Financial Services Authority

# Guide to Client Money for General Insurance Intermediaries

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# Introduction

This Guide has been produced for authorised firms who are carrying on insurance mediation activities to help them understand how to hold client money in accordance with Chapter 5 of the Client Asset Sourcebook (CASS). It is one of many tools we have produced to help you navigate and understand the Handbook. It is not a substitute for reading the rules themselves and is not a comprehensive statement of your firm's obligations under our rules.

This Guide is not formal guidance and does not have the status of guidance in the Handbook. You cannot use this Guide to counter a charge of breaking our rules. While every effort has been made to ensure consistency between the information in this Guide and the Handbook, in the event of any conflict between this Guide and the Handbook, the Handbook takes precedence.

This Guide is current as at 16 March 2007. This Guide does not remove the need for firms to keep up to date with regulatory developments and to consider the potential impact on their business of proposed changes. We will regularly update this Guide but we will not update it each time the Handbook changes.

This Guide uses terms consistent with those defined in the Handbook Glossary. These terms are in *italics* in the Handbook (though not in this Guide). To help you, the Appendix contains brief definitions of some of the terms we use in this Guide. In each case firms should consult the Handbook Glossary for the full definitions.

# 1. Making arrangements to hold client money

## 1.1 What is client money?

Client money is money of any currency that a firm receives and holds for its client (or clients of appointed representatives, field representatives or other agents) when carrying on insurance mediation. It can include premiums, claims money and premium refunds – as well as professional fees due from clients, for example, for onward payment to a loss adjuster.

Money received that:

- is held under a risk transfer agreement (see *Part 1.3.1 – Transferring the risk from firm to insurer*); or
- is not connected with insurance mediation (for example, a deposit for a car (but see *Part 2.5 – Mixed remittances*).

is not client money for the purpose of our rules. A firm's own money is not client money and must not be held in a client bank account because it can invalidate the trust status of the account. There are exceptions to this:

| The Exceptions to the rule |
|---|
| If a minimum sum is required to open or keep open an account or interest which has been credited but not yet withdrawn by the firm. |
| The firm is satisfied on reasonable grounds that it is prudent to put some of the firm's money into a client bank account to protect client money by maintaining a positive margin due to unreconciled items in its business ledger. |
| If for a short time, firms hold money in the client bank account when they have received a mixed remittance. |

## 1.2 Why is it important that client money is held correctly?

Principle 10 requires firms to arrange adequate protection for clients' money when they are responsible for it. Our rules are designed to protect clients if a firm fails while it is holding client money or if it is unable to transfer premiums to insurers or claim money or refunds to clients. This is the case whether the amounts held are small or client money is held temporarily.

## 1.3 What are the options?

There are two main approaches which firms can take to ensure adequate protection.

1. The first is to transfer the risk from the firm to the insurer(s).

2. The second is segregating client money into trust accounts that cannot be used to reimburse other creditors if a firm fails.

However, firms can do a mix of both. We explain each method below.

### 1.3.1 Transferring the risk from firm to insurer

An insurer may agree to let a firm hold money as agent on its behalf. A written agreement must be in place between the firm and the insurer stating that premiums – and if the insurer wishes, claims and premium refunds – are held as agent. This ensures the protection of the money because the insurer bears the risk for any losses arising from either the firm failing to transfer the money or from the misappropriation of the client money by the firm. These agreements are often referred to as risk transfer agreements.

Since the insurer is accepting the risk of a firm holding money as agent on its behalf, the firm will not need permission from us to hold client money if a firm only holds money this way.

However, firms should check an agreement to see whether it includes handling claims money and premium refunds as well as accepting premiums. If a firm receives and holds claims money or premium refunds and it is not covered by the agreement, then this money will need to be segregated and the firm will need permission from us to hold client money.

Firms which hold money under a risk transfer agreement for an insurer do not need to comply with the requirements set out in Parts 2 to 6 of this Guide unless they are co-mingling (see *Part 1.3.3a – co-mingling*).

| **The Exception to the rule** |
| --- |
| A written agreement does not always have to be directly between a firm and an insurer. Sometimes, insurers agree that risk transfer can be passed down to appointed representatives, field representatives or other agents. This will be specified in the insurer's written agreement and firms cannot offer risk transfer to others without first getting the insurer's agreement. See *1.4.1 Risk transfer agreements* for more details. |

### 1.3.2 Segregating client money in a statutory or non-statutory trust bank account

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

There are several differences between the two types of trust. The most significant is that a firm acting as trustee of a statutory trust must not make advances of credit from the client money account. This means a firm must not pay an insurer a premium from the client bank account until it has received that premium from the client. Likewise a firm may not pay out a claim from the client bank account until it has received the claim money from the insurer. If a firm wishes to do either of these things then it will have to extend credit to its clients from its own funds.

Alternatively, the firm can set up a non-statutory trust client bank account if it wants to extend credit to clients or insurers.

Regardless of which type of trust account is being operated, a firm should never make advances of credit to itself out of a client money trust account (for example, by withdrawing commission before the premium has been received or before funds have cleared (see also *Part 2.6 – Withdrawing commission and fees and relevance of cleared cheques*).

Note that if a firm receives and holds client money and does not do so as agent for an insurer, it must get permission from us to hold client money.

### 1.3.3 Holding client money as agent and segregating client money into a trust account

We have seen that a firm can hold client money by either segregating it in a statutory or non-statutory trust client bank account, or by transferring the risk to one or more insurers. However, it can also hold client money in more than one way. For example, it can operate a non-statutory trust client bank account and a statutory trust client bank account and hold money as agent for an insurer.

#### 1.3.3a Co-mingling

If a firm wants to mix – or co-mingle as we call it – money held as agent of an insurer with client money held in a statutory or non-statutory trust client bank account, it must have the insurer's agreement to do so. That agreement:

- Must be in writing; and
- Must subordinate the interests of the insurer to the interests of the firm's other clients.

Without this written agreement in place, money held as agent of the insurer may not be co-mingled with other client money in the trust client bank accounts. Instead, a firm may have to have a separate account to hold money as agent of the insurer that conforms to the terms of the agreement with the insurer.

If the insurer's agreement permits a firm to co-mingle, then the money held as agent of the insurer which is mixed with other client money becomes subject to our CASS requirements set out in Chapters 5.3 to 5.6 and which are covered in this Guide.

| The Exception to the rule |
| --- |
| Firms that are required to segregate money in accordance with section 42 of the Landlord and Tenant Act 1987 comply with our rules on segregating money in a statutory or non-statutory trust client bank account. |

## 1.4 Making the arrangements

A firm has decided how it wants to handle client money so what arrangements need to be made? Here's some help on how to:

- check the appropriate agreements are in place with insurers;
- set up a statutory trust client bank account;
- set up a non-statutory client trust bank account;

- choose an appropriate bank; and
- check that a firm has adequate capital resources.

### 1.4.1 Risk transfer agreements

A risk transfer agreement is an agency agreement between a firm and an insurer which makes clear when money is held by the firm as agent of the insurer. However, a firm may have a risk transfer agreement with another insurance intermediary but only if the intermediary firm has the insurer's permission in its agreement to pass on risk transfer to another firm. The terms on which a firm can do this may vary from insurer to insurer – insurers may need a firm to get their consent before passing on risk to a particular firm.

There are some important checks firms can carry out before relying on another firm's word that it can pass risk transfer on to other firms. Ask to see a copy of the agreement that gives authority to the firm offering you risk transfer. If your firm is not named as being able to hold money as agent for the insurer within the agreement, consider asking the firm for documentation that proves it has notified the insurer and got its consent to your firm holding money as agent. Firms have a duty to their clients to ensure that risk transfer agreements are properly in place.

The questions below will help firms decide whether they are acting within the terms of their agreement(s).

| | Questions | Yes | No |
|---|---|---|---|
| 1 | Do you have a current written and signed agreement in place with each insurer or firm with authority to pass on risk transfer that you want to hold money as agent for? | | |
| 2 | Does the agreement expressly say that you can receive premiums from clients as agent of the insurer? | | |
| 3 | Does the agreement expressly say that you can receive and hold claim money or refunded premiums as agent of the insurer?* | | |
| 4 | Does the agreement state that premiums received and held by appointed representatives, field representatives or other agents working for the firm may hold client money as agent of the insurer? | | |
| 5 | Does the agreement state that claims money and refunded premiums received and held by appointed representatives, field representatives or other agents working for the firm may hold client money as agent of the insurer?* | | |
| 6 | Does the agreement permit you to co-mingle the insurer's money with other client money? If so, does the insurer agree to subordinate its interest to clients' interests? | | |
| 7 | Does the agreement specify where the money should be held (for example, in a statutory or non statutory trust account or designated account)? | | |

**** This is essential in an agreement where the insurer has given 'binding authority' to a firm. Binding authority is where the firm has contractual authority to commit the insurer to risk or to settle claims or handle premium refunds on an insurer's behalf.***

If a firm answers 'no' to any of the questions, it should consider whether it is acting outside the agreement and if appropriate, take immediate action to rectify. Firms should keep their agreements under review to ensure they reflect the firm's activities.

### 1.4.2 Setting up a statutory trust client bank account

Unlike the non-statutory trust, which requires a firm to declare a trust and have a properly executed trust deed, the trust status of a statutory trust arises automatically – our rules impose a trust on client money. Although a separate bank account is needed, no special type of account is required and a conventional deposit or current account is suitable. However, a firm owes a duty of care to its clients when it decides which bank(s) to use (see *Part 1.4.4 – Choosing an appropriate bank*).

Instead of opening a general trust account a firm may want to set up designated client bank accounts. A designated account is one set up for a specific purpose: for specific customers or to enable a firm to manage client money in a specific way. For example, a firm could have designated client bank accounts for different offices (there is no limit to the number of designated accounts which can be set up).

Designated accounts are not compulsory, so even if a customer requested their money be held separate to other customers' money, our rules do not oblige firms to offer a designated account. If the firm should fail, money that is held in a designated account is pooled with other client money accounts (designated and general) which means all clients share in any client money shortfall. The reverse is true if a third party or the bank fails. In these circumstances, a shortfall in the designated client money account is not shared by other clients and likewise, any shortfall in other client money accounts is not shared by the designated account holder.

When a firm opens an account, it will need to notify the bank that it requires written confirmation that the account has been set up according to our rules. The questions below will help firms decide whether they have set up the account correctly and have the appropriate written confirmation.

| | Questions | Yes | No |
|---|---|---|---|
| 1 | Does the title of your client money account(s) distinguish it from other accounts of your firm for example, by including the words 'client' or 'client money'? | | |
| 2 | Do you have in writing from the bank confirmation that all money held in the account(s) is held by your firm as trustee (or in Scotland, as agent)? | | |
| 3 | Do you have the bank's written confirmation that the bank is not entitled to combine the client money account(s) with any other account or to exercise any right or set-off or counterclaim against money in that account in respect of any sum owed to it on any other account of the firm? | | |
| 4 | Do you have the written confirmation in 2 and 3 above from the bank for every trust bank account held, including any suspense or short term deposit accounts? | | |
| 5 | If you have set up a designated client bank account, does the title include 'designated client' or 'designated client money' in its title? (For example, XYZ insurance brokers statutory trust designated client account) | | |

If a firm answers 'no' to any question, it will need to contact the bank to put things right immediately.

### 1.4.3 Setting up a non-statutory trust client bank account

The same steps for setting up a statutory trust client bank account apply when setting up a non-statutory trust (see *Part 1.4.2 – Setting up a statutory trust client bank account*). However, the trust status does not automatically arise for a non-statutory trust and so a firm will need to execute a formal trust deed. (Firms may need to seek their legal adviser's help to execute a trust deed or refer to other help available from some of the insurance industry's trade associations.) The trust deed should make clear that the money is held:

- for the purposes of and on the terms of CASS 5.4;
- for the purposes of and on the terms of the applicable parts of CASS 5.5;
- for the purposes of and on the terms of the client money (insurance) distribution rules; and
- in the event that the firm fails:
  - for payment of the costs of distributing the client money;
  - then for clients (other than insurers), according to their respective interests in it;
  - then for clients who are insurers according to their respective interests in it; and
  - finally for the firm itself after valid claims and costs of the people listed above have been paid.

Firms can use the wording in our rule CASS 5.4.7R (which is summarised above) in the trust deed. However, it is acceptable for firms to use other wording provided they can prove that the legal document meets the requirements of CASS 5.4.7R.

The trust deed may also:

- specify whether credit can be given to clients or insurers from the non-statutory trust client bank account and if so that any debt or obligation is held on the same terms as set out above;
- specify that a letter of credit or unconditional guarantee given by an approved bank to make good a client money shortfall is held on the same terms as set out above; and
- if applicable, specify that client money may be invested in designated investments which will be held on the same terms as money that is subject to the non-statutory trust.

Before firms can start handling client money in a non-statutory trust client bank account, they must be able to answer 'yes' to the questions below:

| | Questions | Yes | No |
|---|---|---|---|
| 1 | Do you have and maintain systems and controls which are adequate to ensure you can monitor and manage client money transactions and any credit risk arising from operating the trust arrangement? | | |
| 2 | If you operate statutory as well as non-statutory trust client bank accounts do those systems and controls cover client money transactions on the statutory trust account? | | |
| 3 | Have you obtained and do you keep current, written confirmation from your auditor that you have systems and controls in place which are adequate to ensure you can monitor and manage client money transactions and any credit risk arising from operating the trust arrangement? | | |
| 4 | Have you designated a manager to be responsible for overseeing the firm's day-to-day compliance with Chapter 5.4 of CASS and to oversee the systems and controls in 1 above? | | |
| 5 | Do you handle client money for retail customers and if so, do you have and can you maintain capital resources of not less than £50,000? | | |
| 6 | Do your terms of business or client agreements adequately explain that you hold client money in a non-statutory trust account and have you obtained your clients' consent to holding money this way (see *Part 1.5 – Telling clients about a firm's client money handling arrangements*)? | | |

Operating a non-statutory trust also allows firms to segregate client money in designated investments provided the trust deed allows it. While this is not common practice in the general insurance market, firms that want to segregate client money in designated investments should read CASS 5.5.14R-5.5.15G and Annex 1 of CASS 5. Firms that invest client money in designated investments must accept the risk that they are liable for any loss in the amount of client money invested as a result of a fall in the value of investments.

### 1.4.4 Choosing an appropriate bank

A firm owes a duty of care to its clients when it decides which bank(s) to use. Firms must place client money with an approved bank or banks. There is an exception. For small firms holding relatively modest amounts of client money this requirement can be satisfied by placing client money with an authorised UK clearing bank or building society.

| The Exception to the rule |
|---|
| A firm may hold client money with a bank that is not an approved bank if certain conditions are met. |

Before opening a client money bank account - and as often as appropriate and at least once a year - a firm should assess whether the bank chosen is appropriate to hold client money. Points to consider include:

- the capital of the bank;
- the amount of client money placed, as a proportion of the bank's capital and deposits;
- the credit rating of the bank (if available); and
- if the information is available, the level of risk in the investment and loan activities of the bank and its affiliates.

If a firm chooses to open an account with a bank in the European Economic Area, it can limit its ongoing verification of the bank to whether it remains authorised by an EEA regulator (for example, UK banks can be checked on the FSA Register).

In choosing a bank, firms may also want to consider whether the bank can provide timely information to the firm to enable it to comply with our requirements. For example, can it provide bank statements when a firm needs them to reconcile its own records after doing the client money calculation?

### 1.4.5 Capital resources

Firms that hold client money are required to hold more capital than those who do not hold client money at all (for example, if they hold money as agent of an insurer). In addition, higher minimum resource requirements apply to insurance intermediaries that hold client money relating to retail customers in a non-statutory trust client bank account. The table below can help firms check how much capital they should be holding depending on how they handle client money.

| How do you handle client money? | Capital requirements |
|---|---|
| Holding money as agent of an insurer only. | £5,000 or, if higher, 2.5% of the firm's annual income from regulated activity. |
| Holding money in a statutory trust for retail or commercial customers or holding money in a non-statutory trust for commercial customers. | £10,000 or, if higher, 5% of the firm's annual income from regulated activity. |
| Holding money in a non-statutory trust for retail customers. | £50,000 or, if higher, 5% of the firm's annual income from regulated activity. |

## 1.5 Telling clients about a firm's client money handling arrangements

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. Firms therefore are required to disclose how client money is handled and when client money stops being client money. This includes telling retail customers about whether the firm keeps any interest earned on the client money account and, if applicable, any returns from investing the client's money. Usually, firms disclose this in their terms of business but a firm can disclose it another way as long as it is in writing and disclosed before the transaction takes place.

The table below can help firms check what they are required to disclose to the client and whether informed consent is needed before they handle client money in a certain way. Getting informed consent involves two things – informing the client and securing their consent to a course of action. Precisely what this requires will vary from case to case but we would expect firms to give information in plain, intelligible language that the average client is likely to understand. A firm will also need to consider pointing out to the client relevant parts in the terms of business so they have a satisfactory basis for securing consent. A firm's terms of business is acceptable to meet our requirements for notification, informed consent or agreement in writing from clients.

| How do you handle client money? | Disclosure requirements | Informed client consent needed? |
|---|---|---|
| Holding money as 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 restrictions. For example, 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 retail customers if you pay or do not pay interest. If you do not pay interest, then you must get the retail customer's informed consent to keep the interest earned unless you are reasonably satisfied that interest earned will not exceed £20 per transaction. | Yes to the firm 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 retail customers if you pay or do not pay interest. If you do not pay interest, then you must get the retail customer's informed consent to keep the interest earned unless you are reasonably satisfied that interest earned will not exceed £20 per transaction. Explain to retail customers if applicable, that client money is segregated in designated investments and whether the firm will keep any investment returns earned. | Yes to all unless firm is keeping interest of less than £20 |
| 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 |
| Holding money in a bank outside the UK for retail customers | Inform affected retail customers that:<br>• Money is deposited in a client bank account outside the UK but that the client can request that its money is not held outside the UK (see CASS5.5.56R for what to do if client makes that request);<br>• The legal and regulatory regime outside the UK is different and if the bank fails the client's money may be treated differently to if it was held in a UK bank; and<br>• 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 | Inform all affected clients (retail customers must be informed in the firm's terms of business or client agreement) that their money will not be held with an approved bank. Also:<br>• The legal and regulatory regime outside the UK is different and if the bank fails the client's money may be treated differently to if it was held in an approved bank in the UK; and<br>• 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 (see *Part 2.2 – Passing client money to a third party*) | Notify retail customers that their money may be transferred to a third party. | No |
| Passing to a third party outside the UK (see *Part 2.2 – Passing client money to a third party*) | Notify retail customers that:<br>• their money may be transferred to a third party outside the UK but that the client can request that its money is not passed outside the UK (see CASS 5.5.60R for what to do if a client makes that request); and<br>• The legal and regulatory regime outside the UK is different and if the third party fails the client's money may be treated differently to if it was held by a third party in the UK. | No |

**** The firm must still request the bank to give its written confirmation that the bank is not entitled to combine the client money account with any other account or to exercise any right or set-off or counterclaim against money in that account in respect of any sum owed to it on any other account of the firm, although the bank may not give this confirmation.***

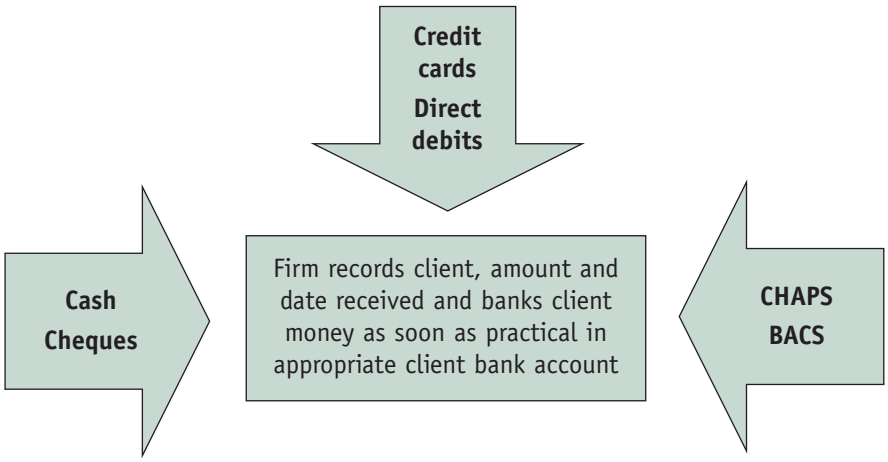
# 2. Holding client money

**This part of the Guide is not relevant to those firms who only hold client money under risk transfer agreements.**

This part of the Guide explains how to:

- Receive, record and bank client money;
- Pass on client money to a third party;
- Discharge your trustee duties;
- Repay client money to customers;
- Handle mixed remittances;
- Withdraw commission and fees; and
- Control client money.

## 2.1 Receiving, recording and banking client money




Client money should be paid into a client bank account as soon as practicable. In most circumstances we expect it to be practicable for a firm to pay money received into a client bank account by close of the following business day.

If a firm receives CHAPs or BACS payments or some other automated transfer, then it should make arrangements for those automated payments to be paid directly into a client bank account. If an automated payment is received in error directly into a firm's own business account, then it should be transferred to the client bank account by no later than the next business day.

## 2.2 Passing client money to a third party

A third party is for example, another insurance 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 when it is with them. Firms should exercise appropriate skill, care and judgement in selecting third parties with whom they do business and transfer client money to. The consequence for firms who do not, could be that they become liable for client money because a third party fails.

A firm can only allow another insurance intermediary to hold its client's money if it is for the purpose of a transaction for the client. Note that retail customers must be notified in writing if their money may be transferred to a third party (a firm need only notify them once and this can be done in a firm's terms of business or client agreement).

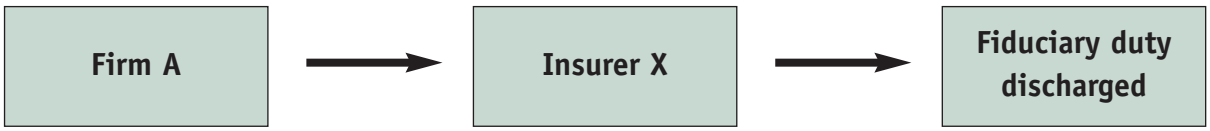
Firms must keep a record of client money held by third parties to enable them to do the client money calculation.

## 2.3 Discharging your fiduciary duty

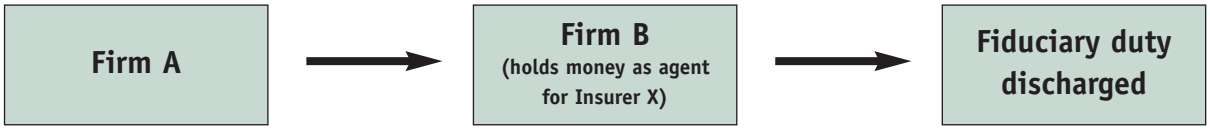
Trust law plays an important role directly and indirectly in operating client money bank accounts. A firm holding client money under a statutory or non-statutory arrangement is held by law to have a fiduciary duty to its clients when holding and administering their money. Firms should be aware that they may be accountable to their clients if a firm demonstrates that they have not correctly discharged their fiduciary duty.

For example, as trustee, firms are responsible for their clients' money until it reaches the insurer or someone who receives that money as agent of the insurer. Once an insurer has received a client's premium a firm has discharged its fiduciary duty. If a firm pays a client's premium on to a third party (who does not have risk transfer in place with an insurer) it cannot discharge its fiduciary duty until the third party confirms that the insurer has received the premium. Here are some examples.

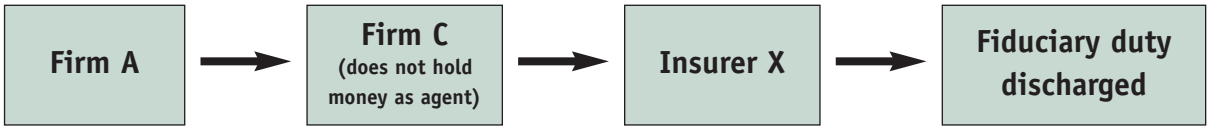
Firm A pays his client's premium directly to Insurer X thereby discharging his fiduciary duty to his client.




Firm A pays his client's premium, for the purpose of the transaction, to Firm B who holds money as agent for Insurer X thereby discharging his fiduciary duty to his client. (Paying a premium to a broker who has a risk transfer agreement in place with an insurer is equivalent to paying the insurer directly. However, firms may want to ask for written confirmation from the third party that risk transfer is in place before relying on it.)




Firm A pays his client's premium to Firm C who then pays Insurer X. Firm A's fiduciary duty is not discharged until Firm C pays the premium to Insurer X. Firm A must assume that its client's money is still at Firm C and continue to include the premium paid to Firm C in its client money calculation, until Firm C tells Firm A that he has paid Insurer X. In Part 3 we explain how to account for client money held at third parties until a firm's fiduciary duty is discharged.




Note that if a firm draws a cheque or other order payable to discharge its fiduciary duty, that cheque or order remains client money until it is presented and paid by the bank. A firm's fiduciary duty is not discharged when a third party presents a cheque and it clears (unless the third party acts as agent of an insurer). This is because a firm's fiduciary duty is only discharged when an insurer receives the client's money.

Only one firm has a relationship and a duty to a client. This is why a firm keeps their fiduciary responsibilities to their client even when their client's money is working its way through one or more insurance intermediaries. A duty to a client does not pass along the chain from one broker to another.

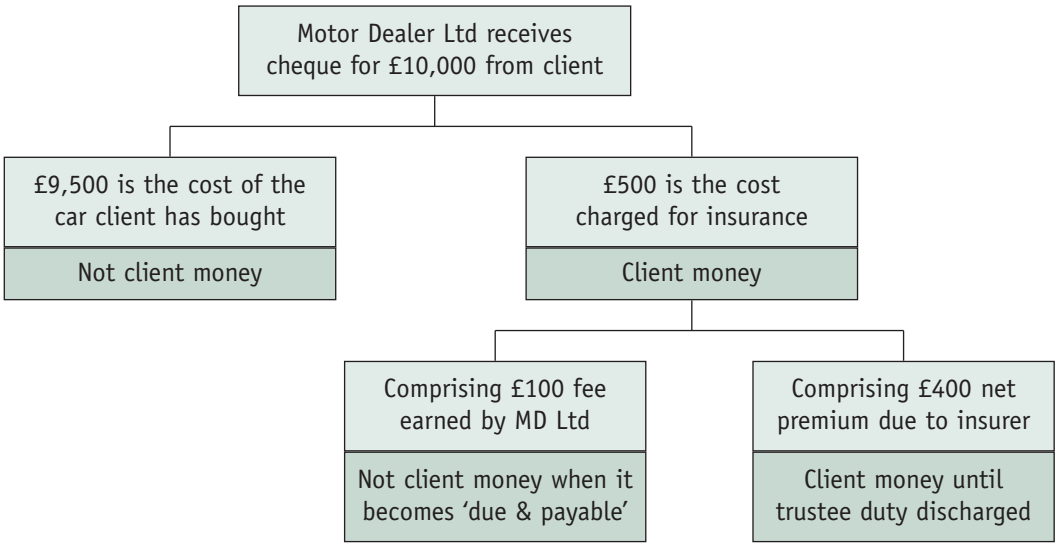
The process of discharging fiduciary duties is less complex when client money (premium refunds or claims for example) comes back from the insurer via one or more insurance intermediaries to the client. The firm's fiduciary duty does not resume as soon as the money leaves the insurer. Instead the firm's fiduciary duty is resumed when it receives the client money and is discharged when it pays the money back to the client. Remember, if paying clients by cheque, a firm's fiduciary duties are not discharged until the client presents the cheque and it clears.

## 2.4 Repaying money to clients

When a firm receives money for a client, for example in settlement of a claim or a refund of premium, this must (unless held under a risk transfer agreement) be paid into either the statutory or non-statutory trust client bank account or directly to the client as soon as possible. This must be no later than one business day after it becomes due. Remember, firms operating a statutory trust client bank account must not pay money to a client until the firm has received the money from the insurer or third party.

## 2.5 Mixed remittances

A mixed remittance is a payment comprising client money and money that is not client money. Typically, a mixed remittance could include fees belonging to the firm but a mixed remittance could also include payment for some other good or service provided by the firm. See the example of a mixed remittance (we have highlighted what is client money and what is not client money).




If a firm receives a mixed remittance, it must pay the full amount into a client bank account as soon as practical. It must then remove the money that is not client money from the client bank account as soon as practical and no later than 25 business days after the mixed remittance is cleared. If there is any doubt as to whether a mixed remittance is a mixed remittance, treat it as though all the money is client money until it can be established it is a mixed remittance.

## 2.6 Withdrawing commission and fees from cleared funds

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

- it has received payment from the client (or from a premium finance company on the client's behalf);
- that payment has cleared; and
- the commission is paid in accordance with terms of business with its client and the insurer (see *Part 1.5 – Telling clients about a firm's client money handling arrangements*).

This is so both the client and the insurer are clear about the point when commission or fees will cease to be client money.

Sometimes a firm may receive payment from a client in instalments. When this happens a firm may only remove from the client money account the commission payable on each instalment as it is earned by the firm. For example, if it receives an instalment of £100 which represents 10% of the total premium, the firm may remove only 10% of the total commission. However, insurer's agreements may restrict the amount of commission which can be taken.

| Cleared cheques and 'due and payable' | |
|---|---|
| What is a cleared cheque? | A reasonable amount of time needs to be allowed between banking a cheque and drawing on it. It would generally be prudent, based on the standard cheque clearing cycle, to allow 3-5 working days to allow a sterling cheque to clear. |
| Why is it important to ensure a cheque has cleared before drawing on it? | Firms operating a statutory trust bank account are not allowed to extend credit either to clients or to itself; if a firm knowingly draws on an uncleared cheque it would be extending credit.<br>In the case of a non-statutory trust account, firms can extend credit, but they are not permitted to make advances of credit to themselves. Therefore, a firm cannot withdraw commission from the client money trust account before it has received the premium as cleared funds from the client as this would amount to extending credit to itself. |
| When can a credit card payment be considered cleared? | This is for firms to determine based on the systems they use. Typically, it is prudent to allow at least five working days after processing for clearance. |
| What makes money due and payable for the purpose of withdrawing commission? | A payment needs to be in the form of cleared funds, and be made in accordance with any terms the firm may have in place with its clients and insurers. |

## 2.7 Controlling client money

**This paragraph is only relevant to firms who have their client's permission to control, as well as hold, client money.**

A firm must have written authority from its client to control that client's assets or liabilities. Controlling a client's assets or liabilities would include:

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

Firms that have written authority from their client should:

- Have an up-to-date list of clients who have given authority with details of any special conditions placed by the client (for example, must not debit more than £x from credit card in any 6 month period) or the firm's management (for example, client B's bank account must not be debited until the Managing Director has approved it);
- Record all transactions entered into using the client's authority; and
- Have appropriate internal controls to ensure that:
  - the client's money is controlled according to the written agreement and any special conditions set by the client or the firm;
  - instructions are given and received according to the written agreement; and
  - where a firm holds a client's passbook or similar documents, it safeguards against loss, unauthorised destruction, theft, fraud or misuse and it keeps a record of what it holds (see *Part 7 – Record keeping*).

# 3. The client money calculation

**This part of the Guide is not relevant to those firms who only hold client money under risk transfer agreements.**

This part of the Guide explains:

- Why and when a client money calculation has to be done;
- The difference between the accruals and client balance method of doing the calculation;
- How to do the client money calculation;
- How and when to reconcile the bank statements with the calculation; and
- When to notify the FSA that there is something wrong in the client money account.

## 3.1 What is the client money calculation?

The client money calculation is done as often as necessary but at least every 25 business days so that the firm can verify that the amount of client money segregated in the client money account(s) and held at third parties is enough to meet its obligations to clients. The calculation is done using the firm's own accounting records as these are the most up-to-date figures, but within 10 business days of the calculation being done, a firm must have reconciled its own records with its bank statements.

## 3.2 Accruals method vs. Client balance method

Firms can use one of two methods to do the client money calculation – accruals or client balance method. Whichever one is chosen, a firm must use only one method during each annual accounting period and record in writing which method it has chosen. If a firm is operating both a statutory trust and non-statutory trust client bank account it must use the same method for both types of account.

The accruals method aggregates amounts of client money recorded on a firm's business ledgers and includes insurance debtors and creditors. The client balance method uses individual client balances to calculate the client money requirement. An example of each method is given in *Part 3.3 – Doing the client money calculation*.

## 3.3 Doing the client money calculation

Simply, the client money calculation works out the client money resource (the amount of client money segregated in appropriate accounts) and the client money requirement (the amount of money a firm has to segregate to meet its obligations to clients) and then compares one with the other. Ideally this should balance out at zero but more commonly there will be less money than there should be (a client money shortfall) or too much money (a client money surplus). The reasons can be varied but the most common reasons for a shortfall are:

- Premiums have been paid to insurers before they have been received from clients;
- Money has been paid to clients before it has been received from insurers; and
- Commission has been withdrawn from the client account before it has become 'due and payable' to the firm.

The most common reasons for a surplus are:

- Commission has become due and payable but has not been paid to the firm; and
- Interest has accrued on the credit balance and has not yet been paid to the firm.

It is important that firms do not keep their own money in the client money trust accounts as a buffer because it could potentially invalidate the trust status of the account. This is because keeping firm's money in the account increases the risk for clients that the client money bank accounts will become 'polluted'. As a consequence, if the firm failed, the receivers may not distinguish between client money and the firm's money and instead use all the money to repay general creditors. So clients would only receive a share of what money is left after the receiver has paid other secured creditors of the firm. However, there are circumstances where keeping client money and firm's money together is acceptable – see *Part 1.1 What is client money?*

For many firms the accruals method is the simpler of the two methods to perform. We show two examples, one for firms that operate a statutory trust client bank account the other is for firms that operate a non-statutory trust client bank account. **Remember that firms who have permission to co-mingle money held as agent with client money and do this, must treat the money held as agent as client money and include it in the calculation.**

Firms may use the examples as templates for their own calculations, removing our example figures, but will need to tailor it to suit their business (for example, a firm may not have all the types of bank accounts listed). Please note our examples use sterling equivalent balances for all foreign currency balances although firms can choose to perform the calculation on a currency by currency basis.

### 3.3.1 Client money calculation using the accruals method for a statutory trust account

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 (see the notes at the end of this section for an explanation)).

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 FSA immediately (see *Part 3.5 – Notifying the FSA*).

Use the numbered notes at the end of this section (*3.3.4*) to help you understand what should be included in the calculation. Here's an example.

**Resource**

| | | |
|---|---|---|
| **(1) Bank balances** | | |
| Client Statutory Trust Account 1 | £36,502.45 | |
| Client Statutory Trust Account 2 | £15,120.78 | |
| Client Statutory Trust Deposit Account | £25,000.00 | |
| Suspense Account (unreconciled items) | £350.07 | |
| Client currency account 1 | £15,103.00 | |
| Client currency account 2 | £ 0.00 | |
| **Aggregate bank balances** | **£92,076.30** | |
| **(2) Money held at third parties** | | |
| Intermediate broker 1 | £7,550.75 | |
| Intermediate broker 2 | £19,362.03 | |
| Overseas intermediate broker 1 | £3,775.00 | |
| Overseas intermediate broker 2 | £0.00 | |
| **Aggregate of balances held with third parties** | **£30,687.78** | |
| **(3) Insurance debtors (not including pre-funded items)** | | |
| Insurance debtors (due from clients) | £27,239.90 | |
| Insurance debtors (due from insurers) | £22,108.25 | |
| **Total insurance debtors** | **£49,348.15** | |
| **Resource available** | **£172,112.23** | |

**Requirement**

| | | |
|---|---|---|
| **(4) Insurance creditors** | | |
| Insurance creditors (due to insurers) | | £52,256.56 |
| Insurance creditors (due to other persons) | | £9,123.75 |
| Insurance creditors (due to clients) | | £17,149.39 |
| **Total insurance creditors** | | **£78,529.70** |
| **Interest accrued** | | **£365.25** |
| **(5) Unearned commission** | | **£23,526.25** |
| **(2) Money held at third parties** | | **£30,687.78** |
| **(6) Money with appointed representatives** | | **£8,506.25** |
| **Requirement to cover** | | **£141,615.23** |
| **Resource** | **£172,112.23** | |
| **Surplus/deficit** | | **£30,497.00** |

In the example there is a surplus of funds in the client money account – most likely a result of accrued commission and interest which has not yet been withdrawn. This surplus must be removed from the client money account on the same day the calculation is done.

### 3.3.2 Client money calculation using the accruals method for a non-statutory trust account

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 (including pre-funded items(see the notes at the end of this section for an explanation)); PLUS
4. if applicable, any designated investments valued on a prudent and consistent basis; PLUS
5. if applicable, an amount of letter of credit or unconditional guarantee.

Next calculate the client money requirement which is:

6. 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
7. unearned commission of the firm; PLUS
8. money held at third parties; PLUS
9. 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 FSA immediately (see *Part 3.5 - Notifying the FSA*).

Use the numbered notes at the end of this section (3.3.4) to help you understand what should be included in the calculation. Here's an example.

| | | |
|---|---|---|
| **Resource** | | |
| **(1) Bank balances** | | |
| Client Non-Statutory Trust Account 1 | £9,262.55 | |
| Client Non-Statutory Trust Account 2 | £5,120.78 | |
| Client Non-Statutory Trust Deposit Account | £10,000.00 | |
| Suspense Account (unreconciled items) | £350.07 | |
| Client currency account 1 | £15,103.00 | |
| Client currency account 2 | £0.00 | |
| **Aggregate bank balances** | **£39,836.40** | |
| **(2) Money held at third parties** | | |
| Intermediate broker 1 | £7,550.75 | |
| Intermediate broker 2 | £19,362.03 | |
| Overseas intermediate broker 1 | £3,775.00 | |
| Overseas intermediate broker 2 | £0.00 | |
| **Aggregate of balances held with third parties** | **£30,687.78** | |
| **(3) Insurance debtors (including pre-funded items)** | | |
| Insurance debtors (due from clients) | £27,239.90 | |
| Insurance debtors (due from insurers) | £22,108.25 | |
| **Total insurance debtors** | **£49,348.15** | |
| **(7) Value of any designated investments** | **£0.00** | |
| **(8) Amount of letter of credit or unconditional guarantee** | **£0.00** | |
| **Resource available** | **£119,872.33** | |
| **Requirement** | | |
| **(4) Insurance creditors** | | |
| Insurance creditors (due to insurers) | | £25,016.66 |
| Insurance creditors (due to other persons) | | £9,123.75 |
| Insurance creditors (due to clients) | | £7,149.39 |
| **Total insurance creditors** | | **£41,289.80** |
| **Interest accrued (due to clients)** | | **£965.25** |
| **(5) Unearned commission** | | **£23,526.25** |
| **(2) Money held at third parties** | | **£30,687.78** |
| **(6) Money with appointed representatives** | | **£8,506.25** |
| **Requirement to cover** | | **£104,975.33** |
| **Resource** | **£119,872.33** | |
| **Surplus/deficit** | | **£14,897.00** |

In the example, premiums have been advanced to insurers before the client has paid the firm and claims money has been paid to clients before the firm has received it from the insurer. This is reflected in reduced balances in the client money trust accounts and insurance creditors (compared to the statutory trust example). The example shows there is a surplus of funds in the client money account – most likely a result of accrued commission and interest which has not yet been withdrawn. This surplus must be removed from the client money account on the same day the calculation is done.

### 3.3.3 Client money calculation using the client balance method for statutory and non-statutory trust accounts

The client balance method is almost identical whether a firm operates a statutory or non-statutory trust account. Just remember to include the value of any designated investments if operating a non-statutory trust account and you have chosen to segregate client money in designated investments in place of cash.

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.

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 paying 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. |
| 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. |

Use our example as a template for doing the client money calculation using the client balance method. Remember to make good any shortfall or withdraw any surplus on the same day the calculation is done.

| | | |
|---|---|---|
| **Resource** | | |
| **(1) Bank balances*** | | |
| Client Statutory Trust Account 1 | £36,502.45 | |
| Client Statutory Trust Account 2 | £15,120.78 | |
| Client Statutory Trust Deposit Account | £25,000.00 | |
| Suspense Account (unreconciled items) | £350.07 | |
| Client currency account 1 | £15,103.00 | |
| Client currency account 2 | £0.00 | |
| **Aggregate bank balances** | **£92,076.30** | |
| **(2) Money held at third parties*** | | |
| Intermediate broker 1 | £7,550.75 | |
| Intermediate broker 2 | £19,362.03 | |
| Overseas intermediate broker 1 | £3,775.00 | |
| Overseas intermediate broker 2 | £0.00 | |
| **Aggregate of balances held with third parties** | **£30,687.78** | |
| **(7) Value of any designated investments*** | **£0.00** | |
| **Resource available** | **£122,764.08** | |
| **Requirement** | | |
| **(9) The sum of all (positive) individual client balances** | | **£82,755.95** |
| **(2) Money held at third parties*** | | **£30,687.78** |
| **(5) Commission on uncleared cheques or other orders** | | **£9,320.35** |
| **Requirement to cover** | | **£122,764.08** |
| **Resource** | **£122,764.08** | |
| **Surplus/deficit** | | **£0.00** |

**** Use the numbered notes at the end of this section (3.3.4) to help you understand what should be included in the calculation***

***In the example, the client money requirement and resource balance so there is no shortfall or surplus. If there were, then the surplus must be removed or the shortfall made good on the same day the calculation is done.***

### 3.3.4 Notes to help you understand what to include in the client money calculation

**(1) Bank Balances**

This should include the aggregate balances of **all** of a firm's client money accounts including deposit accounts and money held in error or suspense accounts which hold unidentified or unreconciled client money. The balances should be taken from the firm's own client money ledgers as at close of business on the day before the calculation is done. Our examples shows the balances from the different types of accounts firms typically use to hold client money. However, firms may not operate all the different types of accounts we have shown so if using this example as a template, firms should tailor it to their requirements. Firms that hold money in different currencies should refer to *Part 5 – Foreign Exchange* for details. It should also include payments received from insurers, third parties or clients which have not yet cleared.

**(2) Money held at third parties**

In *Part 2.3 – Discharging your fiduciary duty* we explained that a firm's fiduciary duty is not discharged until a transaction is successfully completed through payment of a premium to an insurer or agent of an insurer. Until the firm has confirmed the transaction is complete, money held at third parties must be included in the client money calculation. Firms should note that they do not need to set aside a sum of money equal to that held by third parties because the calculation includes money held at third parties in both the client money resource and client money requirement parts of the calculation.

Firms must keep a record of the amount of money passed to third parties so that they can do the client money calculation and demonstrate, if necessary, how the figures used are supported. Firms can communicate with each other so that a firm knows when a transaction has been successfully completed and can therefore amend its records of money held at third parties. Firms can ask third parties for a monthly statement to include amounts held on their behalf and amounts paid to insurers.

Client money held at third parties must be included in the client money calculation until confirmation has been received that the transaction is complete. However, firms that deal with third parties overseas may treat a transaction as complete and may stop including the transaction in the client money calculation if 12 months have passed without the transaction being confirmed. However, a firm should have taken reasonable steps to find out whether the transaction had been completed.

**(3) Insurance debtors**

This includes money due from clients and insurers (premium refunds and claims money) and can also include pre-funded items if the firm is operating a non-statutory trust account. Firms should use their own business ledgers (for example, an aged client report or credit control report) to calculate the amounts due from clients. Similarly, amounts due from insurers can be taken from the firm's own records (for example, broker-system generated reports or insurer statements).

Pre-funded items. These include client money recorded on a firm's business ledger as being advanced to a client, insurer or other person before it is received. For example, a client's claim is paid before the money is received from the insurer or an insurer is paid a premium before it is received from the client. These 'advances' should be valued prudently and consistently to the extent required to meet any shortfall of the client money resource compared with the firm's client money requirement.

**(4) Insurance creditors**
The sum of all insurance creditors shown in a firm's business ledgers as owed to insurers, clients and other persons. This could be premiums received from clients and not yet paid to insurers or to a third party. Or it could be money owed to a client and not yet paid (for example, settlement of a claim or interest earned). It also includes cheques payable to insurers, third parties or clients which have not been presented and cleared. A firm must continue to treat uncleared cheques as client money and include it in the client money requirement until it has been presented and paid by the bank.

**(5) Unearned commission**
This is the amount of commission showing as accrued on a firm's business ledgers but which has not yet become 'due and payable' to the firm when the calculation is done. This could be because:

- the firm has not received the premium from the client; or
- the client's cheque has not cleared; or
- the insurer's agreement specifies that commission is not due and payable until the insurer receives the premium.

A prudent estimate of unearned commission may be used if an exact figure is not available. Firms whose systems show commission as earned when cheques are received from clients should add back that commission into unearned commission until the cheque has cleared.

**(6) Money with appointed representatives**
This is the amount of money received and what is due from appointed representatives, field representatives and other agents. Firms that do periodic segregation and reconciliation (see *Part 4 – Appointed representatives*) must include within this part of the client money requirement, the amount which it has already received and the amount which it estimates is still due from its representatives or other agents. Periodically, this estimated amount must be reconciled with the amount paid into the client money bank account and the client money received and held by representatives and other agents. Firms that do immediate segregation should not need to include anything in this part of the calculation.

**(7) Value of designated investments**
Some firms operating a non-statutory trust account may choose to segregate designated investments rather than money, provided the trust deed allows it. There are restrictions on which designated investments can be segregated and these can be found in CASS 5 Annex 1. Firms must ensure the value of designated investments is at least equal to the amount of money that would otherwise have been segregated into a client money bank account and **must meet any shortfall that arises as a result of a fall in the market value of the designated investments**. Firms can obtain the value of designated investments from statements provided by custodians or unit trust managers. The valuations must detail the method of valuation and demonstrate it was carried out consistently and prudently (any investment with more than one rating should apply the lowest rating).

**(8) Amount of any letters of credit or unconditional guarantee**
Few firms will have arranged with their bank for a letter of credit or unconditional guarantee for the benefit of the trust account. It enables them to have immediate funds available to make good a deficit or extend credit to clients of the trust account. If a letter of credit or unconditional guarantee has been utilised, then firms should include it within the calculation.

**(9) The sum of all (positive) individual client balances**
See the table in Part 3.3.3 for details of how to calculate individual client balances.

## 3.4 Reconciling bank statements

Within 10 business days of doing the client money calculation firms must have reconciled the balance on each client bank account, using bank statements, to its own records. The bank statement reconciliation may be carried out as part of the client money calculation, provided the calculation:

- is still completed within one business day of the firm closing its ledgers to do the calculation; and
- within the 25 business days cycle.

Doing a bank statement reconciliation contributes to safeguarding client money as it reduces the risk of theft and enables identification of errors by either the bank or the firm.

If there is a difference between the firm's records and the bank's statement(s), the firm should identify the reason for the difference and correct it as soon as possible unless the difference is solely as a result of timing differences between the bank and firm's records. If a firm is unable to identify the reason for the difference, it should assume that the record indicating a greater amount in the client money account is the correct record and should top up the client money account from its own funds if necessary. For example, if the firm's client money ledger shows a balance of £1000 and the corresponding bank statement stands at £900, but the difference cannot be reconciled, the firm should assume that the client money ledger is correct and pay £100 into the client money account whilst continuing to investigate the discrepancy. A firm that cannot reconcile its bank accounts should not pay out a surplus until it is prudent to do so.

When reconciling bank statements, firms should be aware that cheques which have been drawn for the benefit of its clients and which have not yet been presented and cleared could create a surplus in the client money account which, if removed after doing the client money calculation, could result in an actual shortfall.

## 3.5 Notifying and reporting to the FSA

A firm must notify us immediately if it is unable to, or does not, perform the client money calculation. A firm must also notify us immediately if it cannot make good a shortfall in the client money account(s) by close of business on the day the calculation is done.

It is a serious breach of our rules not to perform the calculation and not to make good any shortfall in the client money account. When dealing with rule breaches we consider how open and honest a firm has been with us (Principle 11). We expect to hear from a firm directly if there is a breach of our rules rather than from the firm's auditors. (Auditors have a statutory responsibility under the Financial Services and Markets Act 2000 to report any material breaches of the client money rules.)

If a firm passes client money to a third party and that third party fails, the firm must notify us as soon as it becomes aware. Likewise if the firm's bank or the bank that a third party holds client money in fails, the firm must notify us as soon as possible. Firms must also, as soon as practical, let us know whether they intend to make good any shortfall in client money that may have occurred as a result of the failure of a bank or a third party (see *Part 2.3 – Discharging your fiduciary duty*).

The Retail Mediation Activities Return (RMAR) asks for information about client money held by a firm. This must be reported regularly in line with a firm's own accounting reference date. When completing the client money section of the RMAR, firms should take information from their business ledgers and note that the client money credit and debit totals are the client money balances as at the last day of the reporting period, not the total of entries over the course of the reporting period. Firms can use the 'help' buttons on the RMAR to help them complete the online form accurately.

# 4. Appointed representatives

**This part of the Guide is only relevant to those firms who have appointed representatives, field representatives and other agents and whose risk transfer agreements do not extend to them.**

This part of the Guide explains:

- What to do if a firm's agreements to hold money as agent do not extend to its appointed representatives, field representatives and other agents;
- How appointed representatives, field representatives and other agents should segregate client money; and
- How to monitor how client money is handled by appointed representatives, field representatives and other agents.

## 4.1 What to do if a firm's agreements to hold money as agent do not extend to its appointed representatives, field representatives and other agents

In Part 1.4.1 of this Guide we suggest firms check their agency agreements with insurers and insurance intermediaries to see whether the authority to hold money as agent can be extended to appointed representatives, field representatives or other agents. Firms that do not have authority in their agreements and want their representatives and agents to hold money as agent, should contact the insurer to get a new agreement in place. If agreements are in place, then there is no need for the firm to follow the requirements described in Part 4 of this Guide.

However, if the insurer is unwilling to amend the agreement, a firm must consider:

- whether it needs to vary its permission to hold client money so that its appointed representatives, field representatives and other agents can handle client money; or
- whether its appointed representatives, field representatives and other agents can change the way they do business so that they do not handle client money (for example, clients' cheques are made payable to the Principal or insurer directly).

## 4.2 Segregating client money held by appointed representatives, field representatives and other agents

The same principle applies of adequate protection for clients' money when money is received and held by an appointed representative, field representative or other agent of a firm. Firms should make arrangements with their appointed representatives, field representatives and other agents to protect clients' money in one of two ways:

- immediate segregation; or
- periodic segregation.

Firms should record which method they are using so that an audit trail can be followed should any queries arise about how client money is handled.

Client money held by appointed representatives, field representatives and other agents is the responsibility of the firm and therefore it must be able to account for any client money (either owed to its clients or due to the firm from clients). If a shortfall in client money arises, then the firm will be liable to make good the shortfall. Firms must keep a record of the amount of money received or due from the appointed representatives, field representatives or other agents. Robust procedures are therefore essential to ensure that money is handled properly by appointed representatives, field representatives and other agents and that the firm and its clients' interests are protected.

## 4.3 Immediate segregation

Money received from clients by appointed representatives, field representatives and other agents must be paid:

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

Money received by appointed representatives, field representatives and other agents 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, field representatives and other agents is clearly identifiable from any other money held, including the firm's own money.

## 4.4 Periodic segregation and reconciliation

A firm may allow its appointed representatives, field representatives and other agents to pass on client money on a less regular basis. However, the firm must ensure that it holds in a segregated client bank account an amount of money which it reasonably estimates is likely to be received and held over a given period of time (for example, three or six months) by its representatives or agents. This estimated amount must be reconciled within 10 business days of the end of the time period against the information obtained from the Appointed Representative, field representative and other agents about how much money they have received and are holding. The time period is flexible and firms can choose what period is reasonable for the nature and frequency of business done by representatives and agents, provided that the period is regular.

Once the reconcilliation is complete the firm must then make any necessary payments into or withdrawals from its client bank account to ensure that there is neither an excess nor a deficit.

Even though appointed representatives, field representatives and other agents have flexibility over when client money is passed to the firm, there is no flexibility in repaying claims money or premium refunds to clients. Appointed representatives, field representatives and other agents must repay client money when it is due and no later than the next business day.

## 4.5 Monitoring activities of appointed representatives, field representatives and other agents

Firms must have adequate and appropriate systems and controls in place to monitor appointed representatives, field representatives and other agents. In Part 4.1 above we explained why it was important to have robust procedures in place for handling client money but firms must also be able to demonstrate to us that they have control over what their representatives and agents do on their behalf. So appropriate records should be maintained to show what:

- procedures are in place to ensure client money is received, segregated and paid on by appointed representatives, field representatives and other agents according to our requirements;
- training has been given to appointed representatives, field representatives and other agents for handling client money according to the firm's own procedures; and
- monitoring is done to ensure appointed representatives, field representatives and other agents handle client money according to the firm's own procedures.

# 5. Foreign exchange

**This part of the Guide explains how to perform a foreign exchange calculation. It is relevant to those firms who receive client money in more than one currency.**

Firms will need to perform a foreign exchange calculation if they receive client money in a currency which is different from that of their client money calculation (for example, accounting records and calculation are in sterling but a firm receives client money in US dollars as well as sterling). This is because the amount of client money held in the bank must be adjusted to ensure that there is enough to meet all liabilities, regardless of the currency of the liability. The foreign exchange calculation and any necessary adjustment should be made at least every 25 business days, using the previous day's closing spot exchange rate. Records of the conversion rates used and when and from where they were obtained may help firms show and explain their foreign exchange calculation.

Alternatively, to avoid having to make foreign exchange adjustments, firms can set up separate bank accounts for each currency and perform a calculation for each currency. This can however incur additional bank costs.

# 6. Auditing client money

**This part of the Guide is not relevant to those firms who only hold client money under risk transfer agreements.**

This part of the guide explains:

- which firms are required to arrange a client money audit;
- what the client money audit report should cover; and
- how often it should be done.

## 6.1 Which firms are required to arrange a client money audit?

A client money audit is required of all general insurance intermediaries (irrespective of whether they are a limited company, partnership or sole trader) who:

- hold client money in a non-statutory trust client bank account; or
- have held more than £30,000 in a statutory trust client bank account at **any** time (even if only for one day) in the client money audit reporting period (see Part 6.3 below).

A firm should review regularly whether it needs a client money audit and appoint an external auditor to carry out the audit in accordance with Handbook requirements in CASS 5 and Chapter 3 of the Supervision Manual. A firm is not exempt from the requirement to arrange a client money audit even if:

- it is able to rely on the rule waiver which removes the need for the firm to have its accounts audited (the small firm audit exemption); or
- it does not need to have its accounts audited because it is a partnership or a sole trader.

## 6.2 What must the client money audit report cover?

The client money audit report principally covers the systems and controls a firm operates to handle client money. It is not an audit of the actual client money account(s). The auditor must submit his report to the firm giving his opinion on whether:

- the firm has maintained systems adequate to enable it to comply with Chapter 5 of the CASS Sourcebook (except CASS 5 .2 which relates to holding money as agent); and
- the firm has been compliant with the rules in Chapter 5 of the CASS Sourcebook (except CASS 5.2) throughout the year and at the date of the report.

There is no requirement for the firm or the auditor to submit the client money audit report to the FSA though we may request to see it. (Firms should keep their client money audit reports for up to six years.) Firms that operate non-statutory trust accounts do not need to have separate audit reports to meet the requirements in CASS 5 and Chapter 3 of the Supervision Manual – they can be combined in the same report.

## 6.3 When, and for what period, does the client money audit report have to be done?

The audit report can cover any time period but the period must not be more than 53 weeks:

- from the last report; or
- from the date the firm became authorised if it is the first report.

This enables firms to tie the client money audit requirement into their other accounting or audit practices. For example, a firm who meets the criteria in 6.1 with a financial year ending 30 April could have arranged an audit report to cover the period 14 January 2005 (the date of authorisation) to 30 April 2005 (its financial year end).

The client money report must be issued to the firm within 4 months of the end of the relevant reporting period.

# 7. Record Keeping

This part of the Guide highlights the information you should keep for your records and to demonstrate compliance with specific CASS rules. Information has to be current but some information needs to be kept even when it is no longer current. The table below tells you how long some information must be kept.

| Information | How long to keep? | Compliance with which rule? |
|---|---|---|
| Written agreement to act as agent of an insurer | Current. 6 years from date agreement was terminated | CASS 5.2.3R (2) |
| Non-statutory trust deed | Current | CASS 5.4.7R |
| Written confirmation from auditors that systems and controls are in place to operate non-statutory trust | Current | CASS 5.4.4R (2) |
| Written acknowledgement(s) from bank(s) that trust account(s) have been set up according to firm's notification | Current | CASS 5.5.49R |
| Record of whether firm does client money calculation using accruals or client balance method | Current | CASS 5.5.64R |
| Record of transactions and commitments for client money (for example, bank statements, internal accounting records, client money calculations, foreign exchange calculation) | Current. 3 years from the date the record was made | CASS 5.5.84R |
| Copy of client money audit report | Up to 6 years of the end of the period covered | SUP 3.10.8AR |
| Record of whether appointed representatives, field representatives or other agents segregate client money immediately or periodically | Current | CASS 5.5.18R (2) |

The table below only applies to firms who have authority from their clients to control their money (for example, take direct debit payments or debit a client's credit or debit card) or have possession for safekeeping any client documents or assets (for example, a policy document or passbook).

| Information | How long to keep? | Compliance with which rule? |
|---|---|---|
| Up-to-date list of authorities and details of those authorities for each client | Current | CASS 5.7.6R (1) |
| Record of all transactions using the authority | Current | CASS 5.7.6R (2) |
| Written procedures for carrying out the authority | Current | CASS 5.7.6R (3) |
| Record of client documents or assets held by the firm, for whom and when they were received or returned | 3 years after the document or asset was returned to the client | CASS 5.8.3R (1) – (2) |

# Appendix 1

A brief description of key terms used in this Guide.

| Defined term | Meaning |
|---|---|
| Appointed representative and field representative | An appointed representative acts for an FSA authorised firm (the Principal). The Principal has full responsibility for ensuring that the appointed representative complies with the FSA's rules. The appointed representative must have a written agreement in place with the Principal and the appointed representative can only carry on business which the Principal has permission to do.<br><br>A field representative is an appointed representative of an authorised firm, or an employee of the firm (or of its appointed representative), whose normal fixed place of business is not a business address of the firm which appears on the firm's stationery. |
| Approved bank | Any of the following:<br>• The Bank of England;<br>• a UK bank or building society;<br>• the central bank of a member state of the OECD;<br>• a bank which is supervised by the central bank or other banking regulator of a member state of the OECD;<br>• a credit institution established in an EEA State other than the United Kingdom and duly authorised by the relevant Home State regulator;<br>• a bank which is regulated in the Isle of Man or Channel Islands;<br>• a bank supervised by the South African Reserve Bank; or<br>• any other bank which:<br>– is regulated by a national banking regulator;<br>– is required to provide audited accounts;<br>– has minimum net assets of £5 million (or its equivalent in any other currency at the relevant time) and has a surplus revenue over expenditure for the last two financial years; and<br>– has an annual audit report which is not materially qualified. |
| Client | A person with whom a firm conducts or intends to conduct insurance mediation activities. |
| Client money | Money that a firm holds on behalf of a client in the course of carrying on insurance mediation activities. This includes money that a firm treats as client money in line with the FSA client money rules in CASS. |
| Client bank account | An account at a bank which:<br>• Holds the money of one or more clients;<br>• Is in the name of the firm;<br>• Includes in its title an appropriate description to distinguish the money in the account from the firm's money; and<br>• Is a current or deposit account. |
| Commission | Any form of commission or remuneration including a benefit of any kind, offered or given in connection with insurance mediation activity. |

| Defined term | Meaning |
|---|---|
| Designated investment | A security or contractually based investment (but not a funeral plan contract). For example, shares, warrants, government and public securities, futures and options. |
| Fee | Any payment or remuneration offered or made by a client to a firm in connection with insurance mediation activities including (where applicable) any mark up or mark down. |
| Insurance intermediary | A firm carrying on insurance mediation activities. |
| Insurance mediation activities | Any of the following regulated activities:<br>• Dealing as agent in contracts of insurance;<br>• Arranging (bringing about) deals in contracts of insurance;<br>• Making arrangements with a view to transactions in contracts of insurance;<br>• Assisting in the administration and performance of contracts of insurance;<br>• Advising on contracts of insurance; and<br>• Agreeing to carry on any of the above activities. |
| Mixed remittance | A payment comprising of client money and money that is not client money. |
| Money | Any form of money including cheques and other payable orders. |
| Premium | The consideration payable under the contract by the policyholder to the insurer. |
| Retail and commercial customer | A retail customer is a customer who is an individual acting outside his trade, business or profession.<br>A commercial customer is a customer who is not a retail customer. |
| Shortfall | The amount by which the client money in a client bank account is insufficient to satisfy the claims of clients in respect of that money, or not immediately available to satisfy such claims. |
| Terms of business and client agreements | Terms of business are a statement in a durable medium of the terms and conditions on which a firm will conduct insurance mediation activities with or for a customer.<br>Client agreements are terms of business which have been signed by the customer or to which the customer has consented in writing. |

# Appendix 2

We have not significantly cross-referenced to rules throughout this Guide except in *Part 7 – Record keeping*. Instead we list here the relevant rules we have referenced to write the Guide.

| Part | Title | Rules |
|---|---|---|
| 1 | What is client money? | CASS 5.5.3R, CASS 5.5.9R, CASS 5.5.10R, CASS 5.5.16R(2) |
| | Why is it important that client money is handled correctly? | CASS 5.1.7G (1) |
| | What are the options for handling client money? | CASS 5.1.7G (2) |
| | Transferring the risk of holding client money from firm to insurer | CASS 5.2.1G – 5.2.7G |
| | Segregating client money in a Statutory or Non-Statutory Trust Bank Account | CASS 5.5.3R, CASS 5.3.3G (2), CASS 5.4.1G, CASS 5.5.14R, AUTH 3.7.3G |
| | Holding client money as agent and segregating client money into a trust account | CASS 5.1.5A R |
| | Co-mingling | CASS 5.1.5A R |
| | Risk transfer agreements | CASS 5.2.1 – 5.2.7G, CASS 5.1.5A R, CASS 5.5.16R |
| | Setting up a statutory trust client bank account | CASS 5.3.1G -5.3.3G, CASS 5.5.42G, CASS 5.5.13G, CASS 5.5.39R, CASS 5.5.40G, CASS 5.5.49R |
| | Setting up a non-statutory trust client bank account | CASS 5.4.1G – 5.4.8R, CASS 5.5.14R, CASS 5.5.15G |
| | Choosing an appropriate bank | CASS 5.5.41R,CASS 5.5.42G, CASS 5.5.43R – 5.5.46G |
| | Capital resources | MIPRU 4.2, CASS 5.4.4R (4) |
| | Telling clients about a firm's client money handling arrangements | CASS 5.2.3R (3), CASS 5.5.30R, CASS 5.5.16R (1) (b), CASS 5.4.4R (5), CASS 5.5.14R (2) (a), CASS 5.5.39R (3), CASS 5.5.53R, CASS 5.5.41R (4), CASS 5.5.34R (2), CASS 5.5.58R |
| 2 | Receiving, recording and banking client money | CASS 5.5.5R – 5.5.6G, CASS 5.5.12R |
| | Passing client money to a third party | CASS 5.5.81G (3), CASS 5.5.34R – 5.5.35G, CASS 5.5.81G (4) |
| | Discharging your fiduciary duties | CASS 5.5.79G – 5.5.84R, CASS 5.5.33G |
| | Repaying money to clients | CASS 5.5.4R |
| | Handling mixed remittances | CASS 5.5.16R (2), CASS 5.5.17G |
| | Withdrawing commission and fees | CASS 5.5.16R (1), CASS 5.5.17G |
| | Controlling client money | CASS 5.7.1R – 5.7.6R |

| Part | Title | Rules |
|---|---|---|
| 3 | What is the client money calculation? | CASS 5.5.62G (1), CASS 5.5.63R |
| | Accruals vs. cash based method | CASS 5.5.62G (2), CASS 5.5.64R |
| | Doing the client money calculation | CASS 5.5.63R, CASS 5.1.5A(R) (1) |
| | Example Client money calculation using the Accruals Method for a Statutory Trust Account | CASS 5.5.65R, CASS 5.5.68R, CASS 5.5.63R (1) (c), CASS 5.5.65R (b) |
| | Example Client money calculation using the Accruals Method for a Non-Statutory Trust Account | CASS 5.5.65R, CASS 5.5.68R, CASS 5.5.63R (1) (c), CASS 5.5.65R (b) |
| | Example Client money calculation using the Client balance Method for Statutory and Non-Statutory Trust Accounts | CASS 5.5.65R, CASS 5.5.66R, CASS 5.5.67R, CASS 5.5.69R, CASS 5.5.82R, CASS 5.5.65R (b) |
| | Notes to help you understand what to include in the client money calculation | CASS 5.5.62G (1), CASS 5.5.65R (1), CASS 5.5.81G (4), CASS 5.5.65R (4)-(6), CASS 5.5.65R (3) (a), CASS 5.5.68R (1), CASS 5.5.82R, CASS 5.5.68R (2), CASS 5.5.63R (c), CASS 5.5.23R, CASS 5.5.24G, CASS 5.5.14R (1) |
| | Reconciling bank statements | CASS 5.5.63R (2) – (4) |
| | Notifying and reporting to the FSA | CASS 5.5.76 – 5.5.77R, SUP 3.10.8B G, CASS 5.5.61R, SUP 16 Annex 18 (notes for completion of RMAR) |
| 4 | Segregating client money held by appointed representatives, field representatives and other agents | CASS 5.5.18R |
| | Immediate segregation | CASS 5.5.19R, CASS 5.5.20G, CASS 5.5.21R |
| | Periodic segregation and reconciliation | CASS 5.5.23R, CASS 5.5.24G |
| | Monitoring activities of appointed representatives, field representatives and other agents | SUP 12.6.7G, SYSC 3.2.3G |
| 5 | Foreign exchange | CASS 5.5.8R |
| 6 | Which firms are required to arrange a client money audit? | SUP 3.10.8C G |
| | What must the client money audit report cover? | SUP 3.10.5R, SUP 3.10.8A R |
| | When, and for what period does the client money audit report have to be done? | SUP 3.10.6R, SUP 3.10.8A R |

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