FINANCIAL CONDUCT AUTHORITY

12 Endeavour Square
London
E20 1JN

Tel: +44 (0)20 7066 1000
Fax: +44 (0)20 7066 1099
www.fca.org.uk

May 2025 update:
This letter is historical. See our supervisory correspondence page for more information and current views.

2 July 2021

Dear CEO

Maintaining adequate client money arrangements - general insurance intermediaries

Over the past year, firms have completed the FCA's financial resilience surveys. Based on the results, we followed up with some firms we believed were at risk of failure or of not having adequate financial resources. As part of this work, we reviewed certain general insurance intermediaries' client money arrangements and identified common shortcomings we believe may indicate more widespread non-compliance throughout the sector.

While our letter of 30 September 2020 had reminded firms of their obligations, we are writing to remind firms holding or controlling client money that they must establish and maintain arrangements to ensure the funds are adequately protected. Sound client money controls are vital in reducing customer harm in the event of firm failure. Firms should ensure their client money arrangements are in line with the expectations set out in this letter.

Your obligations

Firms holding client money are responsible for ensuring they understand the associated regulatory requirements. Principle 10 of the FCA's Principles for Business states a firm must arrange adequate protection for clients' assets when it is responsible for them. Further, Principle 3 requires firms to take reasonable care to organise and control its affairs responsibly and effectively.

Your firm should continually review its client money arrangements and its compliance with the rules in Chapter 5 of the Client Asset Sourcebook (CASS). In doing so, you may find our Guide to Client Money for General Insurance Intermediaries (the 'Client Money Guide') useful.

What you need to do

We expect your firm to review its client money arrangements in light of the issues highlighted in this letter, and to take robust action if needed to ensure that client money is appropriately safeguarded. You should discuss this letter with your firm's Board or equivalent governing body and identify what actions, if any, are needed to ensure your firm has adequate client money arrangements in place.

Firms that are required under our rules to obtain client money audits should also ensure their auditor is aware of this letter and the material we have referenced (eg the Client Money Guide).

We continue to expect senior management to have appropriate oversight of their firm's client money arrangements. A firm cannot outsource its responsibility for compliance, and is responsible at all times for the protection of its customer's client assets. However, if after reviewing this letter, the client money rules and the referenced materials, you feel that you need additional support to fully understand the client money requirements applicable to your firm, you may find external advice useful.

Action we may take

We take failure to comply with the Principles for Business and the client money rules seriously. Where it appears that firms may be contravening or not meeting our standards, we may use our powers under Part 4A of FSMA to vary a firm's permission, impose requirements or change individuals' approvals on our own initiative. These powers may be used to prevent or to stop harm from becoming serious including:

- to impose an asset restriction
- to prohibit a firm from carrying out specified regulated activities

When misconduct is identified, we will take action including referrals to enforcement, where necessary. In the past, we have taken enforcement action against firms and individuals which have failed to arrange adequate protection for the client assets for which they were responsible. For example, we have imposed:

- fines on firms that failed to adequately protect client assets in line with our rules
- a prohibition order on a director who had specific responsibility for the firm's client money arrangements, but failed to exercise due skill, care and diligence in managing the business for which he was responsible

Key issues found and our expectations

Below, we highlight the key issues found and clarify what we expect firms to do to ensure the adequate safeguarding of client money.

1. Client money calculation

Over half the firms we assessed did not appear to have client money calculations that aligned with our rules and expectations. A client money calculation must be performed regularly to ensure that your firm has sufficient money in its client bank accounts (and held by third parties) to meet its obligations to clients. The calculation involves a comparison of the firm's client money requirement and its client money resource (CASS 5.5.62G) and must be performed at least every 25 business days (CASS 5.5.63R). However, to ensure the accuracy of records, we believe larger firms would generally need to perform the calculation more frequently.

a. Calculating client money resource and client money requirement

CASS 5.5.65R - CASS 5.5.68R specifies how firms should calculate their client money resource and their client money requirement, using either the client balance or accruals method. The calculation must be derived from the firm's internal records and capture all the firm's client money bank accounts, regardless of the amounts held in the account or the frequency of activity. We have identified that firms have made errors in capturing the required information in their client money calculations. The Client Money Guide contains annotated examples showing how firms can perform and document client money calculations in a manner consistent with our rules. While we acknowledge firms may set out their calculations differently, we expect that they contain the required information, and are performed in a manner compliant with our rules.

b. Timing of client money information and processes

When performing the client money calculation, your firm must use 'close of business' balances from the previous business day (CASS 5.5.63(1)(a)R). Further, your firm must remove any surplus or rectify any shortfall calculated by close of business of the day of the calculation (CASS 5.5.63(1)(b)R). We have seen instances where these timeframes have not been met, resulting in shortfalls or surpluses in client money bank accounts being left unrectified. This, in turn, results in client money not being protected adequately, a breach of trust law and a risk of firms trading while insolvent (ie where it is unable to rectify a client money shortfall on the day it occurs).

Under our rules, firms must also reconcile the bank account balances used in their client money calculation (taken from the firm's records on their internal systems) with the balances set out on the firm's bank statements. The reconciliation should be completed within 10 business days of performing the client money calculation. The Client Money Guide contains further detail about reconciling bank statements. Further, CASS 5.5.63(3)-(4)R outlines the steps that firms must take if a discrepancy is identified as a result of the reconciliation.

2. Appropriate withdrawal of commission

We have seen many instances where firms have withdrawn commission from client money accounts before a client money calculation is completed. Firms should only draw down commission after a client money calculation is performed and a surplus has been identified. This is because the amount of surplus in the calculation should represent the value of commission due and payable to the firm or interest earned on the bank account, which must be withdrawn on the day of the client money calculation in line with CASS 5.5.63(1)(b)R. This approach ensures firms can evidence that the balances held for clients are accurate and there will not be a deficit once the withdrawal(s) have been made. Firms may perform a client money calculation more often than every 25 business days if they wish to withdraw surplus client money more frequently.

3. Client money bank accounts and acknowledgement letters

Firms holding client money must segregate client money from its own money by paying it into a client bank account. The title of a client bank account must clearly distinguish the account from your firm's other accounts. Our general expectation is that the name of all client money accounts should include the term 'client bank account'.

It is important firms ensure acknowledgement letters are held for every client bank account they operate. You must also ensure the wording of each acknowledgement letter complies with CASS 5.5.49R. Specifically, the letter must acknowledge that all money in the account is held by your firm as trustee (or as agent in Scotland), and the bank is not entitled to combine the account or use money in the account to exercise any right of set-off or counterclaim with other accounts of the firm. Further, the letter must acknowledge that the title of the client bank account sufficiently distinguishes it from the firm's other accounts, and is in the form requested by the firm.

We have seen many acknowledgement letters with incorrect details, particularly where the letters are several years old. If any details change, such as your firm's name or address, or bank account name, the acknowledgement letter should be updated to reflect this. More generally, firms may find it useful to review their acknowledgement letters periodically to ensure these are in place for every client bank account operated by the firm. If your firm is no longer using a client money bank account, we expect your firm to contact the bank to close the account, obtain a closure letter for your records and arrange with the bank to update the firm's acknowledgment letter(s) accordingly. Further, until a client bank account is closed, the account should continue to be included in your firm's client money calculations (within the calculation of client money resource), even if the account balance is zero.

4. Segregation of client money

It is imperative that firms segregate client money by paying it into a client bank account. It is also important firms take care to ensure their client bank account remains a trust account at all times. In line with CASS 5.5.9R and CASS 5.5.10R your firm must not hold money other than client money in a client bank account unless:

1. It is the minimum sum required to keep the account open.
2. It is mixed remittance in line with CASS 5.5.16R (eg if a client's payment includes both premium (which is client money) and commission, or both client money and risk transfer funds).
3. It is interest not yet withdrawn by the firm.
4. Your firm deems it prudent to hold an additional amount in the client bank account to ensure that client money is protected. If this is the case, the additional amount in the firm's client bank account must be held in line with the firm's prudent segregation policy. This should be a written policy agreed by the firm's Board or equivalent.

We have seen instances where firm money is being held in client bank accounts to cover bank charges without any prudent segregation policy being in place. Wherever possible, any bank fees should be charged to the firm's business account rather than the client bank account.

5. Co-mingling risk transfer money with client money

We remind firms that risk transfer money held in a client money account is subject to the client money rules. If there is no valid risk transfer agreement in place in line with the client money rules, the client funds received by the firm will also be subject to the client money rules.

If your firm holds money as agent of an insurer and some or all risk transfer money is co-mingled with client money, you must have the insurer's agreement to do so. This agreement must:

- be in writing;
- expressly provide for the firm to act as agent of the insurance undertaking;
- specify when the firm would be acting in this capacity;
- agree that co-mingled money will be client money in line with the client money rules; and
- subordinate the insurer's interest in the co-mingled funds to the interest of the firm's other clients.

If some (or none) of your firm's risk transfer money is co-mingled with client money, your firm should also operate an insurer trust account to hold risk transfer money. However, where a client's payment comprises both client money and risk transfer money which cannot be co-mingled, the payment would constitute mixed remittance under CASS 5.5.16R and the entire sum must be received into the firm's client bank account.

As a matter of best practice, firms that hold risk transfer money (whether co-mingled or not) should maintain a register that lists all the firm's risk transfer agreements. This should clearly specify:

- when the firm is acting as agent of the insurer (eg whether for premium only, or also for the handling of claims money or premium refunds);
- when commission can be drawn down;
- whether each agreement allows for co-mingling; and
- if so, whether the insurer has subordinated its interest in the co-mingled funds to the interest of the firm's other clients.

6. Client money audit

Your firm must arrange a client money audit if it operates a non-statutory client money account, or has held over £30,000 in a statutory client money account at any point during the client money audit period. Before appointing an external auditor, we expect firms to perform their own due diligence to ensure the auditor has the appropriate experience and expertise to adequately review and test the firm's client money arrangements, in line with our rules.

Other issues to consider

Using client money for the purposes it's intended

Firms that hold client money do so in their capacity as trustee. Although the firm has legal ownership of the client money and can deal with it on clients' behalf, that money remains in the beneficial ownership of the firm's clients.

Firms can only use client money for the purposes for which it is intended. Client money cannot be used to meet personal or businesses expenses, even if repaid within a short period, or to support a firm's financial position. We consider the misuse of client money a significant failure.

It may be deemed a financial crime, representing a lack of integrity in the individuals responsible.

Reviewing your firm's permission

A firm's business model can change over time. Different FCA regulatory capital requirements apply depending on whether a firm has a requirement on its permission that allows it to hold client money. If your firm is no longer using the client money requirement in its permission, you should consider removing it by applying for a variation of permission on Connect.

Next steps

We will continue to assess firms' client money arrangements in line with our supervisory strategies for general insurance intermediaries. Where we find that firms are not meeting their obligations under our rules, we will take appropriate action, including exercising our regulatory powers if needed. You are also reminded that (in line 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 arrangements.

Yours sincerely

Matt Brewis

Director of Insurance and Conduct Specialists