Adequate Client Money Arrangements

For General Insurance Intermediaries

On 30 September the FCA issued a Dear CEO letter for insurance intermediaries setting out their concerns over the handling of client money. Despite being relatively concise, the letter covered a huge number of topics at quite a high level.

Behind a number of the FCA statements are some expectations which, if not met, could mean that your firm is not complying with the CASS 5 rules in the way the FCA expects. Here are the key messages from the Dear CEO letter and our interpretation of what they mean in practice. The application of the letter will be different for each firm and our comments are intended to be a guide only.

Dear CEO comment	What does this mean in practice?	What resources are available?
You should discuss the contents of this letter with your Board	You should produce a matrix of the items mentioned in the Dear CEO letter and ensure that the firm has addressed each of the issues. This should be a formal document that is approved at Board level. If the Board is unclear about whether the firm is compliant, they need to seek help from their team or from external experts. If issues need to be addressed, there should be a clear plan of action and timetable for dealing with them. Depending on their severity, any deficiencies should be reported to the FCA in a timely manner. The Dear CEO matrix and the discussion should form part of the minutes of that Board meeting.	Dear CEO letter
We will continue to conduct assessments of firms' client money arrangements	There is a continual program of calls, meetings and investigations carried out by the FCA in respect of client money. You can expect this to continue and possibly increase due to the elevated risk.	N/A
…review the annual independent external auditors' client assets reports	The FCA does not automatically receive the client asset audit report. You report who the auditor is and the status of the audit in your Gabriel submission. An Adverse report will result in communication from the FCA. A Clean report is seen as higher risk as the FCA expects some level of breaches due to the difficulty in achieving absolute compliance with the rules. Audit firms without specialist teams are seen as higher risk as they may not have the experience to carry out the audit in line with the required standards. You must make sure your auditor is competent and carries out the audit in accordance with the required client asset assurance standard. You should not be overly worried about individual minor breaches in the audit report but should be worried if you see breaches being repeated every year; you should be looking for continual improvement.	Client asset assurance standard (available on FRC website)
We will expect you to be prepared to explain the actions taken in response to this letter.	You need store your assessment of compliance with the Dear CEO letter for future reference. If you don't have evidence that you have properly considered the contents of the FCA's letter that could be seen as poor regulatory behaviour.	Dear CEO letter

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You are reminded that (in accordance with SUP 15.3 and Principle 11) you are required to notify us of any material issues or concerns your firm identifies with its client money arrangement	Any material issue or concern that poses a risk to client money should be immediately reported to the FCA together with a remedial plan. Examples might be: • Missed client money reconciliation • Deficit to client money that has not been remedied by the close of the same business day • Systemic error in the historic calculations • Adverse client money audit report • No client money audit report.	SUP 15.3 and Principle 11
Application of client money rules to firm's business model	You need to review the CASS 5 rules carefully and ensure that these are understood and that, if applicable, the firm has relevant controls in place. This should be documented, for example in a risk matrix which sets out the rules, their applicability and the controls. You need to demonstrate the conclusion that the controls as documented are appropriate and are working. Once completed, this should be reviewed on a regular basis, and updated if necessary.	The CASS 5 rules are set out in the FCA handbook.
Holding client money under a non-statutory trust can potentially expose client money to additional credit risk, as it enables the firm to advance credit to clients and insurers from the non-statutory trust.	In order to link debtors (therefore giving visibility to credit risk) to the client money reconciliation it is preferable to perform your client money calculation using the accruals method if you are using a non-statutory trust You should be able to generate a funding report showing the advances of credit made. You should be reviewing this at least monthly to ensure any exposure to bad debt is minimal. You should have a clear bad debt policy. You should review bad debts every month and document your conclusions. You should carry out the client by client reconciliation in accordance with CASS 5.5.69. Do not let anyone tell you this is not expected by the FCA. This needs to be done on at least an annual basis. If you are still unable to perform this reconciliation, this should become a priority. Of all the controls you can have around the client money reconciliation this is the most effective.	Templates from the FCA Client Money Guide (PKF accruals method template available on PKF website) CASS 5.5.69 / PKF example client by client calculation (available on PKF website)
If your firm is operating a non-statutory trust, you must ensure there is a properly executed trust deed in place which complies with the additional conditions for using the non-statutory trust set out in the client money rules	There is a standard NST trust deed designed by BIBA – use this. Execute the trust as a deed.	PKF Article: Executing NST deeds (Broking Business, Summer 2019) and BIBA website
If your firm operates risk transfer arrangements, it should ensure that its contractual agreements and operational arrangements with insurers are robust, so that insurance cover for policyholders is not put into doubt.	You need a TOBA register which identifies all the key terms required to ensure you fully understand how the TOBA impacts on client money or risk transfer status. You need to read all TOBAs in detail as they are not sometimes not clear and can be ambiguous. If in doubt you should get the status confirmed in writing by your insurers. Every TOBA must be signed by appropriate people and a signed copy must be retained in a central repository. There can be no exceptions to the above, If there are, these could result in ambiguity around the status of client money.	PKF TOBA register template (available on PKF website)
Your firm should have adequate governance to identify material risks to your client money arrangements and ensure monitoring of those arrangements. This includes appropriate oversight by the senior manager with responsibility for client money. It should also include monitoring and testing by Compliance and/or Internal Audit where relevant, or using external resource as needed, aligned to the risks identified within the business.	You need to nominate a Client Money Manager. The controls referred to in the risk matrix above should be validated on a regular basis. The Board should receive sufficient information to allow them to understand the basis on which the firm manages its client money risk. This might mean there is regular discussion about client money at the Board or appropriate committee and evidence is presented to demonstrate that the firm is compliant. In larger firms there is an expectation that there is a separate committee such as a CASS oversight committee. In larger firms there is an expectation that the compliance function will regulatory test the CASS controls and that the internal audit function will also review the CASS control framework. A client asset audit is not in itself a tool that management should use to satisfy themselves of compliance with the rules.	CASS 5.5.4 and Principle 10

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Your firm is required to carry out periodic due diligence reviews on third parties holding client money. If your firm deposits client money with any institution in the EEA, you should review your due diligence to ensure that client money will not be subject to increased risk due to any changes arising from the end of the EU withdrawal transition period, and manage the risks accordingly. Your firm should make sure that existing safeguards and protections for client money, especially in the event of insolvency, remain effective from the end of the transition period.	We would envisage that all EU business will be handled by an EU regulated broker from 1 January 2021. Where your funds are deposited at an EEA institution such as a bank you need to understand any changes that may arise from the UK leaving the EEA. The change may be to do with your ability access those funds or carry out business in the EEA as well as say a change in the financial strength of that institution.	5.5.42 LIIBA / BIBA Brexit guidance
The firm should have adequate systems and controls to monitor the activities carried out by Appointed Representatives on its behalf. Your firm must have procedures in place to help ensure that client money is handled properly and accurate records are maintained.	There are very specific rules around how client money is handled by appointed representatives. This is an area in which the FCA sees significant shortfalls - hence the level of detail in this section. You must choose one of the two prescribed methods. There is no alternative way.	CASS 5.5.19 / 5.5.23
In particular, the client money calculations help verify the accuracy of the balances held for clients and confirm that they are held in client accounts.	Client money calculations are a core component of the CASS 5 rules and are frequently done incorrectly. Some of the pitfalls we see are; • Firms not using the FCA recommended templates – do not use anything else • Mathematical errors • No evidence of review • Data missing - old data from legacy systems not included / unearned commission omitted • Data errors – items from accounting records incorrectly excluded or included in the calculation • Calculations not done on the day after the period end • Calculations not validated e.g. failure to check whether the answer represents the commission actually received in the period, or assumption that the automatically calculated unearned commission figures are correct and not checked. • Surplus not transferred immediately • Calculations do not consider commission that cannot be extracted because of restriction in insurer TOBAs.	Client money guide / CASS 5.5.62
If your firm uses the accruals method, we expect it to value any client money advanced to clients or insurers from the non-statutory trust prudently and consistently, so that its books and records remain accurate.	See point above re accruals method.	
Where bad debt is written off and a deficit is identified, the firm will need to top up the client money account with its own funds.	Generally, only a bad debt on a funded item will cause a deficit to arise. A bad debt on an uncollected premium that has not been funded to the insurer will result in an adjustment to both insurance debtors and unearned commission.	CASS 5.5.65
Your firm should maintain adequate arrangements to assure itself of the completeness and accuracy of the acknowledgement letters, conducting reviews where necessary.	There are very specific requirements of the FCA in respect of the bank letters. They should contain the exact wording that is set out in the CASS 5 rules. If they do not then you should contact the bank and get the letter reissued.	CASS 5.5.49

Contact us

PKF has been a trusted adviser to the UK insurance sector for over 100 years and has one of the largest and most experienced specialist teams of insurance industry experts in the accountancy profession.

We complete over 100 CASS 5 audits every year for a range of intermediaries, including those in the Top 50. This gives us an unparalleled insight into the most common client money-related issues and pitfalls, the importance that the FCA will place on them, and the most effective strategies for mitigating against the potential repercussions.

We also provide a wide range of consultancy services in this area, including:

- **Supporting firms** when they identify client money problems
- **Client Money assurance and health checks** for firms that are not confident of the client money audit opinion they have been given – either as a one-off project or as ongoing assurance on Client Money systems and controls
- **Client Money transformation projects** – including supporting the rebuilding of the Client Money environment
- **Giving advice on legacy issues**
- **Transaction support services** – from integrating CASS 5 into due diligence for funding and acquisitions to assisting integration planning and Client Money remedial plans
- **Providing education and training** – targeted at either a senior level (CASS governance) or operational (finance/CASS ops)
- **Acting as a sounding board** to the Client Money manager or team.

If any of the issues we have discussed are causing you concern or you would like to discuss then please get in touch with our broking team.

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