



Financial Services Authority

# Client Money & Asset report

January 2010



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# 1 Executive summary

This report has the following key messages to firms:

- **Customers must have confidence that their money and assets are safe and will be returned within a reasonable timeframe in the event a firm becomes insolvent.**
- **Customers must have confidence that firms holding their money and assets have strong management oversight and control over their business.**
- **We consider the protection of client money and assets to be a fundamentally important part of regulation and, as a result of the more difficult economic climate and our own findings we are intensifying our supervision in this area.**
- **We have taken steps to rectify procedures at firms that have fallen short of our requirements. Targeted supervision and regulatory intervention will continue throughout 2010.**

- 1.1 We highlighted the more difficult market conditions and an increased risk of intermediary firms entering into insolvency in our 2009 Financial Risk Outlook.<sup>1</sup> Following this assessment and in response to the current economic climate we created a CASS Risk team in March 2009. They are a team of specialist supervisors who are tasked with the measurement and mitigation of risks to client money and assets.
- 1.2 We published a Dear Compliance Officer (CO) letter<sup>2</sup> in March 2009. In that letter we explained the obligations a firm has to protect their clients' money and assets and that we would follow-up with visits to firms to assess their compliance with the Client Asset Sourcebook (CASS).
- 1.3 In the last six months we have undertaken visits to a range of investment and insurance broker firms, to review their compliance with CASS. These visits identified a number of failings. We believe failings identified at these firms are very likely to be indicative of weaknesses in other firms doing similar business.

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1 [http://www.fsa.gov.uk/pubs/plan/financial\\_risk\\_outlook\\_2009.pdf](http://www.fsa.gov.uk/pubs/plan/financial_risk_outlook_2009.pdf)

2 [http://www.fsa.gov.uk/pubs/other/letter\\_client\\_assets.pdf](http://www.fsa.gov.uk/pubs/other/letter_client_assets.pdf)

- 1.4 Weak areas we discovered include poor management oversight and control; lack of establishment of trust status for segregated accounts; unclear arrangements for the segregation and diversification of client money and incomplete or inaccurate records, accounts and reconciliations.
- 1.5 These failings have led to the following regulatory actions:
- skilled person reports
  - two Enforcement Referrals and a number of other firms under active consideration for Enforcement Referrals
  - private warnings
  - an industry letter notifying Contract for Difference (CFD) /spread-betting firms that they should ensure retail client balances are segregated
  - letters of direction requiring firms to safeguard money
  - letter to Board Directors, reminding them of their regulatory and fiduciary duty to segregate client money
  - a freeze on assets
  - a ban on the use of Appointed Representatives
  - a ban on taking on new business
- 1.6 The findings from these visits and other risk mitigation work we have conducted during 2009 shows that compliance with CASS across the industry is poor. We have initiated remedial work at a number of firms and expect this number to increase during 2010. We shall put in place arrangements to raise the level of awareness across the market on compliance with CASS.
- 1.7 The protection of client money and assets will continue to be a regulatory priority in 2010. Specialist visits will continue throughout the coming year. We anticipate increasing the enforcement resources that we devote to client asset cases and our investigations will consider the conduct and competence of Significant Influence Function holders (SIFs) as well as the firms themselves. Other areas of focus will include the form and content of CASS audit reports, firms' use of title transfer arrangements, the application of unallocated excess cash in segregated accounts (buffers), the use of 'alternative approaches'<sup>3</sup> to client money segregation, and work with the Treasury on their resolution proposals for investment firms.<sup>4</sup>
- 1.8 This report is set out into two sections. The first section sets out the findings from our visits to investment firms and insurance brokers. Section 2 outlines our future work programme.

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3 CASS 7.4.14G and CASS 7.4.15R

4 [http://www.hm-treasury.gov.uk/d/consult\\_investmentbank110509.pdf](http://www.hm-treasury.gov.uk/d/consult_investmentbank110509.pdf)

1.9 The table below summarises the findings from our visits.

**Key findings:**

- ✓ There were a few instances where robust governance arrangements and detailed management information helped to provide assurance to senior management that the firm's CASS risks were adequately evaluated, monitored and mitigated.
- ✗ Inadequate senior management oversight and control was often the underlying cause of more serious CASS breaches.
- ✗ Overly complex processes around client money and assets led to an increased risk of human error.
- ✗ Operational and systems changes during transitional periods posed a high risk of segregation errors.

**INVESTMENT FIRMS:**

*Good practice:*

- In a few instances, firms were able to quickly produce trust letters, reconciliations, calculations and error/breaches logs.
- In a few cases, firms had robust oversight arrangements in place over CASS systems and procedures, including where applicable those of service providers such as Third Party Administrators (TPAs).

*Poor practice:*

- Some firms could not locate trust acknowledgement letters from banks or other third parties for each of their client money accounts.
- Many firms had not checked whether the acknowledgement letters contained the required details.
- Due diligence concerning the selection and use of banks was often inadequate or poorly documented.
- Client money and assets reconciliations were delayed or completely overlooked.
- Inappropriately claiming ownership rights over client money.
- There were issues with TPAs around errors not being rectified promptly.

## **INSURANCE BROKERS:**

### *Good practice:*

- In a few instances, firms regularly updated policies and procedures in line with regulatory developments.

### *Poor practice:*

- Unclear allocation of duties by senior management led to confusion between staff or a lack of accountability.
- Client money processes had in some cases been delegated too far, leading to a lack of senior level responsibility and accountability.
- There were inconsistencies between Terms of Business Arrangements (TOBAs) and client money calculations.
- Review and sign-off processes surrounding client money calculations and reconciliations were not always evidenced.
- Some firms had failed to perform sufficient due diligence to assess client money risks arising from an acquisition.
- Whilst we allow Non-statutory trust bank accounts to be used to extend credit for funding insurers' and clients' normal insurance transactions, client money may not be utilised for other purposes.
- Unallocated cash and legacy balances were not being reduced promptly enough.
- Firms over-relied on CASS audit reports rather than perform their own assurance checks.



# 2 Firm visits – Investment firms

- 2.1.1 Our visits evidenced good practice where firms that carry out investment business were able to quickly produce trust letters, reconciliations, calculations and error/breaches logs. Where applicable, the majority of the investment firms that we visited also had robust arrangements in place for oversight of their Third Party Administrators (TPAs). However we identified the following areas for improvement.

## **Management oversight and control**

- 2.1.2 **Our key finding was that inadequate senior management oversight and control is often the underlying cause of more serious CASS breaches.**
- 2.1.3 During our visits, we found that the risk of non-compliance was higher when senior management had not put in place adequate CASS governance arrangements or had not communicated these arrangements to staff. We found that the risk of non-compliance was higher during periods of change. For example, following internal restructuring or acquisitions, where a firm transferred to a new reporting and reconciliation system, or when it merged different systems.
- 2.1.4 **Robust governance arrangements and detailed management information help to provide assurance to senior management that the firm’s CASS risks are adequately evaluated, monitored and mitigated through policies and procedures. They help to ensure that robust controls are both understood and implemented.**

## **Acknowledgments of trust status**

- 2.1.5 Some firms could not locate trust acknowledgements for each of the firms’ client money accounts or produce evidence that the trust status extended to the deposit or money market facilities they used.
- 2.1.6 The majority of firms we visited had not checked whether the acknowledgement letters contained the required details and confirmations. Examples of this included misquoting the account name and number, omitting a signature on behalf of the

bank or not including any information on the identity of the signatory. Such details can be vital in establishing the trust status of the client money account.

- 2.1.7 CASS<sup>5</sup> requires firms to obtain a letter as a written acknowledgement of trust from the banks that they use to hold client money and sets out the minimum detail that must be contained in this letter. For example, the letter should clarify that the title of the account distinguishes it from any other accounts belonging to the firm and confirm that the bank may not exercise any lien or set off in respect of balances in the client money account. These requirements extend to other third parties that hold client money (e.g. intermediate brokers).
- 2.1.8 Having this documentation in place is an important requirement. **Letters confirming the trust status of the account acknowledge that a statutory client money trust has been established for the proper segregation of client money. As such, we expect firms to be able to demonstrate to us that they have the appropriate trust documentation in place.**

### **Due diligence of banks**

- 2.1.9 Due diligence and review of banks, credit institutions or qualifying money market funds<sup>6</sup> that were used to hold client money was often limited. Typically firms just relied on the credit rating of the banks used. The majority of firms we visited failed adequately to document the rationale for choosing to use a particular bank. We found a lack of consideration for the need to diversify risk, where firms used only one bank or group to hold their client money.
- 2.1.10 **A firm, on receiving any client money, must promptly place this money into one or more accounts opened with a central bank, a Banking Consolidation Directive (BCD) credit institution,<sup>7</sup> a bank authorised in a third country<sup>8</sup> or a qualifying money market fund.<sup>9</sup> It is also required to exercise all due skill, care and diligence in the selection, appointment and periodic review of the credit institution, bank or money market fund and to make a record of the grounds upon which it has satisfied itself of the appropriateness of its selection.<sup>10</sup>**
- 2.1.11 As the recent financial crisis demonstrates, simply looking at the credit rating of a bank does not constitute appropriate due diligence. In line with our more intensive supervision, **we expect firms to perform appropriate due diligence, such as assessing a bank's market reputation, assessing legal requirements or market practices, and considering risk diversification as well as credit ratings on an ongoing basis.**

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5 CASS 7.8.1R

6 CASS 7.4.7R

7 A credit institution that has its registered office (or, if it has no registered office, its head office) in an EEA State, excluding certain institutions to which the Banking Consolidation Directive (No 2006/48/EC) does not apply.

8 A country outside of the EEA.

9 A collective investment scheme which meets certain conditions (see the FSA Handbook Glossary for further details).

10 CASS 7.4.7-10R

## Segregation

- 2.1.12 Most firms that we visited were aware of the basic requirement to segregate client money from the firm's own money and had arrangements in place to facilitate this. However we found a lack of understanding of the segregation requirements and errors occurring during periods of operational change. We found that changes to systems that link to or perform CASS reconciliation processes could result in the loss or omission of data, or process distortions. Operational changes therefore posed a high risk of segregation errors.
- 2.1.13 **A firm must take the necessary steps to ensure that client money is held in an account or accounts identified separately from any accounts that hold money belonging to the firm.**<sup>11</sup>
- 2.1.14 Firms should also be in compliance with the requirements for the 'holding of client assets'.<sup>12</sup> These requirements are in place to ensure that adequate arrangements to safeguard clients' ownership rights have been made, to prevent the firm using<sup>13</sup> a client's safe custody assets – except with the client's express consent – and to ensure appropriate registration or recording of legal title to safe custody assets has been carried out.

## Reconciliations

- 2.1.15 Carrying out reconciliations of records and accounts for each client is one of the ways that a firm can satisfy itself that client money and custody assets are appropriately segregated. During our visits, we observed breaches of the CASS reconciliation rules.<sup>14</sup> For example some firms left prolonged periods of time between performing internal reconciliations, or in some cases omitted internal reconciliations altogether.
- 2.1.16 Although CASS does not specify the frequency of reconciliations, we would expect firms to have considered what frequency is appropriate for them to maintain accurate records that correspond to client holdings and enable them to distinguish client money and assets at any time and without delay.<sup>15</sup> These records should be accurate and should correspond to the client money or assets held.<sup>16</sup> **In determining whether the frequency of reconciliations is adequate, a firm should consider the risks to which the business is exposed, such as the nature, volume and complexity of the business, and where and with whom the client money is held.**<sup>17</sup> To maintain accurate records a firm that is undertaking daily transactions and/or revaluing client positions would normally also undertake daily reconciliations.

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11 CASS 7.4.11R

12 CASS 6.2

13 I.e. securities financing transactions under CASS 6.4 or under contractual 'rights of use' or 'rehypothecation' under CASS 6.4.

14 See the requirements set out in CASS 6.5 and CASS 7.6

15 CASS 6.5.1R and CASS 7.6.1R

16 CASS 6.5.2R and CASS 7.6.2R

17 CASS 6.5.8G and CASS 7.6.10G

## **Client ownership rights**

- 2.1.17 Some firms had entered into agreements with clients that transferred ownership rights over money to the firm, for example Title Transfer, or inappropriately claiming money to be “due and payable” in order to claim this as their own. FSA is concerned that this practice results in clients not receiving the protections they are entitled to and that we expect.
- 2.1.18 We have written to some firms expressing our concerns regarding this treatment. We will clarify the intention of this rule through a planned Quarter 1 Consultation Paper.

## **Oversight of Third Party Administrators (TPAs)**

- 2.1.19 Most of the firms that we visited that used Third Party Administrators (TPAs) to hold and control client money had robust arrangements in place to receive, review and keep information and records on the reconciliation of client money and assets. Examples of good practice included:
- Service Level Agreements (SLAs) which were reviewed and updated periodically;
  - visits to the premises of the TPA to assess security and processes;
  - holding regular meetings to discuss performance and regulatory matters;
  - receiving frequent management information on CASS compliance or breaches and errors;
  - performing ad hoc checks to evidence CASS compliance; and
  - assessing business continuity plan arrangements.
- 2.1.20 However, we observed that the degree of oversight exercised by firms related directly to the compliance culture within the firm and in some firms, errors were repeatedly not rectified promptly. A small number of firms relied solely on the terms of the SLA to gain assurance about a TPA’s control environment, while others performed additional oversight work.
- 2.1.21 **A firm that outsources any relevant services and activities remains fully responsible for discharging all of its obligations under the regulatory system.<sup>18</sup> We expect to see firms establishing methods for assessing the standard of performance of the service provider, taking appropriate action if the service provider appears not to be carrying out the functions effectively and ensuring that plans for disaster recovery and periodic testing of back-up facilities are in place.<sup>19</sup>**

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18 SYSC 8.1.6R; see SYSC 8.1.1 for further details on what constitutes “relevant services and activities”.

19 Both for the firm and the provider.

# Firm visits – Insurance brokers

- 2.2.1 We identified areas of good practice during our visits to insurance brokers. Recent improvements had been made by some firms. For example we saw that in some cases, policies and procedures were regularly updated in line with regulatory developments. However our visits also uncovered areas for improvement.

## **Management oversight and control**

- 2.2.2 As with the investment firms we visited, our major finding was that many CASS breaches were the direct result of **inadequate senior management oversight and control**. We found that unclear allocation of duties by senior management led to confusion between staff and teams, or a lack of accountability for performing basic client money processes. Split responsibility for client money often led to a break down in communication with Finance, Compliance and Treasury departments failing to adequately interact. We found examples of client money processes being delegated to staff without clear lines of delegated responsibility and appropriate senior management oversight .
- 2.2.3 **Robust governance arrangements and detailed management information help to provide assurance to senior management that the firm’s CASS risks are adequately evaluated, monitored and mitigated through policies and procedures. They help to ensure that robust controls are both understood and implemented.**

## **Documentation**

- 2.2.4 We found inconsistencies in the quality of documentation and in record retention practices. For example, the quality of Terms of Business Arrangements (TOBAs) was variable and insurance TOBAs were not always consistent with how client money calculations were performed, leading to over or under segregation of client money. In addition there were concerns

that a number of insurance TOBAs were signed by people without the authority to commit the insurer.

- 2.2.5 We require firms to take reasonable steps to ensure that its terms of business or other client agreements are in accordance with our rules.<sup>20</sup>
- 2.2.6 Firms are also obliged to ensure that proper records, sufficient to show and explain the firm's transactions and commitments of its client money, are made and retained for a period of three years after they were made.<sup>21</sup>

### **Acknowledgments of trust status**

- 2.2.7 As with the investment firms we visited, some insurance broker firms could not locate trust acknowledgements for each of the firms' client money accounts and had not checked whether the acknowledgement letters contained the required details and confirmations.
- 2.2.8 As set out in the section on investment firms, CASS<sup>22</sup> requires firms to gain written acknowledgement of trust from the banks that they use to hold client money and sets out the minimal detail that must be contained in this letter. For example, the letter should clarify that the title of the account distinguishes it from any other accounts belonging to the firm and confirm that the bank may not exercise any lien or set off in respect of balances in the client money account.
- 2.2.9 Having this documentation in place is an important requirement. Letters confirming the trust status of the account acknowledge that a statutory or non-statutory client money trust account has been established for the proper segregation of client money. We expect firms to be able to demonstrate to us that they have the appropriate trust documentation in place.

### **Due diligence of banks**

- 2.2.10 As with the investment firms we visited, due diligence and review of banks, credit institutions or qualifying money markets<sup>23</sup> which were used to hold client money was often limited, with insurance broker firms relying on the credit rating of the banks used. In the majority of cases, there was inadequate documentation of the rationale for choosing to use a particular bank. In some cases, firms failed to obtain appropriate acknowledgments regarding deposits and on occasion, there was limited or no evidence of consideration of asset concentration issues.

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20 CASS 5.1.5AR and CASS 5.4.4 R (5)

21 CASS 5.5.49R

22 A credit institution that has its registered office (or, if it has no registered office, its head office) in an EEA State.

23 CASS 5.5.42–5.5.46R

- 2.2.11 A firm, on receiving any client money, must promptly place this money into one or more accounts opened with a central bank, a Banking Consolidation Directive (BCD) credit institution,<sup>24</sup> a bank authorised in a third country.<sup>25</sup> It is also required to exercise all due skill, care and diligence in the selection, appointment and periodic review of the credit institution,<sup>26</sup> and to make a record of the grounds upon which it has satisfied itself of the appropriateness of its selection.
- 2.2.12 As the recent financial crisis demonstrates, simply looking at the credit rating of a bank does not constitute appropriate due diligence. In line with our more intensive supervision, we expect firms to perform appropriate due diligence, such as assessing a bank's market reputation, assessing legal requirements or market practices, and considering risk diversification as well as credit ratings on an ongoing basis.

### **Performance of client money calculations and transfers**

- 2.2.13 Our visits uncovered several issues relating to client money calculations and transfers. These included: insufficient consideration of the frequency of the calculation and reconciliation; commission being withdrawn before it was due and payable to the firm; the calculation and transfer of funds into or out of the client money accounts not occurring promptly; and a lack of evidence of the review and sign-off process surrounding the client money calculations and reconciliations. We observed that controls over complex processes were not sufficient to mitigate the risk of human error.
- 2.2.14 We require firms to be able to demonstrate that appropriate procedures exist to ensure that client money reconciliations are performed, reviewed and retained.<sup>27</sup> A firm must notify us immediately if it is unable to, or does not, perform the calculation required by CASS.

### **Due diligence of acquisitions**

- 2.2.15 We found several examples of firms that had acquired or merged with another insurance broker firm, without a proper understanding of the risks to their client money arrangements that arose from the nature of the acquired firm's pre-existing relationships with insurers. Such risks include the impact of non-compliant insurance TOBAs on trust arrangements, income recognition and the subsequent transfer of funds between the client accounts and the firm's accounts.
- 2.2.16 We expect insurance broker firms to perform appropriate due diligence of firms that they are looking to acquire, to assess and mitigate the risks to the appropriate segregation of funds.

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24 A country outside of the EEA.

25 CASS 5.5.5R

26 CASS 5.5.84R

27 CASS 5.5.63R, CASS 5.5.84R and SYSC 3.1.1

## **Discharge of fiduciary duty**

- 2.2.17 During acquisitions we found that there had been instances where insurance broker firms failed to discharge their trustee duties.<sup>28</sup> Client money and assets were transferred from the acquired firm's trust accounts to the acquiring firms trust accounts without due consideration for the existing trustee obligations. In some cases the firms failed to obtain the client's informed consent for extinguishing the trustee obligation of the acquired firm. In another case, money was also transferred into an acquiring firm's Non-statutory trust accounts from a statutory trust account without obtaining the client's informed consent. Firms need to obtain informed consent from client to extinguish trustee obligation. If a small amount of clients fail to respond a firm can approach FSA to discuss the potential granting of a waiver. These findings are of particular concern given the number of recent acquisitions in this sector.
- 2.2.18 **We require firms to establish procedures to ensure they gain the informed consent of customers and/or apply for a waiver when trying to discharge an entity's fiduciary duties.**<sup>29</sup>
- 2.2.19 We found examples where third party balances were either not accurately included in client money calculation or not included at all.
- 2.2.20 **We require firms to maintain accurate information on their fiduciary obligations, so that in the event of a default, the cost of administration is minimised while an appropriate level of consumer protection is achieved.**

## **Segregation**

- 2.2.21 We were very concerned by instances we found of co-mingling client money with non-client money. In one case, a firm was using client money to fund a premium financing operation. While we allow non-statutory trusts accounts to be used to extend credit for funding insurers' and clients' insurance transactions, client money may not be used for other purposes.
- 2.2.22 We also found that some firms failed to consider the appropriateness of taking commission on unallocated cash. Where funds remain unallocated, a firm will not know the commission that might relate to this transaction and therefore must deem the whole amount to be an un-reconciled item that must be segregated.
- 2.2.23 **Appropriate segregation and accurate record-keeping of client money is essential for the effective operation of the trust that is created to protect client money.**

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28 See CASS 5.5.79G to CASS 5.5.83R

29 CASS 5.5.80R and CASS 5.5.81G together with CASS Schedule 6.



## **Legacy balances and credit write-backs**

- 2.2.24 Many insurance broker firms had not allocated sufficient resources to reducing the amount of unallocated cash that they held. As we have previously stated,<sup>30</sup> where a firm has significant unallocated cash positions, in the first instance the implication is that a firm's systems and controls are ineffective. A firm will be liable for a breach of trust and regulatory action if it takes client account monies to its own account when it considers they are properly due, but it transpires they are not.
- 2.2.25 **All firms should ensure that they have adequate procedures to ensure that legacy balance issues do not develop. Firms are only allowed to transfer legal ownership of client money to themselves under very limited conditions and firms must ensure that they discharge their obligations fully under any credit write-back.**

## **Client money audits and audit reports**

- 2.2.26 We found a wide variance in the quality of CASS audit reports of the firms we visited. For example some reports failed to identify breaches and, in certain cases, firms failed to rectify breaches reported over a number of years. We are concerned that despite these failings, firms relied too heavily upon the audit as the quality control over client money processes and procedures.
- 2.2.27 **As part of the process for the appointment of an auditor, firms must consider whether their auditors have the appropriate skill set to conduct client money audits. Where an auditor raises breaches of the CASS rules, the Board (and where applicable the Audit Committee) must satisfy themselves that these breaches are promptly rectified. Firms must operate their own assurance checks over client money processes and procedures in order to meet their regulatory responsibilities.**

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30 In 'Credit Write-Backs – an articulation of the FSA's position' [www.fsa.gov.uk/pubs/other/write\\_backs.pdf](http://www.fsa.gov.uk/pubs/other/write_backs.pdf)

# 3 Future CASS work programme

- 3.1 Our future work programme reflects the growing significance that we attach to the protection of client money and assets. The following are some of the areas that we plan to work on throughout 2010.

## **Firm visits**

- 3.2 In line with our more intensive approach, we will increase the number of CASS visits to a range of firms that have a responsibility to protect client money and assets. These visits will continue to include generic CASS visits and will also include specialist thematic CASS visits, which will have a strong focus on specific areas of risk. We are currently undertaking a number of visits to custodian firms which will continue throughout 2010. **We aim to produce a further report of our findings later in the year and we will continue to take regulatory intervention where we find failings in compliance with our rules.**

## **CASS audit reports**

- 3.3 We have analysed a wide selection of CASS audit reports and found a significant number of errors and inconsistencies. We are concerned that the quality of CASS audit reports does not currently provide us with the level of independent assurance that we require.
- 3.4 We are working with the professional standards section of the Institute of Chartered Accountants in England and Wales (ICAEW) to create referral arrangements for them to investigate cases where we have concerns surrounding the CASS audit report. **We will continue to work with CASS auditors and all relevant professional bodies to improve standards. We also plan to consult on proposals to improve Handbook guidance for CASS auditors in due course. The purpose of our proposals will be to drive consistency and quality in the CASS audit reports received from auditing firms .<sup>31</sup>**

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31 [http://www.hm-treasury.gov.uk/d/consult\\_investmentbank110509.pdf](http://www.hm-treasury.gov.uk/d/consult_investmentbank110509.pdf)

## **Title transfer agreements and 'due and payable'**

- 3.5 We stated in CP06/14 and PS07/2 that whilst we were not proposing any specific rules to counter the risk of inappropriate use of title transfer arrangements, we would be concerned if firms tried to use the flexibility provided for use with professional counterparties to avoid providing client money protection to retail clients. We are now concerned that the use of title transfer arrangements is far more extensive than we had envisaged when the current rules were agreed. Furthermore, title transfers and the use of 'due and payable' is being applied inconsistently. As a result, **in 2010 we will clarify the rules in a quarterly CP to bring firms' practices into line with our expectations.**

## **Unallocated excess cash in segregated accounts (buffers)**

- 3.6 Firms have asked us for guidance on the use of buffers in their client money accounts. Firms should be able to fully reconcile their client money holdings to be in compliance with CASS. However, we allow some firms in limited circumstances (and in consultation with their accountants and auditors) to hold a specific amount of money to ensure that money that should be protected is given client money protection; for example as a way to protect unallocated client money under an alternative approach. Any use of a buffer requires transparency, robust accounting and audit trails. There should also be a clear rationale for why the buffer is needed, which has been discussed and signed-off at board level. **The use of buffers is an area that we will be scrutinising in the future. For firms using the alternative approach, we expect to discuss what would be an appropriate buffer to mitigate the risk that there will be a shortfall in the amount segregated for clients, and we plan to engage with firms on this subject during the first half of 2010. If firms are uncertain about their position, they should seek advice.**

## **Improving reporting**

- 3.7 We understand that our ability to target our specialist supervisory resource and to identify risks requires robust information. As such, **we intend to reintroduce client money reporting. We have already engaged five firms to help us trial a suitable system, and we plan to roll out an interim solution in 2010, with a view to rolling out the full system in 2011.**

## **Work with the Treasury**

- 3.8 The Treasury is consulting on proposals (Resolution Regime for Investment Banks<sup>32</sup>) to address the issues highlighted by the failure of Lehman Brothers. The objectives of the proposals are ensuring appropriate segregation of client money and assets, restoring confidence and clarifying market settlement

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32 [http://www.hm-treasury.gov.uk/d/consult\\_investmentbank110509.pdf](http://www.hm-treasury.gov.uk/d/consult_investmentbank110509.pdf)

protocols. Our CASS Risk Team has been working closely with the Treasury on these proposals, which include some bold initiatives that could impact significantly on us and on firms. Most of the proposals that relate to client money and assets will require our consultation to convert them into detailed solutions. **We will continue to work with the Treasury throughout the year and will analyse the costs and benefits of their proposals. Our timetable will be dependent on the Treasury's work. However we are looking to publish a CP on amendments to the CASS rules in Q1 2010.**

# 4 Conclusion

- 4.1 Under Principle 10 (Clients' assets) **a firm is required to arrange adequate protection for clients' assets when the firm is responsible for them.** There is still a significant amount of work for firms to do in order to ensure clients' money and assets are adequately protected.
- 4.2 Nearly all of our visits have resulted in actions for firms to improve their compliance with CASS. Our actions taken so far demonstrate that our tolerance level for CASS compliance failures is low. In line with this, we will continue to take a more intrusive approach to the protection of clients' money and assets and we anticipate increasing the enforcement resources that we devote to client asset cases. As well as continuing our broader thematic work, our CASS visits to follow-up on specific issues and risks will carry on throughout 2010. We will also continue our wider work to improve protection for clients, such as through a dialogue with the audit profession and by responding to the Treasury's investment firm resolution proposals.





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