Technical CONNECTION

CONTENTS

Published by Technical Connection Ltd,
7 Staple Inn, London, WC1V 7QH.
Tel: 020 7405 1600 Fax: 020 7405 1601
E-mail: host@technicalconnection.co.uk
www.techlink.co.uk

DEPOSITOR PROTECTION

The existing compensation scheme set to change post Northern Rock

The current compensation arrangements for UK depositors operated by the Financial Services Compensation Scheme (FSCS) have been found seriously wanting by the events at Northern Rock. Since 1 December 2001, the FSCS has been the sole scheme for compensating consumers when authorised firms are unable, or likely to be unable, to satisfy claims against them. The FSCS is a company limited by guarantee which is independent in its day-to-day decision making but accountable to the Financial Services Authority (FSA).

The FSCS replaced eight previous arrangements that provided compensation if a firm collapsed owing money to investors, depositors or policyholders. As far as depositors are concerned, the FSCS replaced the Deposit Protection Scheme (for banks) and Building Society Investor Protection Scheme. The FSCS currently provides:

- 100% cover for the first £2,000 of deposit; and

- 90% cover for the next £33,000 of deposit.

The FSCS's maximum payment to depositors is therefore £31,700. The limit is per bank/building society, per accountholder. Thus, for a jointly held account, the maximum payout would be £63,400 for a joint deposit of £70,000 or more. If an individual has more than one account with the same bank/building society then the limit applies to the total of all the moneys held in all the accounts.

The per bank/building society provision is complicated by the fact that many large financial organisations (eg HBOS, RBS and HSBC) have more than one bank within their group. The FSCS maximum payment is per FSA authorised bank, so the extent of overall cover depends on whether the failed bank has its own separate banking authorisation or operates under its parent company's authorisation.

The FSCS protection for deposits was an improvement over its two predecessors, which paid 90% of the first £20,000 of deposits, but since its introduction in 2001 the protection limit has not increased. One reason why the FSCS limit has not increased since the scheme started is that the banks etc, which ultimately pay for it via a levy, have resisted any improvements. The argument against raising the limits under the scheme is a familiar one with all compensation schemes: moral hazard. The big banks for example – with the largest share of deposits – do not want to end up paying for the injudicious actions of their smaller rivals.

The Chancellor gave an indication in a recent interview with the Times that he favoured moving to a 100%, £100,000 limit. The new structure would echo the US deposit insurance scheme, which is capped at $100,000. Under such a scheme, compensation payments would be made within days rather than the six months which the FSCS would currently take.

It is arguable that at present the UK has a limitless compensation scheme, given that the actions taken to defend Northern Rock depositors have set a precedent for dealing with any other crisis-hit bank. The Chancellor will therefore want to put a new scheme in place as quickly as possible.

COMMENT

Any move to increase deposit protection would probably have knock-on effects on other parts of the FSCS, notably the £48,000 compensation limit that currently applies to investments.

For those who are concerned about the safety of their deposits it would currently make sense to limit the amount of a deposit with any one institution to £35,000.

POWERS OF ATTORNEY

Enduring powers of attorney replaced by lasting powers of attorney from 1 October 2007

A power of attorney is a document by which one person (the "donor") gives another person (the "attorney") the power to act on his behalf and in his name.

Before 1 October 2007 there were two types of power of attorney available:-

1. *An ordinary or traditional power of attorney (POA)*

The POA is granted to authorise the attorney to manage the donor's property and financial affairs. The attorney's authority comes to an end if the donor ceases to have mental capacity. The relevant legislation is contained in the Powers of Attorney Act 1971 and these POAs can still be made after 30 September 2007.

2. *An enduring power of attorney (EPA)*

The EPA, which could be granted from 10 March 1986 to 30 September 2007, is the same as the POA except that it may continue (provided it is registered) after the donor loses mental capacity. The relevant legislation is the Enduring Powers of Attorney Act 1985 and EPAs granted before 1 October 2007 can remain valid until the donor dies. No new EPA can be granted after 30 September 2007.

From 1 October 2007 a new type of power of attorney is available in England and Wales, under the Mental Capacity Act 2005, called a lasting power of attorney (LPA). Like the EPA, the LPA remains effective after the donor loses mental capacity. Unlike the EPA though, a LPA can give authority to deal with the donor's personal welfare. This is a significant improvement as previously many decisions concerning personal welfare matters after the donor lost mental capacity could not be taken by an attorney, and a single decision could involve consideration of both property and welfare.

It is not possible to change an existing EPA into a LPA; instead a new separate LPA will have to be drawn up and the EPA revoked.

There are two separate forms of LPA, one dealing with property and affairs, the other with the donor's personal welfare. Each must be granted on a prescribed form (ie. a combined LPA is not available) which incorporates a certificate, which must be provided by a suitably qualified third party, to confirm that, after discussion, the donor understands the meaning of the power.

A LPA can only be used after it has been registered with the Office of the Public Guardian (OPG). Registration can be made straight away (there is a fee for this) or it can be delayed until the attorney needs to use the power. In contrast, before 1 October 2007 an EPA had to be registered with the Court of Protection on the onset of mental incapacity (and not before). From 1 October 2007 existing EPAs will still need to be registered on the onset of mental incapacity but instead with the OPG.

The Property and Affairs LPA allows an attorney to make decisions about all money and property affairs, including operating bank accounts, paying bills, collecting income such as pensions and benefits, managing investments, selling the house and making gifts.

As far as the power for an attorney to make gifts without reference to the Court of Protection is concerned, it is the same under a LPA and an EPA although the terminology used is different. For both there is an overriding requirement that the value of a gift is not unreasonable having regard to all the circumstances and, in particular, the size of the donor's estate. Gifts can be made to a charity if the donor would have made a gift to such a charity and gifts can be made to persons related or connected with the donor on "customary" occasions such as a birthday, on marriage and at Christmas.

A Personal Welfare LPA allows the attorney to make decisions about the donor's welfare, eg. where they live and with whom, moving to a residential home, giving or refusing consent to particular types of treatment as well as day-to-day matters such as clothing, diet, holidays etc. A special express power may be included in the LPA to make decisions about "life-sustaining treatment" (ie. treatment needed to keep the donor alive), eg. serious surgery, cancer treatment or an organ transplant.

Clearly, more formalities and increased costs are involved in making a LPA as compared with the earlier EPA (which can no longer be granted).

A point of difference between LPAs and EPAs is that with LPAs, where the attorney is the spouse or registered civil partner of the donor, an attorney's appointment will terminate on the dissolution or annulment of the marriage or civil partnership between the donor and attorney, unless specifically provided for otherwise in the LPA.

COMMENT

Given the ability for potentially both financial and welfare decisions to be handled by an attorney under a LPA, more thought will have to be given to the appointment of an attorney , particularly in connection with a Personal Welfare LPA.

Existing powers should be examined to determine whether they should remain in force, be replaced or operate in tandem with the new lasting powers. However, the most important issue to discuss is the new opportunity for the Personal Welfare LPA. This is the first ever opportunity that individuals in England and Wales have, in effect, to leave legally valid instructions on what should happen to them in the event of them becoming severely ill or disabled. While there are still no provisions to effect the so-called "living wills", a grant of such a power, especially with the inclusion of express powers concerning "life-sustaining treatment", is as close as one can legally get to ensuring that their wishes will be carried out.

NATIONAL MINIMUM WAGE

Rates increased from 1 October 2007

The national minimum wage (NMW) is the minimum amount prescribed by law that an employer must pay its workers.

Regulations, which amend the National Minimum Wage Regulations 1999, come into force on 1 October 2007 and increase the minimum hourly rate of the NMW from that date as follows:-

- The adult ("main") rate rises from £5.35 to £5.52 per hour for workers aged 22 and over.

- The development rate rises from £4.45 to £4.60 per hour for workers aged 18 to 21 inclusive. This rate also applies to workers aged 22 and over, starting a new job with a new employer and doing accredited training.

- The rate for workers under age 18 who are no longer of compulsory school age rises from £3.30 to £3.40 per hour.

ADVICE TO EXPATS

The arrival of the MiFID means a change to the rules on advising expats resident in other European Economic Area (EEA) States

Do you give investment advice to a client who has retired to Spain? Or do you keep in contact with someone who bought Jersey funds and has since returned to Germany for retirement? In either of these situations, and many others involving cross-border advice, the arrival of the MiFID (Market in Financial Instruments Directive) from 1 November could affect your firm.

In the negotiations which led to the Directive, the UK secured an opt-out from the MiFID for financial advisers. UK financial advisers are thus not automatically subject to the MiFID rules, although the FSA has necessarily drawn on MiFID in creating its new Conduct of Business Rules, which also take effect from 1 November 2007.

The MiFID opt-out is purely domestic, covering advice given and received in the UK. If clients are contacted in other EEA States, whether by email, telephone, letter or personal visit, then it is likely the MiFID opt-out is of no help. As the FSA factsheet on the subject explains, the exact position depends upon the nature of the business involved:

- For insurance-based products, a "passport" (see below) under the Insurance Mediation Directive (IMD) is required. This can be obtained by emailing the FSA.

- For MiFID products (which includes collective investment schemes and shares) a passport under MiFID is required.

- For business which falls outside the IMD and MiFID there is no passporting. This means that any requirements in the individual EEA State where advice is being given will have to be considered and may include the need for EEA State authorisation.

To obtain a MiFID passport, a firm must opt in to MiFID. This means that the firm becomes subject to all the MiFID requirements, including financial resource levels, more detailed systems and controls tests and tighter conduct of business rules. These will apply to its domestic business as well as to its overseas business.

Failure to obtain the appropriate passport leaves the firm open to prosecution in the EEA State(s) in which it is doing business.

COMMENT

Many advisers may decide that they should hand over EEA clients to MiFID firms rather than opt for passporting.

INSURANCE AND SEX DISCRIMINATION

Legislation will be introduced later this year to limit the basis on which insurers can discriminate on sex grounds

The Government has issued a draft Statutory Instrument to bring into effect the European Directive on sex discrimination. The Statutory Instrument will apply to all insurance contracts entered into after 21 December 2007 and amends section 45 of the Sex Discrimination Act 1975.

The new law will affect insurance providers who seek to differentiate between men and women in setting premiums and benefits (for example in health and critical illness insurance). For contracts entered into after 21 December 2007, it will be a legal requirement that the use of sex as a factor in the calculation of premiums and benefits must not result in differences in individuals' premiums/benefits. In addition, the differences in benefits must not result from costs related to pregnancy or the fact that a woman has given birth at any time in the period of 52 weeks ending on the day the treatment occurs or begins.

Premiums and benefits though may still legitimately differ between the sexes as long as the underlying actuarial and statistical data on which the calculations for premium/benefits are based are relevant and accurate, published and regularly updated in accordance with guidance issued by the Treasury.

The public consultation period on the new draft law has just ended and the final regulations will be published shortly, along with final guidance from the Treasury concerning data publication requirements.

COMMENT

Insurers should be on the look out for these and be ready to make changes to the way they set premiums and benefits where gender is a factor.

FSA HIGHLIGHTS CONCERNS REGARDING SIPP ADVICE

In its latest Financial Advisers Newsletter (September 2007), the FSA has set out a number of potential concerns regarding the advice given to individuals to transfer existing pension benefits to a SIPP.

The FSA reviews highlighted "the potential risk that SIPP recommendations may be based on access to a broader range of packaged investment funds than under their previous arrangements rather than because the SIPP provides self-selection of actual investments." The FSA argues that in such a case a stakeholder or an insured personal pension scheme could equally satisfy the client's needs, potentially at lower cost. The FSA indicates that advisers must carry out proper cost comparisons between the SIPP and the alternative pensions vehicle (ie. stakeholder or insured personal pension scheme) so that the "full impact of charges can be taken into account when providing advice".

The FSA goes on "we expect firms to be able to demonstrate that a particular consumer genuinely requires investment flexibility and control. This is particularly important where the customer is charged for flexibility that he or she does not need or will not use".

Finally, the FSA confirms that the RU64 requirement applies to advice on SIPPs and that it expects a firm to be able to demonstrate why a recommended personal pension scheme (including a SIPP) is at least as suitable as a stakeholder scheme.

The FSA is undertaking further investigation into the advice on and distribution of SIPPs. This review work is currently being scoped and the FSA expects to be undertaking visits to firms in 2008.

COMMENT

This is a reminder from the FSA that SIPPs/deferred SIPPs are not automatically right for everyone. This is especially so when the self selection of investment assets is not used or is unlikely to be used by the individual.

INHERITANCE TAX – INVESTIGATION INTO LIFETIME TRANSFERS

Tucked away at the end of HMRC's first IHT and Trusts Newsletter published in August was a short article dealing with lifetime transfers made in the seven years prior to death. In the newsletter HMRC announced that until 31 March 2008 it will be checking IHT returns made by executors to ensure that lifetime transfers have been reported properly. HMRC goes on to mention particular areas that it will be interested in, being

- joint assets – gifts can arise on a transfer into joint names or where a joint owner receives the benefit of withdrawals from accounts funded wholly by the deceased
- loans – gifts can arise on the forgiveness of a debt or part of a debt
- movement of funds between multiple bank accounts – this can lead to gifts being overlooked
- inheritance - gifts can arise if there have been redistributions of property inherited by the deceased
- business or partnership – transfers from a business or partnership interest will not necessarily qualify for business relief
- rights under a pension scheme – a gift may arise if acts or omissions by a member of a pension scheme have the effect of increasing the value of benefits passing outside the member's estate at the expense of his own estate.

HMRC goes on to state that where information has been provided by executors on such matters that is unclear or incomplete it will ask for further information and in some cases it will open an inquiry.

COMMENT

It is clear that what HMRC is looking for are undeclared or under-declared transfers in the seven years prior to death. Where some information is shown on the IHT return (form IHT200) HMRC has a point from which to start.

Executors are required to report the deceased's estate and gifts within the past seven years. If these gifts have not been documented by the deceased the executors may not be in a position to give full, or any, details. Where the executors include family members or close friends it will be easier for them to recall undocumented transfers. However, professional executors are unlikely to be in such a position.

At present potentially exempt transfers do not have to be reported to HMRC. Therefore, it is not surprising that they can go undocumented. Further, HMRC has made reference to gifts (forgiveness of loans, transfers out of joint accounts) that individuals may not realise are in fact gifts.

Executors need to be very careful about the information they put on an IHT200, ensuring that they are in possession of the full facts before submitting the return.

STOP PRESS – DEPOSITOR PROTECTION

At the point of going to print, the FSA announced on 1 October 2007 that it had increased, from that date, the compensation limit for depositors to 100% of £35,000 – an increase of £3,300 in cash terms. This move was made by the FSA, using special powers, to "help reassure depositors with accounts of up to £35,000 that they are 100% covered".

The Government has indicated that it will propose further changes relating to financial services compensation arrangements in the UK to give consumers confidence that their savings and deposits are secure.