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CLIENT ASSETS (CASS)

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2. Client Asset Sourcebook (CASS)

2.1 Handling client money

Principle 10 (clients' assets) requires that a firm should arrange adequate protection for clients' money when the firm is responsible for them.

An essential part of this protection is the proper accounting and handling of client money. These rules are designed to protect customers if the firm fails or is unable to transfer:

(1) an insurance premium paid by the customer to the insurance company; or

(2) claims monies or returned premiums to the customer.

What is client money?

Client money is money of any currency that a firm receives and holds for its clients (or clients of an appointed representative, field representatives or other agents) when carrying on insurance mediation. This can include premiums, claims money, premium refunds and fees due from clients for onward transmission to another party such as a loss adjustor.

Money received that:

- is held under a risk transfer agreement or
- is not connected with insurance mediation, e.g. rent from a flat

is not deemed as being client money (however please also see section 2.1.3 "Co-mingling of insurer monies and client money").

Please note that whilst risk transfer money is not deemed as client money should a firm decide it wishes to remove its permission to hold client money they must discuss this first with their insurers to ensure that by doing so they would not be breaching their terms of business with the insurer. You will also need to re-arrange your banking requirements and may need to transform your client accounts to insurer trust accounts (this will depend on your terms of business with your insurer).

If your firm handles customers' money it has the following options:

(1) it can hold the money as agent of the relevant insurer, where the firm is transferring the risk from the firm to the insurer (otherwise known as 'risk transfer'); or

(2) it can hold the money on trust in a segregated bank account that cannot be used to reimburse other creditors in the event of its insolvency

Firms can do a mix of both.

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2.1.1 Holding money as an agent

What does holding money as an agent mean?

When a firm acts as agent for an insurance company (to receive and handle premiums, claims money or premium refunds) the insurance company bears the risk for any losses that may arise from the failure of the firm to make a transfer of these funds. Such failure could occur, for example, because the money is misappropriated by the firm (or by a third party to whom the firm passed the money) or it is lost through either party's insolvency. When the insurance company bears the risk of such losses, the industry often refers to this as **risk transfer**.

What requirements are there for a firm that is holding money as an agent of an insurance company?

To hold money as an agent a firm must:

a. enter into a written agreement (risk transfer agreement) with the insurer stating that premiums, and if the insurer so wishes, claims and premiums refunds, are held as its agent;
b. ensure it is satisfied that the terms of the policies issued are compatible with such an undertaking;
c. keep a copy of the agreement for six years from the date it was terminated;
d. inform clients that it will hold their money as an agent of the insurer and also the extent of the agreement and whether there are any restrictions e.g. receipt of premiums not claims. This information may be included in the status disclosure. Examples of the appropriate wording can be found in Insurance Conduct of Business Chapter, ICOB Templates 1 & 2;
e. only with the insurer’s agreement, extend this agreement to any appointed representatives, field representative or other agents, in which case they too must ensure that they inform the client as outlined in d. above. If the insurer allows this then it must be included in the insurer’s written agreement;
f. where an intermediary only holds monies as an agent of the insurer (i.e. does not hold client money) such monies do not need to be held in the FCA client account (see “co-mingling” below);
g. if only holding money as an agent of the insurer, the firm does not need permission from the FCA to hold client money. In this instance they must maintain a minimum capital requirement of the higher of £5,000 or 2.5% of its annual income;
h. firms holding only risk transfer money need not comply with CASS 5.3 to 5.6 as outlined in sections 2.1.2 and 2.3;

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i. comply with the terms and conditions outlined in the risk transfer agreement. This may mean there are restrictions imposed on the firm in regard to when they can take commission and where they must hold risk transfer monies.

Risk transfer agreements

A risk transfer agreement is an agency agreement between the firm and an insurer which makes it clear when money is held by the firm as agent of the insurer. A firm may also have a risk transfer agreement with another insurance intermediary but only if that intermediary has permission in its written agreement with the insurer to pass on risk transfer.

If the firm is relying on risk transfer from another firm it should:

- request to see a copy of the agreement giving authority to the firm offering you risk transfer;
- (if the firm is not named in this agreement) request documentation proving that it has notified and obtained consent from the insurer to your firm holding money as an agent of the insurer.

A risk transfer agreement should include the following:

1. express agreement that the firm can receive premiums as agent of the insurer;
2. express agreement that the firm can receive claims and premium refunds as agent of the insurer (this is essential if the insurer has given a “binding authority” to the firm);
3. allow you to transfer authority to appointed representatives, field representatives or other agents;
4. permit you to co-mingle with client money in a statutory or non-statutory client account in which case the insurer must agree to its interests to be subordinated to the interests of the firm’s other clients.
5. state how the money should be held. This can include:
    a. no restrictions;
    b. held in an account for that insurer only;
    c. held in an account for risk transfer money for all insurers with whom the firm has risk transfer agreements with; and
    d. co-mingled with other client money.

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Bank accounts for monies held under a risk transfer agreement

If the insurer stipulates that you need to hold its money in a statutory (or non-statutory) trust account set up in line with FCA or CASS rules then this will negate risk transfer and will mean that you are holding client money. The firm will therefore need to have permission from the FCA to hold client money and the monies will be subject to CASS 5 rules. In addition the capital requirements will be based on holding client money, i.e. a minimum requirement of £10,000 or 5% of insurance income if greater.

Where an intermediary holds just monies under a risk transfer agreement and has a restriction on their FCA permission preventing them from holding client money, the intermediary cannot hold these monies in an FCA statutory or non-statutory account.

BIBA has been in discussion with the ABI for many months and has now gained a suitable banking solution for monies which are exclusively risk-transferred. Firms can set up and use a bank account which resembles the FCA's non-statutory trust account.

This can be done by:

- an exchange of letters with the firm's bank.
- obtaining agreement from the insurers who have granted risk transfer and send them a copy of the deed for their agreement.
- executing a trust deed.

This will mean that:

- the intermediary will hold a trust account for the benefit of all insurers;
- the account has to be called an Insurance Brokers Insurers' Trust Account;
- commissions can only be taken in line with the insurer terms of business or agency agreement;
- the firm cannot use monies in the account to make advances to itself;
- the firm will need to provide access to any insurer, or their auditor, for checks to take place;
- the firm will need to have an annual auditor sign-off that the account is being operated correctly;
- at least every 25 working days a formal reconciliation will be needed;
- any interest belongs to the firm not the insurer;
- investment of insurer monies can only be in line with FCA designated investments and the firm is responsible for any shortfall should there be one.

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This will then mean:

- the firm no longer needs a permission to hold client money (assuming that all insurers are in agreement) and can rescind this permission (if they have it);
- the capital requirements will be a minimum of £5,000 or 2.5% of insurance income if higher;
- whilst the firm does not need to comply with FCA CASS rules, the Deed that it executes will still impose onerous and very similar requirements on it.

Examples of the instructions to execute the deed, the trust Deed, and exchange of letters with the bank can be found in the template section at the end of this chapter.

2.1.2 Segregating client money in a statutory or non-statutory trust account

Any client money that a firm receives and holds which is not held as agent of an insurer must be held in either a statutory trust client bank account or a non-statutory trust client bank account.

The most significant difference between holding money in a statutory and non-statutory trust account is that **under a statutory trust account the firm cannot make advances of credit from the client account, i.e. you cannot pre-fund from this type of account.** This will mean that a firm must not pay premiums to an insurer from the account until it has received the premium from the client. Likewise claims or premium refunds cannot be paid to the client until the money has been received from the insurer.

If the firm wishes to extend credit then it will need to set up a non-statutory trust account.

Regardless of the type of trust account being operated a firm should never make advances of credit to itself out of the client trust account, e.g. withdraw commission before the premium has been paid and cleared.

If the firm operates a statutory trust account then it is required to maintain a minimum capital of, the higher of, £10,000 or 5% of annual income.

A firm can only operate a non-statutory trust if it meets all the following requirements:

a) holds a minimum capital resources requirement of £50,000 where it wishes to pay client money relating to transactions with consumers into the non-statutory trust;
b) has and maintains systems and controls which are adequate to ensure that the firm is able to monitor and manage its client money transactions and any credit risk arising from the operation of the trust arrangement;

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c) for each client, where it holds client money in a non-statutory trust account, the firm must take reasonable steps to ensure that its terms of business or other client agreements adequately explain and obtain the clients' informed consent to the firm holding monies this type of account;

d) designates a manager with responsibility for overseeing the firm's day to day compliance with the systems and controls and the rules in this section; and

e) obtains and keeps written confirmation **from its auditor** that it has in place systems and controls which are adequate to meet these requirements.

Setting up a statutory trust account

Although a separate bank account is needed, no special account is required and a conventional deposit or current account is acceptable. The trust is automatically created by the exchange of letters with the bank. Letters that can be used to set up a statutory trust with the bank can be found in the template section at the end of this chapter.

A firm should ensure the following in setting up a statutory trust:

- the title of the trust account includes client or client money in the title;
- written confirmation must be received from the bank that all money in the account is held by your firm as trustee (agent in Scotland);
- written confirmation must be received from the bank that it is not entitled to combine client money accounts with any other account or to exercise any right to set-off or counterclaim against money in that account in respect of any sum owed to it on any other account of the firm;

Setting up a non-statutory trust account

In respect of the non-statutory trust, the firm will need to execute a formal trust deed. A non-statutory trust deed can be found in the template section at the end of this chapter.

If the firm does decide to operate a non-statutory trust then as well as the requirements indicated above it will need to take reasonable steps to:

- ensure that its terms of business adequately explain to the client that his money will be held in a non-statutory trust; and
- obtain the client's informed consent to the holding of his money in a non-statutory trust account.

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2.1.3 Co-mingling of insurer monies and client money

Your firm might hold some of its customers' monies as an agent for an insurer, while in its dealings with other customers it might not act as agent for an insurer. In these circumstances it would have to hold money received from the second group of customers as client money in a segregated bank account.

When your firm is holding money as agent of an insurer, the insurer may specify in its terms of business agreement (TOBA) the required banking arrangements.

However with the insurer's written agreement such monies may be co-mingled with client monies in a statutory or non-statutory trust account. This written agreement must include that the insurer subordinates its interests to the interests of the firm's other clients.

Without this written agreement the firm cannot co-mingle risk transfer and client money in a statutory or non-statutory client account. In this instance they will need to set up a separate account to hold the risk transfer money.

If the firm does decide to co-mingle risk transfer and client money, then the money held as an agent of an insurer in a statutory or non-statutory trust account will need to be treated as client money and will be become subject to CASS requirements 5.3 to 5.6 as set out in sections 2.2 to 2.5 in this chapter.

2.1.4 Client bank accounts

The establishment of a statutory or non-statutory trust account seeks to ensure that clients' monies are protected from claims by non-insurers and creditors in the event of insolvency.

The FCA generally requires a firm to place client money in a client bank account with an approved bank. If the firm is a bank then it must not hold money in an account with itself.

A firm can hold money in either a general bank (trust) account or a specifically designated bank account in the name of the client. In the case of a general bank account the client money is held in a common pool. Clients will therefore not have a claim against a specific sum in a specific account they only have claim to the client money in general.

A firm will hold client money in a designated account for those clients that have requested that their client money be part of a specific pool of money. The account must:

a. include the word designated in its title; and
b. clients must have consented in writing to the use of the bank account.

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In this case those clients do have a claim against a specific sum in a specific pool. They will not have a claim against client money in general unless a primary pooling event occurs. This would occur if a firm becomes insolvent and there was a shortfall in client monies held.

If a primary pooling event occurs:

- client money held in each account is treated as pooled;
- the firm must distribute client money so that each client receives a sum which is rateable to its client money entitlement;
- the firm must call in any debts due, liquidate any designated investments and any letter or credit guarantee;
- a client may claim for any shortfall against the firm's own account.

A firm may operate as many client accounts as it wishes.

In selecting a bank the firm owes a duty of care to the client and if the amount of client money warrants it, it should consider opening accounts in more than one bank.

The firm should take reasonable steps to establish that the bank is appropriate for the purpose of a client bank account before opening and on a continuing basis, at least once in a financial year. However in times of market turbulence or instability, these checks may need to be made more frequently.

It should take into account:

a. need for diversification of risk;
b. the capital of the bank;
c. the amount of client money placed as a proportion of the bank's capital and deposits;
d. the credit rating of the bank; and
e. the extent of the information that is available, the level of risk in investment and loan activities undertaken by the bank.

If the bank is part of the same group as the firm, the firm must:

a. undertake a continuous review of the bank in the same way as any other to ensure its appropriateness;
b. disclose in writing to the client at outset or not less than 20 days before it begins to hold client money for that client:
    a. that it is holding or intends to hold client money with a bank in the same group;
    b. the identity of the bank concerned; and
    c. the client can choose not to have his money placed in such a bank, in which case the firm must place client money in another bank account or return the money.

The FCA guidance states that for intermediaries holding "relatively modest" amounts of client money they will be likely to be able to satisfy this requirement by selecting an authorised UK clearing bank.

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When a firm opens a client bank account they must give or have given written notice to the bank requesting that the bank acknowledge in writing that:

a. all money standing to the credit of the account is held by the firm as trustee and that the bank is not entitled to combine the account with any other account or exercise any counterclaim against money held in the account;
b. the title of the account sufficiently distinguishes the account from any account containing money that belongs to the firm and is in the form requested by the firm; and
c. if the bank does not provide acknowledgement referred to within 20 days after the firm dispatched the notice it must withdraw all money standing to the credit and deposit in another bank as soon as possible.

2.1.5 Information to be provided to the customer

Clients need to know how their money is handled so that they can decide whether they are happy with the arrangements before they place their business with a firm. The following table outlines the information that needs to be disclosed to clients and whether you need to obtain informed consent.

The FCA does not stipulate how this information should be provided to the customer only that it needs to be disclosed in writing prior to the transaction taking place. One way of meeting these requirements is by including the information in the firm's terms of business with its client. Examples of the appropriate wording can be found in the Insurance Conduct of Business chapter, ICOB Templates 1 and 2. Firms should also consider pointing out to the client the relevant parts in the terms of business so they have a satisfactory basis for securing consent.

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How do you handle client money?	Disclosure requirements	Informed client consent needed?
Holding money as an agent of an insurer.	Inform affected clients that you will hold their money as agent of an insurer and whether you hold all money this way or if there are any restrictions, e.g. you are restricted to holding premiums only.	No.
Holding money in a statutory trust client bank account.	No requirement to disclose that money is held in a statutory trust account. Disclose to consumers if you pay or do not pay interest. If you do not pay interest, then you must get the consumer's informed consent to keep the interest earned unless you are reasonably satisfied that interest earned will not exceed £20 per transaction.	Yes, for consumers where the firm is keeping interest of £20 or more.
Holding money in a non-statutory trust client bank account.	Explain to affected clients that money will be held in a non-statutory trust bank account. Disclose to consumers if you pay or do not pay interest. If you do not pay interest, then you must get the consumer's informed consent to keep the interest earned unless you are reasonably satisfied that interest earned will not exceed £20 per transaction. Explain to consumers, if applicable, that client money is segregated in designated investments & whether the firm will keep any investment returns earned.	Yes to keeping monies in a non-statutory trust account and yes for consumers where the firm is keeping interest of £20 or more.
Holding money in a designated client bank account	Ask client to confirm in writing that they consent to money being held at a particular bank in a designated client bank account.	Yes.

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How do you handle client money?	Disclosure requirements	Informed client consent needed?
Holding money in a bank outside the UK for consumers.	Inform affected clients that: • money is deposited in a client bank account outside the UK but that the client can request that their money is not held outside the UK (see CASS5.5.56R for what to do if client makes that request); • the legal & regulatory regime outside the UK is different & if the bank fails the client's money may be treated differently than if it was held in a UK bank; if applicable, the client's money may be used to set-off or counterclaim against money owed on another account of the firm.*	No.
Holding money in a non-approved bank – consumers.	Inform all affected clients (in the firm's terms of business or client agreement) that their money will not be held with an approved bank. Also: • the legal and regulatory regime outside the UK is different & if the bank fails the client's money may be treated differently than if it was held in an approved bank in the UK; if applicable, the client's money may be used to set-off or counterclaim against money owed on another account of the firm.*	No.
Passing to a third party in the UK – consumers.	Notify consumers that their money may be transferred to a third party.	No
Passing to a third party outside the UK – consumers.	Notify consumers that: • their money may be transferred to a third party outside the UK but that the client can request that their money is not passed outside the UK (see CASS 5.5.60R for what to do if a client makes that request); and the legal and regulatory regime outside the UK is different & if the third party fails the client's money may be treated differently than if it was held by a third party in the UK.	No.

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2.2 Holding client money

2.2.1 Segregating client money

1. The firm must ensure that client money is segregated from the firm's own money.
2. The firm must pay money due to a client either into a client bank account or to the client as soon as practicable. This should be no later than one business day after the money is due.
3. If an insurance transaction involves more than one firm acting for the client e.g. a chain, then each firm will need to segregate client money in a separate client money bank account.
4. Money may be segregated in a different currency from receipt. In this instance the firm will need to ensure that the amount held is adjusted at intervals of not more than 25 days into an amount equal to the existing currency. This is to allow for fluctuations in exchange rates.
5. A firm must not hold money other than client money in the trust account unless:
   - it is a minimum sum required to open the account
   - it is temporarily in the account in the case of mixed remittance(s)
   - it is interest credited to the account which exceeds the amount due as client interest
   - a prudent amount of the firm's own money to ensure client money is protected (this amount however will be deemed as client money).
6. If the client bank account is set up as a statutory trust then the firm must ensure that the total amount of money held for each client remains positive and no payment can be made out of the account until the funds have cleared.
7. In the case of automated transfers the firm must take reasonable steps to ensure that money is received directly into the client bank account or if into the firms it is transferred no later than the next business day.
8. When a firm receives money for a client, for example claims money or premium refunds, this must be paid into the client bank account directly or as soon as is practicable, but no later than the next business day.
9. If a mixed remittance is received the firm must pay the part of the amount that does not relate to client money out of the client money bank account as soon as is practicable and no later than 25 business days after clearance of funds. A mixed remittance is a payment comprising of client money and money that is not client money. This could include fees that are paid to the firm, for arranging the insurance, together with the insurance premium. It could also include fees for another service not related to the arranging, selling or administering the general insurance contract.

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10. All designated accounts will require reconciliations to be performed at no longer than 25 business day intervals and must also be completed within 10 working days of the due date. The 10-day reconciliation period includes a requirement to resolve queries with insurers.
11. Any monies that do not relate to client monies e.g. commission, must be removed from the account every 25 business working days. Removal of commission must also be in line with your TOBA with the insurer see section 2.2.4 below.
12. Money ceases to be client money if it is paid:
    - to the client;
    - to a third party on the instruction of the client;
    - into the client's own bank account; or
    - to the firm itself whether due to the firm or an excess in the client bank account.
13. When the firm draws a cheque etc to pay a client it must still class the money as client money until the cheque has been cleared.
14. The firm must ensure proper records are kept which show and explain the firm's transactions. These must be retained for 3 years after they were made.

Non-statutory trust – segregation of designated investments

1. A firm which handles client money under a non-statutory trust may segregate client money by arranging for it to be held in designated investments with a value at least equal to the money;
2. A firm may not segregate designated investments unless:
    - reasonable steps have been taken to ensure consumers are aware that the firm may operate this arrangement;
    - terms include provision for the firm to make up any shortfall that may occur in client money resource;
    - the deed provides for designated investments;
3. A firm must ensure that:
    - there is a suitable spread of investments, which are:
        a. made in accordance with an appropriate liquidity strategy;
        b. made in accordance with an appropriate credit risk policy;
    - any foreign risks are prudently managed;
    - any redemption of an investment must be paid into the client bank account;

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- where credit or risk falls below the minimum, the investment must be disposed of as soon as possible (not later than 20 business days from downgrade); and
- where an investment or insurer has more than one rating the lowest shall apply.

Table of permitted designated investments

Investment Type	Qualification
1. Negotiable debt security (including a certificate of deposit)	a. Remaining term maturity of 5 years or less; and b. The *issuer* or *investment* must have a short-term credit rating of A1 by Standard & Poor's or P1 by Moody's Investors Service, or F1 by IBCA if the instrument has a remaining term to maturity of 366 days or less or a minimum long term credit rating of AA- by Standard & Poor's or Aa3 by Moody's Investors Service or AA- by IBCA if the instrument has a term to maturity of more than 366 days.
2. A repo in relation to negotiable debt security	As for 1 above and where the credit rating of the counterparty also meets the criteria in 1.
3. Bond funds	1. An *authorised fund* or a *recognised scheme* or an investment company which is registered by the Securities and Exchange Commission of the United States of America under the Investment Companies Act 1940; and 2. A minimum credit and risk rating of Aaf and S2 respectively by Standard & Poor's or Aa or MR2 respectively by Moody's Investors Service or AA and V2 respectively by IBCA.
4. Money market fund	a. An *authorised fund* or a *recognised scheme; and* b. A minimum credit and risk rating of Aaa and MR1 respectively by Moody's Investors Service or AAAm by Standard & Poor's or AAA and V1 respectively by IBCA.
5. Derivatives	Only for the purpose of prudently managing foreign currency risks.

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2.2.2 Passing money to a third party

A third party is, for example another intermediary. There can be several firms in a chain between a client and the insurer all of whom are responsible for arranging adequate protection of that client's money. Firms should exercise appropriate skill, care and judgement in selecting third parties with whom they do business and to whom they transfer client money. This is important to ensure that a firm does not become liable for client money because the third party has failed.

If an intermediary transfers consumer client money to a third party then they must inform clients in writing that this may happen. Typical wording can be found in ICOB Templates 1 and 2.

The FCA's client money rules require intermediaries to seek confirmation that 'client money' paid to other intermediaries have been remitted to insurers. Typically, this occurs when a retail intermediary places business via a wholesale intermediary, where the wholesale intermediary does not have risk transfer with the insurer.

The guidance at CASS 5.5.82 (G)(4) reminds firms that, in order to calculate their client money resource, they will need to have systems in place to produce an accurate accounting record showing how much client money is being held by third parties at any one time.

To avoid the possibility of wholesale brokers being faced with requests in a multitude of different formats, LMBC (London Market Insurance Brokers' Committee, part of BIBA) developed a model procedure at the end of 2004, following discussions with wholesalers, retailers and the FCA. The protocol has been well received and firms have been working hard to implement.

The protocol

The retail (producing) broker will provide on a quarterly basis a report of all payments to the wholesaler (sub broker) for that quarter together with any amounts previously advised by the wholesaler as unsettled to insurers. The report, which will be produced each mid month of the quarter (e.g. end of Feb for the first quarter) in a similar format to the monthly statement, will be sent with that statement, to the wholesaler's accounts department for their acknowledgement and return by the 20th of the following month (e.g. March 20th) advising:

a) monies paid to insurers where the premium has been settled in full or where the wholesale broker has risk transfer for that item. Details will not be required at the insurer level where a subscription market is used.

b) monies not paid to insurers and, where over 90 days from settlement to the wholesaler, the reasons for their continuing to be outstanding.

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Each retail broker will consolidate these returns to provide an overall figure for inclusion in their client money return to the FCA.

If the retail intermediary is producing the report at the end of each calendar quarter, he will need to seek the information from the wholesale intermediary as at the end of the second month of the quarter. This will mean therefore that the wholesale intermediary's report will reflect the last month of the previous quarter plus the first two months of the current quarter. So, for example, the second quarter would include April, May plus March.

The next table shows how the monies should be tracked, assuming a new relationship starting in March.

	Paid to wholesaler	**Confirmed as paid by wholesaler to insurer**	**Balance of client money held by wholesaler and figure to be used by retail intermediary in client money calculation**
March	£5,000		£5,000
April	£10,000		£15,000
May	£8,000		£23,000
June	£12,000	£18,000	£17,000
July	£10,000		£27,000
August	£15,000		£42,000
September	£15,000	£40,000	£17,000
October	£10,000		£27,000

N.B.

1) The figures above do not take commissions and/or fees into account.
2) The client money calculation is performed at least every 25 business days.

The retail intermediary will need to plot separately client money at each wholesaler (where risk transfer does not apply) and then produce a separate summary of the total monies held by wholesalers without risk transfer, in a similar manner to that shown above.

It would be prudent for the Terms of Business Agreement between a wholesaler and retailer to reflect that both parties agree either to abide by the BIBA Protocol, or agree upon suitable terms to enable the retailer to comply with his obligations under the client money rules.

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2.2.3 Discharging your fiduciary duty

A firm holding client money under a statutory or non-statutory arrangement is held by law to have a fiduciary duty to it clients when holding and administering their money. A firm may be accountable to its clients if it is demonstrated that it has not correctly discharged its fiduciary duty.

Firms are responsible for their clients' money until it reaches the insurer or someone who receives that money as agent of an insurer. Once an insurer has received the money then the firm has discharged its fiduciary duty. However if a firm pays a premium onto a third party (who does not have risk transfer) then it cannot discharge its fiduciary duty until the third party confirms that the insurer has received the premium.

Discharging fiduciary duty is less complex when repaying premiums to clients. The firm's fiduciary duty does not resume as soon as the money leaves the insurer but once the money is received by the firm. It will then be discharged when the money has been paid to the client. However the firm should remember that if the money is paid to the client by cheque then the fiduciary duty is not discharged until the client has presented the cheque and it has cleared.

2.2.4 Withdrawing commission and fees

A firm can only withdraw commission or fees from its client bank account when:

- it has received payment from the client (or a premium finance company on the client's behalf);
- the payment has cleared; and
- the commission is paid in accordance with terms of business with its client and insurer.

If the firm receives payment from a client in instalments it may only remove the commission payable on each instalment as it is earned by the firm.

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2.2.5 Controlling client money

Controlling client assets or liabilities would include:

- having access to the client's bank account or building society including taking direct debits in the firm's favour; and
- holding a client's credit card details including debiting money from a credit card.

If the firm does control, as well as hold, client money it must have written authority from the client to control that client's assets and liabilities. Firms should also:

- have an up to date list of clients who have given them authority with details of any special conditions placed by the client;
- record all transactions entered into using the client's authority;
- have appropriate internal controls in place to ensure that:
  - the client's money is controlled according to the written agreement;
  - instructions are given and recorded according to the written agreement;
  - where a firm holds a client's passbook or similar documents it safeguards these against theft, fraud or misuse and it keeps a record of what it holds.

2.3 Client money calculation

The purpose of this calculation is to ensure that the amount of client money segregated into the client bank account (and the value of any segregated designated investments held under a non-statutory trust), together with the value of the client money held by third parties, is sufficient to meet the firm's obligations to its clients.

In performing the client money calculation the firm must use its own internal records to determine the **client money resource** and the **client money requirement** and then compare them. Having done so:

(1) if the client money requirement **is greater than** the client money resource the firm must top up the resource – i.e. pay money into the client bank account; and

(2) if the client money requirement **is less than** the client money resource the firm must normally withdraw the excess from the client bank account.

The calculation is to be undertaken as often as is necessary to ensure the accuracy of the firm's records and **at least every 25 business days**. Any top ups or withdrawals need to be made by close of business on the day that the calculation was performed.

The firm must then ensure that any shortfall is paid into the client bank account by close of business on the day the calculation is performed.

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Within 10 days of performing the calculation the firm must reconcile its own records with bank statements.

There are 2 methods for performing the client money calculation – accruals or client balance method. A firm must keep a record of which method it uses to calculate its client money requirement (CASS 5.5.67R or CASS 5.5.68R), see below for details. Only one method can be used in each accounting period.

If a firm operates both a statutory and non-statutory bank account it must use the same method for both types of account.

The accruals method aggregates the amounts of client money recorded on a firm's business ledgers and includes insurer debtors and creditors. The client balance method uses individual client balances to calculate the client money requirement.

2.3.1 <u>Client money calculation using the accruals method</u>

First calculate the client money resource which is:

1. the aggregate of balances on the firm's client money bank ledgers as at close of business on the previous business day; PLUS
2. any money held at third parties; PLUS
3. any insurance debtors (not including pre-funded items).

Next calculate the client money requirement which is:

4. the sum of all insurance creditors shown in the firm's ledgers as sums owed by the firm to clients, insurers and other persons; PLUS
5. unearned commission of the firm; PLUS
6. money held at third parties; PLUS
7. if applicable, money held at appointed representatives, field representatives or other agents.

Then compare the client money requirement and the client money resource. If the client money requirement is greater than the client money resource, a firm must pay its own money into the client bank account to make good the shortfall. If the client money requirement is less than the client money resource, a firm must withdraw the surplus from the client bank account. Money must be paid into or removed from the client money account on the same day the calculation is done. If a firm cannot make good the shortfall, it must notify the FCA immediately.

If client money is held in a non-statutory trust then when the firm calculates the client money resource it will also need to add in, if applicable any designated investments valued on a prudent and consistent basis; and the amount of any letter of credit or unconditional guarantee.

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An example of the client money calculation together with notes on the component parts of the client money calculation can be found in the template section at the end of this chapter.

2.3.2 Client money calculation using the client money balance method

First calculate the client money resource which is:

1. the aggregate of balances on the firm's client money bank ledgers as at close of business on the previous business day; PLUS
2. any money held at third parties; PLUS
3. if applicable, any designated investments valued on a prudent and consistent basis (non-statutory trust only)

Next calculate the client money requirement which is:

4. the sum of all (positive) individual client balances.

To calculate the individual client balance for each client, add:

A. the amount paid by a client to the firm; PLUS
B. the amount due to a client; PLUS
C. the amount of any interest or investment returns due to a client.

Then deduct:

D. the amount paid to an insurer for the benefit of a client; PLUS
E. the amount paid by the firm to the client.

The total ((A+B+C) minus (D+E)) is the individual client balance.

Calculating individual client balances

A. The amount paid by a client to the firm.
This should include any amounts that the firm's business ledgers show the client has paid to the firm for the client's own benefit. For example, any premiums which the firm holds before payment to an insurer. This could include money received from or held by appointed representatives, field representatives or other agents. It does not include fees or commission 'due and payable' to the firm.

B. The amount due to a client.
This includes any amounts that the firm's business ledgers show are due to the client. For example, premium refunds or claim settlements that have been received from the insurer but not yet paid to the client.

C. The amount of any interest or investment returns due to a client.
If a firm has agreed to pay interest or investment returns to its clients, it should include these amounts in the calculation of the individual client balance.

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D. The amount paid to an insurer for the benefit of a client.
This includes any premium payments paid to insurers or third parties on the client's behalf. It could also include any commission that has accrued on the transaction that the firm has not yet taken (a firm may have already taken commission which was earned before the individual client balance calculation was done).

E. The amount paid by the firm to the client.
This includes any claims money or premium refunds that the firm's business ledger show has been paid to the client.

An example of the client money calculation together with notes on the component parts of the client money calculation can be found in the template section at the end of this chapter.

2.3.3 Notifying and reporting to the FCA

A firm must notify the FCA immediately if:

- it is unable to or does not perform the client money calculation; or
- if it is unable to make good a shortfall in the client money account by close of business in the day the calculation is performed; or
- if a firm passes money to a third party and that third party fails; it must then let the FCA know if it intends to make good the shortfall.

2.4 Appointed representatives

2.4.1 Risk transfer

If a firm holds client money as an agent of an insurer and has appointed representatives then the firm should ensure that its risk transfer agreement with insurers covers the appointed representatives as well as the principal firm.

If the insurers are unwilling to include appointed representatives then the firm has 2 options:

- vary its permission to hold client money so that it allows for the fact that appointed representatives will hold client money;
- change the way appointed representatives do business so that they do not hold client money, for example, clients' cheques are made payable to the principal or insurer directly.

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2.4.2 Segregating client money held by appointed representatives

The same principles apply regarding protection to client's money when it is received and held by an appointed representative. Firms need to make arrangements with their appointed representatives in one of two ways:

- immediate segregation; or
- periodic segregation.

Firms need to record which method they intend to use so that they have an audit trial.

Client money held by appointed representatives is the responsibility of the principal firm and therefore it must be able to account for any client money held by the appointed representatives. If a shortfall arises then the firm will be liable to make good that shortfall.

Immediate segregation

Money received by the appointed representatives must be paid:

- into the principal's client money bank account as soon as practical and no later than the next business day; or
- to the principal directly or into a specified business address within three business days of receiving the money.

Money received by the appointed representative from the principal for clients must be paid to the client as soon as possible and no later than the next business day.

A firm must ensure that client money held by appointed representatives is clearly identifiable from any other money held.

Periodic segregation

A firm may allow appointed representatives to pass client money to them on a less regular basis. However the appointed representative must segregate client money into a non-statutory or statutory trust account. In addition the firm must hold in a segregated client bank £1 for £1 that which is held in the appointed representative's client bank account. The firm can estimate the client money which it reasonably estimates the appointed representative is likely to receive and hold before passing to the firm over a given time period, for example one month. This estimated amount must be reconciled within 10 business days of the end of the time period. Once the reconciliation has been completed the firm must make the necessary adjustments to its client bank account to ensure there is neither a deficit nor excess. The time period is flexible but should be reasonable based on the nature and frequency of the business completed by the appointed representative.

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Periodic segregation only applies to client money received by the appointed representative from a client. Client money being repaid to the client must be repaid no later than the next business day.

2.4.3 Monitoring appointed representatives

Firms must have adequate and appropriate systems and controls in place to monitor appointed representative's compliance with client money rules. Appropriate records should be maintained to show what:

- procedures are in place to ensure client money is received, segregated and paid by appointed representatives in line with the client money rules;
- training has been given to appointed representatives for handling client money; and
- monitoring is done to ensure appointed representatives handle client money according to the firm's own procedures.

2.5 Client money audit

A client money audit is required for firms who:

- hold client money in a non-statutory trust; or
- have held more than £30,000.00 in a statutory trust at any time, even if only for one day, in the reporting period.

The auditor does not need to send the report to the FCA but the FCA may request to see it. The report needs to be completed within 53 weeks of the last report, or date authorised if this is the first report. The auditor needs to send the report to the firm within 4 months of the end of the relevant reporting period.

2.5.1 <u>What must be covered in a client money audit report?</u>

The client money audit report covers the systems and controls a firm operates to handle client money. It is not an audit of the actual client accounts.

The auditor's report should cover:

- the firm has maintained systems adequate to enable to comply with CASS 5; and
- the firm has been compliant with the rules in CASS 5 during the reporting period.

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2.6 Record keeping

The table below identifies the record keeping requirements.

Information	How long does it need to be kept?
Written agreement to act as agent of an insurer.	Current. 6 years from date of termination
Non-statutory trust deed.	Current
Written confirmation from auditors that systems and controls are in place to operate a non-statutory trust.	Current
Written acknowledgement from the bank that trust accounts have been set up in according to the firm's notification.	Current
Record of whether the firm does the client money calculation using the accrual or client balance method	Current
Record of transactions and commitments for client money, for example, bank statements, internal accounting records, client money calculations etc.	Current. 3 years from the date the record was made
Copy of client money audit report	Up to 6 years of the end of the period cover
Record of whether the appointed representatives will segregate client money immediately or periodically	Current
Up to date list of client authorities to control client money for each client	Current
Record of transactions using the client's authority	Current
Written procedures for carrying out authority	Current
Record of clients' documents/assets held by the firm, for whom and when they were returned	3 years after the document/asset was returned to the client

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The FCA considers it to be best practice for firms to maintain a central file including:

- client assets and money policy and procedure documentation;
- letters of acknowledgement of trust arrangements;
- a copy of all record-keeping requirements;
- a copy of the most recent regulatory audit report (together with steps to address breaches if any);
- the breaches register for the current period; and
- the relevant management information including a copy of the client money calculation records.

2.7 Credit write-backs

Credit write-back is an accounting transaction (the reduction or elimination of a creditor balance) which may or may not result in a cash transfer out of client accounts. From an accounting perspective, firms should always consider the relevant accounting standards before undertaking a credit write-back.

Where credit write-back result in a cash transfer, this tends to represent the net overpayments to a broker and unclaimed balances held on behalf of customers, insurers, reinsurers or third parties. For example these can be:

- bad debts which have previously been written off and a subsequent recovery made;
- long-standing legacy balances created by data transfers or business acquisitions where the audit trail has been lost; or
- identifiable overpayments.

Under FCA regulation firms are required to ensure that client money rules and systems and control requirements pertaining to client money are followed. Where a firm has significant uncorrelated or unmatched cash positions, the implication could be that the firm's systems and controls are ineffective.

Under CASS rules, firms must adhere to strict rules regarding segregation and operation of client money accounts. These are there to ensure that client money is protected and held correctly. The legal status of a client money account is that of a formal trust and the consequences of this are that the firm is deemed by law to have a fiduciary duty to its clients. As these are formal trust accounts, a firm's liability to restore client money wrongly transferred to its own account is strict and is not mitigated by the transfer being done in good faith. Therefore any decision to transfer money must be based on persuasive evidence, in compliance with relevant rules, guidance and trust law.

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The exemption in the Limitation Act 1980 which states that "the firm's liability to an unsecured creditor ceases after the expiry of six years, does not apply to trust accounts". Therefore any credit write-back taken from a client money trust account remains in scope for legal action irrespective of the period of time elapsed. This will mean that a firm will be liable for a breach of trust if it transfer money from client account to its own account when it consider is properly due but it then turns out it is not. This could result in the firm being sued by the creditor and also regulatory censure. This is consistent with the FCA's emphasis on senior management responsibilities.

There are however circumstances where credit write-backs might reasonably arise and be taken. Provided the firm's directors are able to reasonably conclude, that balances held in the client money account have arisen through incorrect or incomplete accounting then the credit write back in itself is a correction and should be made. Incomplete accounting entries are likely to relate to settlement transactions such as forex (foreign exchange market) differences, ancillary charges and immaterial settlement differences. However the FCA would not normally expect this to result in a transfer out of the client account.

There may, however, be balances in the client account resulting from longstanding legacy items created by data transfers or business acquisitions which do not permit firmly evidenced conclusions to be drawn as to their nature. Where this is the case the Directors should assess whether there is sufficient persuasive evidence available to allow a credit write-back to be taken which may result in a transfer of monies out of the client account.

Evidential Considerations

In considering whether to take a credit write-back resulting in a transfer from the client account firms should consider the following:

- the quality of the firm's systems and controls (for the period covered by the proposed write-back;
- the degree of due diligence reasonably capable of being carried out to identify the monies and their potential owners;
- whether leaving the monies in the client account has the potential to impair the trust status; and
- the extent to which the monies relate to legacy or pre-regulation transactions and balances.

If a firm decides to take a credit write-back then it needs to clearly document the process it has followed to ensure the above has been considered and ensure that the director's have signed off the course of action taken.

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2.8 Changes to Consumer Credit Licensing

On 1 April 2014, the FCA assumed responsibility for the regulation of consumer credit licences. This affects firms who currently have a consumer credit licence who will need to inform the FCA that they require an interim permission to carry on activities following 1 April 2014. Interim permission is valid until firms either need to make a change to the type of activity undertaken, or are required to apply for full authorisation. The last day for registration with the FCA is 31 March 2014. The only exception to this is for firms whose OFT licence commences on or after 18 March 2014. These firms can submit their register to the FCA up to 14 April 2014 (although they will not have permission for the period between 1 April 2014 and their date of registration).

Firms can apply to be fully authorised by the FCA from 1 April 2014. There will be different standards for OFT consumer credit licensees that carry out specific activities.

The two main objectives of the regime are to protect consumers and deliver a proportionate risk-based approach to the supervision of firms. Resources will be focused on risks that the FCA deems to have the potential to cause the most harm to consumers.

Supervision will be based on a two-tier approach that differentiates between higher-risk and lower-risk consumer credit activities. Lower risk activities such as consumer lending with no interest or charges will be subject to limited, reactive response to problems that have already materialised. Higher risk activities (personal loans, higher purchase etc.) will be subject to proactive, targeted supervision in accordance with the risk profile of the firm.

Applying for Authorisation

Current FCA firms will need to apply for a variation to their permissions. New firms will need to apply to be directly authorised.

All firms with interim permission should apply during the set application period allocated by the FCA. The periods will run from 1 October 2014 until 31 March 2016 and last for three months. Firms must make their applications before the end of the application period in order to retain their interim permissions. Firms considered to pose a higher risk will be invited to apply first.

If you do not have a consumer credit licence and interim permission from the FCA by 31 March 2014 you will be able to apply for authorisation at any point from 1 April 2014. However firms may not carry out any credit-related regulated activities until the application is approved. Carrying on a regulated consumer credit activity in the absence of the appropriate permission could be a criminal offence.

Once the application period has begun firms can apply through the online application system, Connect.

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A fee will be charged based on the consumer credit activities undertaken by the firm. The FCA will make a decision within six months of receiving a completed application. Incomplete applications will cause a delay and a decision will be made within 12 months.

Appointed Representatives

Under the new regime, a business may be exempt from needing to be authorised if it is an appointed representative. A business cannot be an appointed representative for a regulated activity if:

- it does not have a contract with a principal firm which allows or requires it to carry on business;
- its principal firm has not accepted responsibility in writing for the regulated activity the business undertakes;
- the firm that the business wants to act as its principal only holds an interim permission for the relevant credit activity;
- it operates a credit reference agency;
- it provides credit (unless the credit is free of interest and any other charges); and
- it is authorised for another activity. However, the exceptions to this are:
  - a firm with an interim permission for a credit activity may also be an appointed representative for a FSMA regulated activity that is not covered by its interim permission; and
  - a firm with a limited permission for certain credit activities will be able to be an appointed representative for other regulated activities. e.g. a motor dealer with a limited permission to carry on credit broking can also be an appointed representative insurance intermediary

Financial Promotions

The FCA will have all of the disciplinary tools currently available to them for instances where a promotion for consumer credit does not meet requirements. Therefore, where they see a non-compliant promotion, they will contact the firm, asking them to amend or withdraw it. For repeat breaches, they may also ask to be provided with a signed statement to the existence of effective governance for the approval of compliant financial promotions. Where the firm does not co-operate, the FCA can issue a supervisory notice banning the promotion and in the worst cases, take enforcement action. When deciding whether to take action, they will apply the current approach of proceeding with cases that pose the greatest risk to consumers and our objectives.

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Prudential Standards

The FCA is proposing more stringent client asset standards for debt management companies such as annual audits of client money. Responsibility for client money must be assigned to an approved person and debt management companies will be subject to prudential standards.

It is proposed that the requirement for these firms will be the higher of:

- a fixed minimum amount of £5,000, or
- a percentage of a volume-based measure of 0.25% of the total value of ‘relevant debts under management’ outstanding

These protections are a significant increase in regulation.

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