving advice on the legal implications of a mortgage contract or the giving of negative generic advice to the effect that a client should shop around for another mortgage product..