Consultation Paper

CP12/20**

Review of the client money rules for insurance intermediaries

August 2012

FSA®
Financial Services Authority

Contents

The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by 30 November 2012.

Comments may be sent by electronic submission using the form on the FSA's website at: www.fsa.gov.uk/Pages/Library/Policy/CP/2012/cp12-20-response.shtml.

Alternatively, please send comments in writing to:

Celia Ho and Philippe Marie
Client Assets and Wholesale Conduct
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Telephone: 020 7066 6638/0202 7066 0792
Fax: 020 7066 6639/020 7066 0783
Email: cp12_20@fsa.gov.uk

It is the FSA's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise. A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure.

A confidential response may be requested from us under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Tribunal.

Copies of this Consultation Paper are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

Abbreviations used in this paper

BIBA	British Insurance Brokers' Association
CASS	Client Assets Sourcebook
CASS 5	Chapter 5 (Client money: insurance mediation activity) of the Client Assets Sourcebook
CBA	Cost benefit analysis
CP	Consultation Paper
FSA	Financial Services Authority
FSCS	Financial Services Compensation Scheme
IMD	Insurance Mediation Directive
IP	Insolvency practitioner
LIIBA	London & International Insurance Brokers' Association
NST	non-statutory trust under CASS 5
PPE	primary pooling event under CASS 5
RMAR	Retail Mediation Activities Return
Rules	rules and guidance under CASS 5 (unless the context suggests otherwise)
Section C	Section C of the RMAR
SPE	secondary pooling event under CASS 5
ST	statutory trust under CASS 5
TOBA	terms of business

1 Overview

Introduction and purpose

1.1 We began regulating general insurance intermediaries seven years ago, including how they hold client money. At the start we promised to review the regulations at an appropriate time. We have now conducted this review, in particular whether enhancements can be made to the regime itself or to the detailed rules.

1.2 This Consultation Paper (CP) contains various proposals for changes to the CASS 5 rules.

What are our concerns?

1.3 Various concerns have arisen during the course of our review of CASS 5, which include poor understanding of the Rules and subsequent poor compliance, missing or incomplete documentation such as trust deeds and trust letters. We have also seen many examples of good practice and firms effectively protecting their clients' money.

1.4 Examples of specific issues of concern include:

- inappropriate controls around the use of the non-statutory trust;
- ineffective risk transfer documentation;
- application of the pooling rules;
- infrequent client money calculations;
- client money held by third parties; and
- client money held as designated investments.

What work have we carried out so far?

1.5 In preparation for this CP and as part of our pre-consultation process, we have been engaging with various representative interested parties, including trade associations, brokers, auditors, lawyers, consultants and insolvency practitioners to discuss key topics in relation to CASS 5, as well as considering their thoughts about potential changes to the regime. These comments fed into the formulation of our proposals set out in this CP. We would like to thank the participants of this Advisory Group for their time and input as well as the other parties we have discussed our ideas and suggestions with in our pre-consultation process.

1.6 We have also conducted various meetings with the British Insurance Brokers' Association (BIBA) and the London & International Insurance Brokers' Association (LIIBA), which have involved us talking to a large number of firms and obtaining their thoughts on the proposals. These meetings have been very useful in formulating our ideas and we would like to thank BIBA and LIIBA for facilitating these meetings, as well as the firms who attended and shared their thoughts with us.

Structure of this CP

1.7 There are nine chapters in this CP, including this overview:

- Chapter 2 – improving the effectiveness of segregation and use of risk transfer. In this chapter we analyse the use of the non-statutory trust under CASS 5 and the associated client money concerns. We set out a number of proposals in relation to the non-statutory trust, and how firms can move from operating a non-statutory trust to a statutory trust.

  In addition, we discuss the issues around risk transfer and set out proposals to ensure more effective risk transfer.

  Included in this chapter are our views on mandates, which is an alternative to firms holding client money.

- Chapter 3 – simplifying the distribution and transfer of client money. Here we review the distribution rules, both for primary pooling and secondary pooling, together with costs relating to distribution. We also set out proposals that aim to facilitate firms in the transfer of client money on a sale of business.

- Chapter 4 – improving diversification of client money. In this chapter we clarify our views in relation to diversification of client money and set out our proposal on the amount of client money which can be held in a group bank.

- Chapter 5 – enhancing record keeping and reconciliations. Here we clarify the accrual method of calculating the client money requirement. We also discuss additional guidance on trust letters and our proposal on the CASS 5 resolution pack.

- Chapter 6 – enhancing the requirements on segregation and placement of client money. This chapter contains our proposals relating to credit write backs, unclaimed client money, unallocated client money, client money held at third parties, prudent over-segregation, money held as designated investments, commission, same day draw down and money due to a client from a firm.

  Our proposal in relation to segregation of client money held by a firm's appointed representatives, field representatives or other agents is also contained in this chapter.

- Chapter 7 – improving governance and reporting to the FSA. We set out proposals in relation to firms' governance on CASS oversight, client money audit reports and Section C of the Retail Mediation Activities Return (RMAR).

- Chapter 8 – Section 53 of the Marine Insurance Act 1906. We briefly discuss here our views on Section 53.

- Chapter 9 – commencement date and structure of the draft rules.

Key proposals

1.8 Our key proposals in this CP centre around:

- improvements to the CASS 5 rules to produce a rulebook which is clear, simple and easy to apply and to change inappropriate practices; and

- clarifying and explaining the CASS 5 regime for firms and insurers.

Cost benefit analysis

1.9 We have provided a cost benefit analysis of the proposals in Annex 1 of this CP. The cost benefit analysis noted some potential high costs relative to client money holdings for some of the proposals. The CBA asks for comments on those costs and on the cost benefit analysis in general.

Who should read this CP

1.10 This CP is aimed at all insurance intermediaries to whom CASS 5 applies. This CP would also be of interest to insurers, particularly the discussion on risk transfer. We would also welcome views from relevant trade bodies, market participants, customers and other interested parties.

Next steps

1.11 We invite comments on this paper by 30 November 2012. To assist respondents, we have included a list of questions in Annex 1 to this paper. Please provide corroborating evidence for your views wherever possible.

1.12 Feedback from this CP and the results of our additional work will help to inform our decision on whether to make changes to our rules or supervisory practices. We expect to publish our feedback to this consultation and final rules in the second quarter of 2013.

2

Improving the effectiveness of segregation and use of risk transfer

Non-statutory trust (NST)

2.1 Under CASS 5, a firm can hold client money under a statutory trust (ST) or a non-statutory trust (NST). The main difference between an ST and an NST is that under the NST the firm is allowed to make advances of credit to the firm's clients out of the client money; for example, for premium payments to insurers before the premium money is received from the client or payments of claims or premium refunds to other clients before the money has been received from the insurer.

2.2 We have significant concerns about firms advancing credit out of the NST without having appropriate systems and controls in place to ensure that clients' money is protected and would be available to be distributed to clients in the event of a firm's failure.

The NST and concerns over its use

2.3 We observed that NST is used extensively throughout the London Market and, to a slightly lesser extent, in the regional market.

2.4 We understand that the current business model used in the insurance intermediary industry requires this ability for firms to advance credit out of the client money account. Firms advance credit by means of two different mechanisms: 'voluntary funding' and 'involuntary funding'. Voluntary funding is where a firm consciously makes the decision to advance

credit to a client, for example by way of paying an insurance premium to an insurer before the payment is received from the client. Involuntary funding relates to: (i) the settlement system for the London market, operated by Xchanging; and (ii) the practice of net accounting (where, for example, an overseas broker deducts premiums and anticipated claims monies from a payment remitted to a UK broker – this deduction may be before the UK broker receives the premium payment from its clients or the claims monies from the relevant insurer). We understand that the ability of firms to advance credit makes the insurance broking market operate more efficiently, and is necessary for the market to continue as it currently operates.

2.5 One of the main concerns we have about advancing credit out of the NST is that firms do not necessarily accurately monitor credit being advanced out of the NST and in the event of a failure there may be significant amounts of credit advanced out of the NST which the insolvency practitioner (IP) would need to collect in. This could lead to significant delay before client money is dealt with on the failure of the firm and also increased costs of the relevant IP collecting the debts due to the NST. In addition, some of these debts may not be recoverable and this would leave a shortfall in the amount of client money available for the benefit of clients.

2.6 Another concern is that the ability for a firm to advance credit may lead to poor credit controls as it is not the firm's own money used to fund the credit.

2.7 A further issue is that of documentation. Firms which operate the NST have to put in place a trust deed, in addition to the other documentation required by the rules. Some firms do not have in place such a trust deed. In this scenario we consider that the effect of the CASS 5 regime is that firms would be holding money under the ST (as this regime does not require firms to put in place a trust deed). Firms operating in this way are in breach of the rules if they advance funding from this account.

2.8 Whilst we appreciate that the NST may be a necessary feature of the current insurance intermediary business model, we consider that some firms may be inappropriately using the NST without appropriate controls over the granting of credit out of the NST. We consider it would be more appropriate for some of these firms to operate a ST rather than a NST as all client money would then be held in the client bank account and not used to advance credit to other clients.

2.9 For firms with a business need to use the NST we are leaving the ability for them to do this in the Rules, however, we are proposing various changes, with a view to ensuring better protection of client money on the failure of a firm.

Client money calculations

2.10 Firms are required to conduct client money calculations to compare the amount of client money they have with the amount of client money they should have (comparing the client money resource with the client money requirement). If as a result of the calculation they hold less client

money than they should, the firm must top up the client money account; if they hold more the firm must draw down any excess in the client money account. This exercise must currently be performed at least every 25 business days. This means that only approximately once a month the right amount of client money is held in the client bank accounts.

2.11 In addition, we have heard many arguments why clients are better protected by allowing firms to conduct the calculation less frequently rather than more frequently. These arguments include that clients are protected by commission held in the client bank account, which cannot be withdrawn until after a calculation has taken place, and that there are serious systems issues with performing the calculations more frequently.

2.12 There have also been issues about what should or should not be included in the calculation. We appreciate that the rules by their very nature are complex. Firms are, however, trustees of the client money they hold and they must act accordingly, including understanding and complying with the CASS rules. If they are not clear about the rules they may contact us for clarification and individual guidance if necessary. In this CASS 5 review, we have also attempted to clarify the rules relating to client money calculation to remove any ambiguity. Other than in relation to advancing credit as described below, we are not at this stage proposing changes to the calculation itself.

Frequency of calculation

2.13 We are concerned in particular with firms who are operating an NST and advancing credit out of the NST. Our concerns centre around whether the credit advanced is recoverable and the potential for detriment and a shortfall in the client money resource should the firm fail. We would expect firms to have checks in place to ensure that these accounts do not get overdrawn, however, we consider that one of the best methods to ensure that client money is protected is for the firm to conduct a full calculation and to review its records to calculate the client money resource and requirement.

2.14 Our preferred approach is for firms to do this on a daily basis. This would ensure that on a daily basis there would be an adequate amount of client money in the client bank account (or if there had been credit advanced from an NST, an adequate and well documented receivable in the form of a debt obligation due to the trust). We understand that there could be significant issues with firms being required to conduct calculations on a daily basis, namely that firm's accounting and ledger systems may not be adequate and accuracy of the data may be compromised. This was suggested to be because firms currently prepare reports and analyse data to be included in the calculation at the month end. To do this on a more frequent basis may compromise the accuracy of the data. While we appreciate these issues, we see the benefits of firms conducting more frequent calculations, preparing data and reviewing the constituent data for the calculation and focusing on the client money held by the firm.

2.15 We are therefore proposing that firms operating an NST should conduct client money calculations every seven business days, or on a more frequent basis.

2.16 We are, however, proposing an exception to this for firms who do not hold significant amounts of client money but require the flexibility of operating an NST. If the highest value of money held in the NST during the previous 12 months was less than £250,000 then we are proposing that the firm must conduct a client money calculation every fourteen business days, or on a more frequent basis. This 12-month period refers to the firm's last financial year.

Q1: Do you agree with the proposed frequency of client money calculation?

Reconciliation

2.17 We rely on firms reconciling their client money as a tool to prevent the misuse of client money and to check for fraud. Currently firms have to conduct reconciliations within ten business days of performing the calculation. This means that firms are only required to reconcile their client money balances every 25 business days.

2.18 We consider that firms should be reconciling their balances to bank records after every client money calculation. This would mean that firms would need to conduct full reconciliations much more frequently in line with the increased frequency of calculations described above.

2.19 These reconciliations should be done as quickly as possible, and we are proposing to reduce the period allowed to perform the reconciliation to a maximum of two business days.

Q2: Do you agree with the proposed frequency of bank reconciliation?

Funding from the NST

2.20 As discussed above, one of our main concerns around the use of the NST is the ability of a firm to extend funding to clients out of the client bank account. While we understand that the business model for the insurance intermediary industry currently requires funding, we are concerned that clients may be at risk on the failure of a firm if there is extensive funding from the client bank account.

2.21 To address this concern we are proposing that, although firms may extend credit out of the client bank account, if they do so they must replace the money within a set period of the funding being extended.

2.22 They can do this by either collecting the money from the client for whom funding was granted, arranging finance to cover the credit (premium finance), or alternatively, by the firm paying its own money into the client bank account for this funding. If the firm uses its

own money to repay this funding, any money received from the client for whom the credit was extended would then be due to the firm.

What is 'advancing credit' from an NST?

2.23 The advance of credit is when the firm has not received the funds from the client (for payments of, for example, premium) or from the insurer (for payments of, for example, premium refunds or claims). If a client pays a net amount to the intermediary where they have deducted expected claims monies from a premium payment, then if the premium is paid on to the relevant insurer in full before the claims money is received from the insurer, other clients' money will have been used to fund a proportion of the client's premium. In this case, the debt to the NST would be due from the insurer in respect of the claims money.

2.24 If, for example, the client has not paid the premium, but the firm has paid the premium to the insurer out of the NST, then this debt would be due from the client.

2.25 In case the client pays a net amount in respect of a premium where they have assumed that claims monies are due to them, then if the claim has not been agreed, the premium will be short and if paid to the insurer, would be paid out of the NST.

2.26 Before credit is advanced from the NST it is assumed that all entitlements to client money of a client have been used. Credit will only be advanced and a debt due to the NST from either a client or an insurer if the net position for the client or insurer is negative.

2.27 We are proposing that credit can only be advanced from the NST in respect of a client (i.e. where a debt is due to the NST from a client) for a maximum period of 45 days. For a debt due to the NST from an insurer (for example, advances of credit for premium refunds or claims) then this credit can be advanced for a maximum period of 90 days.

2.28 We are also proposing that firms should monitor the amount of credit on a weekly basis, topping up the client money bank account on a weekly basis following the relevant periods described above.

2.29 The firm should not necessarily wait for the expiry of the 45 or 90 day periods to make a bad debt provision in respect of credit advanced out of the NST. Firms should continue to address bad debts on a prudent basis but bearing in mind the deadlines set out in relation to the advance of credit out of the NST.

2.30 If the firm is unable to identify whether the credit is advanced for an insurer or a client then they should use the shorter of these time periods.

2.31 To avoid doubt, firms shall not advance credit from the ST.

Q3: Do you agree with our proposal in relation to limiting the period where credit can be advanced in a NST including the weekly funding review?

Moving from an NST to an ST

2.32 If firms feel that it is no longer necessary or appropriate to operate an NST but wish to hold client money in accordance with the ST then firms may do this by:

a) ensuring that there is no funding out of the NST;

b) obtaining consents from all clients and insurance undertakings for whom client money is held by the firm, so that the firm can cease to hold money in accordance with the NST but will hold all client money in accordance with the ST (if, however, they request that their client money be returned to them, the firm must act in accordance with the individual client's wishes);

c) clearly record in the firm's own records that the money ceases to be held in accordance with the NST but has been moved to the ST;

d) notify the bank that the client bank accounts are to be changed from NST to ST accounts;

e) ensure that no funding is advanced from the ST and that appropriate systems and controls are in place to monitor this; and

f) make a clear record that the firm is no longer operating under the NST deed but keep the deed on file for a period of six years after it ceases to be used.

Capital requirement

2.33 Currently, CASS 5.4.4R specifies that a firm must maintain capital resources of not less than £50,000 if, under the terms of the NST, it is to handle client money for retail customers. We propose to move this requirement to MIPRU 4.2.11R, so that it sits with the other capital requirements applicable to the firm, to make the Handbook easier to use. We will retain a signpost for the requirement in CASS.

Q4: Do you agree with our proposal to move the £50,000 requirement from CASS to MIPRU?

Risk transfer

2.34 Firms operating under risk transfer granted by an insurer act as the agent of that insurer when they receive money from clients. This means that such money is deemed to be received by the insurer when it is received by the broker. If this is the case then that money is not client money.

Ensuring effective risk transfer

2.35 To receive money from clients under risk transfer, the insurance intermediary must enter into an agency agreement with the insurer. In accordance with CASS 5.2 this agreement must be in writing. We understand that currently, in some instances, these agreements make the appointment of the intermediary as agent conditional on certain events; for example, conditional on the intermediary paying premiums on to the insurer within 30 days. If these conditions are not complied with the agency appointment may be questioned. This could lead to the insurer refusing to honour the insurance if the intermediary failed and the insurer had not received the money, or cause confusion on a failure as clients might for some time not know whether or not they have valid insurance.

2.36 We are therefore proposing to address this concern by prohibiting conditional risk transfer. The grant of risk transfer must be clear and unequivocal. We acknowledge that there is a risk that having such a prohibition might have the effect of discouraging insurers from granting risk transfer. However, we feel it is imperative that the arrangements are effective.

2.37 We are also considering setting out as guidance the wording that risk transfer agreements could adapt to help ensure that the grant of risk transfer is unconditional.

2.38 As risk transfer may be cascaded from one firm to another (in agreement with the insurer), we are also proposing that the agreement to cascade risk transfer must provide that the grant of agency as cascaded is unconditional. As in the case of the grant of risk transfer from one firm to another, this agreement must be in writing.

2.39 While we consult on changes to the rules, we encourage firms to review their risk transfer agreements to ensure that all risk transfer granted is unconditional.

Q5: Do you agree with our proposal in prohibiting conditional risk transfer?

Other risk transfer issues

Risk transfer money to be held as client money

2.40 Insurers often require intermediaries to hold risk transfer monies as client money. The Rules permit risk transfer monies to be held as client money in a client money account so long as the insurers subordinate their interests in the client money to the interests of clients. This means that in the event of a failure, clients will receive their client money before any client money is paid out to insurers. Some firms appear not to have realised that if they have agreed to hold risk transfer money in a client bank account in accordance with CASS then they are holding client money and therefore must have the appropriate authorisation from the FSA and comply with the CASS sourcebook. This is the case even if all the client money they hold is held on behalf of insurers under risk transfer.

2.41 If firms do not hold the money as client money when they have agreed to do so in their risk transfer agreement, then these firms would be in breach of their agreements with the insurers. They are also in breach of the CASS rules, because once it is agreed and the appropriate documentation signed, then in accordance with the Rules, the money becomes client money and must be treated accordingly. We take these breaches seriously and strongly urge firms to review their risk transfer arrangements to ensure that they are treating the money properly.

No written agreement

2.42 If firms do not have a written risk transfer agreement in place then they do not satisfy the requirements in CASS for operating under risk transfer and all money received by the firm in relation to insurance intermediation must be treated as client money. Not treating the money as such is a serious breach of the CASS rules.

Insurer trust accounts

2.43 It is up to firms and insurers to agree how the risk transfer money is held by the firm. These arrangements could, for example, mandate that the firm is to hold risk transfer money in an insurer trust account. So long as the firm does not agree to co-mingle the money and hold it in accordance with CASS, the firm and insurer can agree to appropriate commercial arrangements without reference to CASS.

Mandates

2.44 An alternative to holding client money is for a firm to operate mandates. These would be, for example, where money is held in a bank account in the name of the client and the broker arranges payment directly from the client's own bank account to the insurer.

2.45 No client money would be involved, and on the failure of an insurance intermediary there would be little impact on clients if firms were to make use of mandates.

2.46 If a firm were to operate mandates it must comply with the appropriate rules in CASS 8 to ensure that the firm operates appropriate controls around the use of mandates and operates within the scope of the authority as well as keeping relevant records.

3

Simplifying the distribution and transfer of client money

Pooling

3.1 Protection of client money on the failure of a firm is one of the fundamental aims of the client money regime.

3.2 The distribution rules under CASS 5 seek to facilitate the timely return of client money to a client in the event of the failure of a firm or third party at which the firm holds client money, and to minimise consumer detriment. We are proposing to change the focus of the client money distribution rules, with the primary objective of the insolvency practitioner (IP) to be to complete open transactions.

3.3 On appointment the IP becomes responsible for the client money the firm is holding and is required to act as trustee of the money in accordance with the CASS rules while he is responsible for it.

Primary pooling

What is a primary pooling event?

3.4 A primary pooling event (PPE) occurs in a variety of circumstances, namely on the failure of the firm. The CASS 5 rules currently provide that once a PPE occurs, all client money is pooled and must be distributed back to clients, with each client sharing rateably in any shortfall.

3.5 Shortfalls can occur because firms do not hold the right amount of client money in the client bank account and also because of the IPs fees in dealing with client money. These fees can be deducted from the client money before it is distributed in accordance with the terms of the client money trusts.

3.6 As stated above, we are proposing changing the focus of the IP on a PPE, so that the IP uses reasonable endeavours to complete open transactions using client's entitlements to client money. If there is a shortfall, the IP will use the client money held for the client to attempt to complete the relevant insurance transaction with the insurer. If this is not possible then the IP will have to either sell the business together with the relevant client money or, if this is not possible, distribute the client money back to the client.

3.7 We note that a key consideration for this proposal is the practicality of it. There may very likely be circumstances, or events arising at the time of the PPE, which make it not possible or difficult for the IP to complete open transactions. Such circumstances or events could include litigation, poor records within the insolvent firm, and a material deficit in the client money pool. However, with the various proposals contained in this CP, which aim at improving the firm's segregation of client money and record keeping, the types and probability of circumstances arising that could potentially impede the IP's completion of open transactions would be reduced.

3.8 Clients who suffer a shortfall of client money may be eligible for compensation from the FSCS. This would depend on whether the client is an eligible claimant and other eligibility criteria set out in the COMP handbook.

Transfer of a broker's business, together with client money after the failure of the firm

3.9 We are proposing an optional mechanism which would, in effect, disassociate the pooling event from the obligation on an IP to distribute client money.

3.10 The aim is to allow an IP to consider selling either the whole of or a proportion of the business to another broker together with the associated client money (either all the client money held by the firm, or a relevant proportion of the client money) rather than being required to return the client money to the clients. This could allow the IP to try to obtain value for this business or protect clients by ensuring that they receive the insurance cover they want rather than the return of their client money. As sales of businesses generally proceed quickly after the failure of a firm, we propose that this option is available to IPs for a period of no longer than three months, after which the obligation to return client money would apply.

3.11 To enable this to be a viable option firms must maintain good records and ensure that the right amount of client money is segregated. These are existing CASS requirements. As set out in our proposal relating to the accruals method of calculating the client money requirement under the chapter headed 'Enhancing record keeping and reconciliations', we

are also proposing that firms must be able to, and on an annual basis, carry out a reconciliation of their client money to establish a position for individual clients. This should facilitate any due diligence required by the acquiring firm.

3.12 Before a transfer of client money, each client's entitlement should be calculated and clients would then be entitled to that amount of client money which could be used by the acquiring firm to complete open transactions, clients could top up the amount in respect of any shortfall (or perhaps use FSCS compensation where applicable) or request the return of their client money.

3.13 This transfer would have to be accompanied by appropriate and timely communications with clients. Any transfer must also be in the best interests of the clients.

Q6: Do you agree with our proposals relating to primary pooling events, including the period of no longer than three months for the optional mechanism whereby an IP can transfer a firm's business after its failure?

Clarification in relation to PPE

3.14 For a firm which operates both an ST and an NST, the ST and NST would form separate pools upon a PPE.

Secondary pooling

3.15 Secondary pooling events (SPE) occur when an institution holding a firm's client money fails. This can be a bank where the client money is held as a deposit or a third party broker to whom the client money has been passed in the course of a transaction. If the institution fails the client money may be lost.

3.16 Some clients request that designated client accounts are opened for them. This in effect ring-fences the client money held for them as they will not share in a loss of client money suffered if an institution holding a general client account fails. They will however suffer all the loss if the institution at which they have a designated account fails.

3.17 We are not proposing changes to the system of secondary pooling as there has to be a mechanism for dealing with the scenario that client money is lost by an institution holding that money. We are proposing, however, to clarify in the rules the effect of subordination on a SPE, that is, if there is any loss and if there is any risk transfer money held in general client bank accounts then any shortfall will first be suffered by this money.

3.18 We also propose to delete the reference to 'designated client fund account' in CASS 5.6.27R. We believe that the inclusion of it is an error, given that the provisions where the rules specify which types of client bank accounts that firms can hold client money in only state 'general client bank account' and 'designated client bank account'. We also understand that no firm uses designated client fund accounts.

Q7: Do you agree with the proposed clarifications in relation to the secondary pooling event rules?

Costs on a PPE

Cost of distributing client money

3.19 On a PPE all client money held by a firm is pooled and dealt with in accordance with the Rules. The costs relating to this exercise are deducted from the client money pool in accordance with the terms of the trusts on which the client money is held. This is a principle of trust law which is reproduced in the CASS rules.

Costs of distributing post failure client money following a pooling event

3.20 Currently an IP must return any client money received after the PPE, except in limited specified circumstances; for example, to complete a transaction open at the time of the PPE. There are no provisions in the Rules relating to the costs of this exercise. If client money has to be returned to clients following a PPE we consider that an IP should be able to deduct their reasonable costs of distributing the client money from the money itself. We are proposing to introduce rules to this effect giving the IP the option of deducting their reasonable costs of distribution from the post failure client money either pro-rated for each client or, if relevant, the actual costs of distributing to each client (although this must be reasonable costs limited to the costs actually incurred in returning the relevant payment).

Q8: Do you agree with our proposal on introducing rules to give the IP the option of deducting their reasonable costs of distribution from the post failure client money?

Transfer of business

3.21 We understand that there are frequent sales of books of business between firms. In some cases the client money held in relation to that book is transferred to the purchaser. To move client money between firms, the firm who is holding the client money must first obtain consent to this move from all the relevant clients. This often proves to be problematic and we are often approached for waivers of the requirement to obtain consent.

Pre-consent

3.22 To avoid unnecessary problems we are proposing a mechanism whereby firms may obtain 'pre-consent' from clients to such a transfer. This would be one option available to firms if they wished to transfer client money as a going concern. To take advantage of these proposals, we propose that firms would have to include clauses in their terms of business with clients detailing:

- the type of firm to whom the business would be transferred;
- how the money would be held in the transferee firm; and
- notification requirements (clients to be notified within seven days of the transfer and given the chance to request the return of their client money).

3.23 We consider that this should only be an option if the client money is transferred to another insurance intermediary covered by the Insurance Mediation Directive (IMD). If the client money is to be transferred out of the IMD environment then consent should be obtained for the specific transaction.

3.24 In addition to the above requirements, firms would also have to notify the FSA of their intention to transfer client money at least seven days in advance of the transfer, as this would give the relevant supervision team the opportunity to investigate further or potentially to object to the transfer.

Q9: Do you agree with our proposal on pre-consent for the transfer of business?

4

Improving diversification of client money

4.1 If firms hold a significant amount of client money, they should diversify this money across a number of different banks so that if any of these banks fail the loss of client money is limited. We appreciate that reducing the ability to hold client money in the form of designated investments (as discussed in Chapter 6, 'Enhancing the requirements on segregation and placement of client money') may restrict the ability of firms to diversify, but we consider that firms must adequately diversify their client money holdings across an appropriate number of banks.

4.2 Firms must also conduct due diligence on the bank in which they hold client money to ensure that the bank is an appropriate place in which to hold client money.

4.3 We are proposing to limit the amount of client money which can be held in a bank in the same group as the firm to a total of 20% of the total amount of client money held by the firm. This is because we consider that there is a significant risk that if a bank were to fail within a group the other firms within the group may also fail. If all the client money is held intra-group then there is a risk that all this money would be lost on the failure of the firm.

Q10: Do you agree with our proposal on limiting the amount of client money which can be held in a group bank to a total of 20 per cent of the total amount of client money held by the firm?

Non-approved banks

4.4 Under CASS 5.5.41R, a firm may hold client money with a bank that is not an approved bank if all the conditions in that rule are satisfied. One such condition is that the client money is held in a designated bank account. The term 'designated bank account' is not defined. To ensure that such account would have the necessary characteristics for client protection purposes, we propose to replace the term with 'designated client bank account', which is defined in the Glossary.

Q11: Do you agree that the term 'designated bank account' should be replaced with 'designated client bank account' as defined in the Glossary?

5

Enhancing record keeping and reconciliations

Accruals method of calculating client money requirement

5.1 Under CASS 5.5.69R, firms are required to be able to reconcile down to individual client balances for the majority of their clients if they use the accruals accounting method to do their client money calculation. We understand there are differing practices within the industry about whether firms do in fact conduct this reconciliation.

5.2 The rationale for this rule is that if a firm fails, the IP has to match all the client money down to individual client level. If the firm has already been doing such matching and systems are still running on the firm's failure, there should be no significant delay for the IP to establish for whom the client money is held.

5.3 We are therefore proposing that firms are required to reconcile down to individual client balances on an annual basis. They must do this within a specified period of one calendar month. This can be conducted at any point during the firm's client money year. Firms must attempt to reconcile down to individual client balances for all the money they hold. At an absolute minimum, firms must match at least 95% of their client money to individual clients. This should represent at least 95% of the client money held by the firm for clients and insurance undertakings where the money is co-mingled with client money. Money representing prudent over-segregations of client money or mixed remittances temporarily held in the client bank account should be clearly identified during this exercise.

Q12: Do you agree with our proposal in relation to reconciliation down to individual client balances on an annual basis?

Trust letters

5.4 We are also looking to set out additional rules to clarify our expectations around trust letters. This includes who should sign the trust letter, how long they should be retained and reviewed by the firm and rules around the fact that all accounts in which client money could be held should be covered by a trust letter even if the balance on the account is nil at any time.

Resolution pack

5.5 We have recently introduced a requirement for investment firms holding client money and assets to maintain a 'black box' containing documents to help an IP access information required to deal with client money in a timely manner following appointment. We are proposing that insurance intermediaries be able to provide the following documents to an IP within 48 hours of the firm's failure. We have considered each of these documents in the CASS 5 context and consider that it should be proportionate for firms to be keeping these documents for the resolution pack:

1) a master document containing information sufficient to retrieve each document in the firm's CASS resolution pack;

2) a document identifying all the institutions with which client money may be held, including approved banks, money market funds or other third parties to whom client money may be passed;

3) a document identifying each appointed representative, field representative or other agent of the firm which may receive client money in its capacity as the firm's agent;

4) a document identifying each senior manager and director and any other individual and the nature of their responsibility within the firm who is critical or important to the performance of operational functions related to any of the obligations imposed on the firm under CASS 5;

5) for the institutions identified in (2) all trust letters;

6) the latest client money calculation;

7) the latest bank reconciliation;

8) a copy of the firm's annual reconciliation down to individual client balances; and

9) any NST deeds.

Q13: Do you agree with our proposal on resolution pack?

6

Enhancing the requirements on segregation and placement of client money

Credit write backs

Issues

6.1 Historically, insurance intermediaries have had the ability to make credit write backs, where they wrote back to their profit and loss accounts money in the client bank accounts which they deemed to not to be due to clients or they are unable to pay to clients or insurers. This practice is not consistent with the principle that firms should not take as their own monies which they hold as trustee.

6.2 There are varying standards across the industry about the amount of scrutiny which firms give to balances which they then take as credit write backs. We are proposing to put in the rules a procedure under which firms may take credit write backs in relation to any balances which were grandfathered into the CASS 5 regime and have been held by these firms as client money since 14 January 2005 when the regime began. We are doing this to encourage firms to investigate these legacy balances and deal with them appropriately. We understand that there may be considerable amounts of money held in client bank accounts across the industry which are not due to clients or insurers and should be removed from the client bank accounts.

6.3 We are proposing to make this procedure available to firms for a limited period of thirteen months, during which firms may take credit write backs in accordance with the Rules. After this period firms may not take credit write backs – if the money is held by the firm as client money after the expiry of the period then the money can only be dealt with in accordance with the Rules, which will set out a procedure which firms may use to deal with unclaimed client money. However, they will not be able to take credit write backs.

6.4 At any time firms may and should remove money which is clearly due to the firm (such as FX differences, bad debt provision where the debts have subsequently been collected and held in the client bank account) and should be removed from the client bank account at the next calculation.

6.5 If the firm tries to return client money to clients or insurers for whom it is held, but the client or insurer refuses to accept the money, then the firm may remove this money from the client bank account and take it as firm money. However, before they do this, the client or insurer must be aware that by refusing to accept the money they are giving up any claim in respect of that money, thereby discharging the firm of its client money responsibility in respect of that money.

Credit write backs - proper investigation

6.6 If firms wish to take advantage of the credit write back procedure, they must first investigate all relevant legacy balances. We have set out in the draft rules in more detail what the investigation should include, and we list below some of the actions included:

- review of all documentation relating to the individual balances;
- interrogation of all systems (electronic or otherwise) on which information relating to the balances may be held;
- where possible, review of records held by previous firms if such monies have been transferred from another firm to the firm;
- communication with insurance undertakings, third parties or clients as relevant to establish the nature of the balances.

6.7 Once the balances have been investigated, firms should aim to allocate each of the balances to one of the following 'pots':

i) money clearly held for clients/insurers as client money;

ii) money clearly due to the firm; or

iii) unknown balances.

6.8 In relation to the money held for clients/insurers, these funds are clearly held on trust for the relevant beneficiary. Firms should make all efforts to return these monies to the relevant beneficiary. If the beneficiary does not accept the money, firms may enter into a commercial

agreement with the client or insurer who refuses the payment and, if relevant, the firm may take the money for its own account. In all other circumstances where the firm is not able to return the money to the client or insurer, it may continue to hold the money as client money or pay the amount to a charity of their choice. If the money is paid to charity then the firm must make an unconditional undertaking to make good any valid claim to the monies brought in the future.

6.9 In relation to the money which is clearly due to the firm, this money should be removed from the client bank account at the next calculation.

6.10 In relation to the unknown balances, for the limited period that the credit write back procedure is available, the firm may take a credit write back of this amount. They must have properly investigated the balances and be unable to identify the beneficiary of this money. The money can then be removed from the client bank account and taken by the firm. The firm must make an unconditional undertaking to make good any valid claim to the monies brought in the future.

6.11 We have also sought to deal with credit write backs in the rules by making it clear that firms need to take their own view of the extent to which their fiduciary duties as trustee (as well as relevant accounting standards) allow them to apply a credit write back.

6.12 Firms may obtain insurance to cover the undertaking required if the firm pays money away from the client bank account. Firms may not, however, use any client money to purchase this insurance.

Reasonable costs of investigating the legacy balances

6.13 We propose that a firm which carries out an investigation of all its legacy balances may deduct reasonable costs from each balance to cover the costs of the investigation. The firm may either:

a) deduct the reasonable costs of investigating each balance from that balance; or

b) deduct the reasonable costs of investigating all the balances rateably from all the balances.

Q14: Do you agree with the proposal relating to credit write back, in particular, do you agree that the Rules should allow firms to take credit write back for unknown balances?

Unclaimed client money

6.14 After the period during which the credit write back procedure is available, we are proposing to prohibit credit write backs, but provide a procedure on how to deal with

unclaimed client money, if this is consistent with the firm's contract with the client and if the firm can demonstrate that it has taken reasonable steps to trace the client, insurance undertaking or third party concerned and to return the balance.

6.15 This policy will provide firms with a mechanism to deal with unclaimed client money balances which the firm has held for a minimum of six years following the last movement on the account (disregarding any payment of interest) and where the client cannot be contacted. Firms would not be able to take credit write backs out of money which is clearly held for clients, subject to the agreement of that client at the time the firm attempts to return the money to clients (firms may not obtain this agreement in advance or in terms of business agreements (TOBAs), the rejection of the money must be explicit and at the relevant time). Firms would, however, after taking reasonable steps to trace the client, insurance undertaking or third party concerned to return the balance but are unable to do so, and if this is consistent with the firm's contract with the client, be able to deal with this money by making payments of the money to a charity of their choice and giving an unconditional undertaking to make good any valid claims to this money which arise in the future.

6.16 In the draft rules, we also seek to make it clear that firms need to take their own view of the extent to which their fiduciary duties as trustee (as well as relevant accountancy standards) allow them to deal with unclaimed money.

Q15: Do you agree with our proposal on unclaimed client money?

Returning small amounts of client money in the form of postage stamps

6.17 We propose that if less than £5 is owed to a client, insurance undertaking or third party, a firm may satisfy its obligation to pay them by sending them, by post, the money owed in the form of postage stamps. The firm must have no reason to believe that the relevant client, insurance undertaking or third party has changed their postal address. If the client, insurance undertaking or third party has become untraceable, the firm should not send postage stamps, but should follow the procedure in relation to unclaimed client money.

6.18 This proposal could provide an alternative to firms in returning small amounts of client money in a prompt manner.

Q16: Do you agree with our proposal in relation to returning small amounts of client money in the form of postage stamps?

Unallocated client money

6.19 There is also the problem of unallocated client money. This should not arise in a business which maintains adequate records of the client money held and identifies all receipts within appropriate times as required in the Rules. If firms do have sums for which they have no records or ideas of what or to whom these sums relate, in the first instance the implication is that a firm has not complied effectively with CASS. Firms may also need to consider the extent to which this may be a breach of the firms' obligations as fiduciary under trust law. While we appreciate that the nature of insurance transactions can involve complex money flows, especially where there are a number of different carriers for each risk, with a number of different arrangements, firms should match the client money they receive to transactions within a reasonable period of time.

6.20 We are therefore proposing rules to require firms to match cash to either specific clients or specific transactions within a maximum period of 90 days or to return the cash to the sender or if this is not possible to the remitting bank.

Q17: Do you agree with our proposal on unallocated client money?

Client money held at third parties

Current rules and practice

6.21 If a broker does not have a direct relationship with an insurer, the broker may pass client money to another broker in a chain of brokers to facilitate the client's transaction. This means that client money may pass down a chain of brokers before the money reaches an insurer, or to a broker who has been granted risk transfer.

6.22 There are currently two ways in which a broker may pass money to other brokers in a chain:

i) as part of a transaction, where the firm retains a fiduciary duty to the client; or

ii) as a transfer to another firm where the client becomes a client of the second firm and ceases to have a relationship with the first firm regarding that transaction.

6.23 Firms that use the first method, and transfer money to another broker for the purposes of a transaction retain fiduciary duty regarding that money, must continue to treat it as client money until they have confirmation that the insurance is in place and the money has reached the insurer or a broker with risk transfer.

6.24 We understand there are various different practices to confirm that money has reached the insurer, which range from firms assuming that money has reached the insurer after a set period, to firms continuing to recognise their fiduciary duty indefinitely. Neither of these

practices is consistent with the firm acting as trustee of this money. They should be able to identify monies for which they have a fiduciary duty, and in the event of a firm's failure the IP needs to be able to quickly establish where all those monies are located.

6.25 We are therefore proposing that firms who accept money as third party brokers from other UK-authorised firms are required to send monthly statements to the originating brokers detailing the money they hold for that broker and when it is paid to a different broker, to a broker with risk transfer or to the insurer. This statement would cover all monies paid by the originating broker to the third-party broker. This will enable firms to clearly monitor and document where all the monies over which they retain a fiduciary duty are held.

6.26 In relation to overseas brokers, we are proposing that the current '12 month rule' remains, whereby firms must use reasonable endeavours to discover when monies passed to overseas brokers en route to overseas insurers have been paid to the relevant insurer and, after 12 months, if there is no reason to believe otherwise may assume that the money has reached the insurer. We are considering linking the period after which the firm may assume that the money has reached the insurer to the period of the insurance itself.

Q18: Do you agree with our proposal in relation to client money held at third parties?

Q19: Do you agree that the '12 month rule' should remain or do you think that it is more appropriate to link the period after which the firm may assume that the money has reached the insurer to the period of the insurance itself? Please provide reasons.

Prudent over-segregation

6.27 The rules currently permit prudent over-segregation of client money if it is prudent to do so to ensure that client money is protected. There are, however, differing practices in relation to how and why firms hold prudent over-segregations within the client bank accounts. We are concerned that on the failure of a firm if the prudent over-segregation is not properly documented, dealing with the prudent over-segregation may cause extra costs and delay.

6.28 We are proposing to address this issue by proposing guidance about when a firm may maintain such a prudent over-segregation within the client bank account. We are proposing that if firms wish to do this they must first complete the following steps:

- prepare and have approved by its Board a 'prudent over-segregation policy' detailing what procedures must be complied with to maintain such a prudent over-segregation;

- any prudent over-segregation should relate to a specific event and be a realistic estimate of the amount of client money which should be segregated to ensure client protection;
- there should be an audit trail for any prudent over-segregation held within the account; and
- it should be clear the reason why money is held and also clearly documented that the money has become client money.

Q20: Do you agree with our proposal on prudent over-segregation?

Money held as designated investments

6.29 One of the features of an NST is that firms may hold client money in the form of designated investments. Annex 1 of CASS 5 sets out the permitted investments, general principles and conditions in segregating these designated investments. There are also various safeguards around this, such that the firm takes the credit risk of the investments and must make good any losses.

6.30 Firms fought hard for the ability to hold client money as investments when the CASS 5 regime was initially drafted. With the volatility in the financial markets as we see today and the repercussions that the failure of Lehman has on its clients and counterparties, we think it is important for us to review the rules on holding client money as investments.

6.31 We therefore propose to remove the list of designated investments in Annex 1 of CASS 5, and align CASS 5 with CASS 7 to allow client money to be held in either client bank accounts or money market funds.

Q21: Do you agree with our proposal on allowing client money to be held only in client bank accounts or money market funds?

Q22: Under Chapter 7 of the Client Assets Sourcebook, firms can, on receiving any client money, promptly place this money into an account open with a qualified money market fund. Do you think that we should change money market funds under CASS 5 to qualified money market fund (as defined in the Glossary) in order to be in line with CASS 7? The rules for this proposal are currently drafted with reference to money market funds.

Commission

6.32 We are proposing to clarify the position around commission, in particular when it can be withdrawn from the client bank account. This will be in line with current procedures but will be clearly set out in the Rules.

6.33 We are proposing to set out in the Rules that before commission is withdrawn from the client bank account the firm must complete a client money calculation and associated reconciliation.

6.34 Withdrawing commission must also be consistent with the terms of the relevant TOBAs, between either the firm, the client and the insurer, or the firm, the client and the next broker in the chain. If these TOBAs are inconsistent then the firm must comply with the most onerous condition. If there are no conditions in the TOBA or agreement with client, insurer or other broker then the firm may assume that they can deduct their commission from the client bank account once cleared funds have been received from the client and a client money calculation carried out.

Commission only transactions

6.35 Where for example a client pays an insurer directly and the insurer pays the commission to the firm this is not client money or a mixed remittance. We are proposing that these transactions may be dealt with in the same manner as commission and can be received into the client bank account and removed at the next client money calculation.

Q23: Do you agree with our proposal on clarifying the Rules in relation to commission?

Same day draw down

6.36 One issue which firms have raised with us is the requirement for same day movement of monies. This requirement means that the calculation and balancing payment must be made the same day. We understand that some firms are experiencing problems with meeting bank deadlines to ensure that money is moved the same day.

6.37 In light of the above, we are proposing that firms are allowed where necessary to give an irrevocable instruction to the bank the same day as the calculation, but if necessary for the physical movement of the money into or from the client bank account to take place the following day. In general, this would not be to the detriment of the client, as the balancing payment usually represents the commission payment being drawn down by the firm.

Q24: Do you agree with our proposal in relation to same day draw down?

Money due to a client from a firm

6.38 We are looking at the ability of firms to return client money to clients if clients request it. Currently firms, as trustee of this money, must act in accordance with their duties as trustee.

6.39 We are considering setting out in the Rules that firms must return client monies to their client within a reasonable time of the client's request, with the reasonable time being a maximum of five business days. This would only apply in the case where the firm does in fact hold the client money for the client and the client has requested payment.

Q25: Do you agree with our proposal on money due to a client from a firm?

Appointed representatives

6.40 We have considered the Rules regarding segregation of client money held by a firm's appointed representatives, field representatives or other agents. While we would prefer firms to segregate client money immediately, some firms make appropriate use of the ability to segregate an estimated amount which they reconcile with the actual required amount periodically. The frequency of this reconciliation is not prescribed and firms can use whatever period they deem to be appropriate. We are concerned about the period some firms use when complying with the rules regarding periodic segregation so are proposing that the maximum period should be no longer than three calendar months.

Q26: Do you agree with that the maximum period should be no longer than three calendar months for firms to perform the reconciliation in relation to periodic segregation?

7

Improving governance and reporting to the FSA

Governance

7.1 We have noted from various supervisory exercises that some firms do not maintain appropriate oversight of client money at a sufficiently high level within the organisation.

7.2 We are therefore proposing that all firms conducting insurance mediation activities must allocate to an approved person responsibility for client money oversight. We are not creating a new Controlled Function, rather we propose that responsibility is allocated to an individual who is a sufficiently senior person within the firm who is an FSA approved person. This would be in addition to the manager designated by a firm operating an NST. The CASS responsibility we are proposing encompasses all CASS oversight within the firm, including responsibility for CASS-related data.

7.3 We believe that this proposal can enhance the focus of firms in client money protection and the related processes, systems and controls, as well as ensuring appropriate client money oversight at a sufficiently high level within the firm. The individual who has been allocated responsibility of CASS oversight could also serve as our point of contact of a firm for CASS-related matters.

7.4 The firm must make an internal record of this appointment and share this with us only if requested. Should the person appointed to perform this oversight role leave the organisation or, for whatever reason, no longer be the appropriate person to perform this role, the firm must appoint an alternative approved person to perform this oversight role as soon as possible and no later than two months after the previous approved person ceases to perform the role.

7.5 All firms must appoint an individual to perform the client money oversight role even if they do not hold client money. If the firm does not hold client money then the role focuses on overseeing that the firm does not at any time hold client money.

Q27: Do you agree with our proposal on CASS oversight?

Client money audit reports

7.6 Currently all insurance intermediaries who operate an NST are required to have an annual client money audit. In addition, those firms who held more than £30,000 in a statutory trust during the previous client money year must also have a client money audit. These audit reports must be obtained by firms but are not required to be submitted to the FSA.

7.7 Firms who operate entirely under risk transfer and have not agreed to co-mingling are not required to obtain a client money audit report.

7.8 We have examined whether firms who held less than £30,000 in an ST should also have a client money audit report. Our analysis showed that less than 25% of insurance intermediaries who hold client money held less than £30,000 in a statutory trust during the course of the previous year. As firms have no ability to advance credit from the ST and money is protected automatically on the receipt or segregation of client money (as appropriate) then we consider that these firms do not pose a high risk of loss of client money. Of course, if these firms are just not segregating then there may be significantly more risk of clients losing money that should have been protected as client money by the firm. We do not, however, consider the costs of imposing a client money audit on these firms to be proportionate to the risk, and so are proposing that the £30,000 limit remains.

7.9 In relation to the firms which do require client money audit reports to be prepared, we are considering a number of options regarding submission of those reports to the FSA:

1) all client money audit reports are required to be submitted to the FSA. The submission period is within seven months from the period end date;

2) client money audit report of a firm that held more than a specified threshold of client money at any point in the year reported in the relevant client money audit report would need to be submitted to us. We are considering a threshold of £250,000 (we used the same figure for our proposal on fortnightly client money calculations for NST), or £1m;

3) client money audit reports that contain an adverse opinion and/ or note a notifiable breach would need to be submitted to us; or

4) we would undertake random samples of firms' client money audit reports.

7.10 We consider that client money audit reports are a useful supervisory tool and we would review particular aspects of the reports collected based on our resources and focus at the time.

7.11 In the draft instrument, we have included draft rules for the first option above, which we feel is the option that gives rise to the greatest change.

7.12 We are also concerned that some firms do not have client money audits when they are supposed to. We are therefore proposing that for all firms holding client money in an ST not exceeding £30,000, or do not hold client money at all when they conduct insurance mediation, the person who is appointed to have oversight over client money must report to the Board the reasons why the firm does not require a client money audit. The Board must specifically approve the fact that the firm does not require an independent client money audit.

7.13 We would also like to explore the possibility of electronic submission of these reports.

Q28: Which of the above options in relation to the submission of client money audit reports would you support and why? If you support the option of setting a threshold below which firms do not have to submit their client money audit reports to us, which of our proposed thresholds would you think is appropriate and why? If neither, what threshold would you suggest?

Q29: Do you agree with the actions that we are proposing to require firms to do in relation to client money audit reports if they hold client money in an ST not exceeding £30,000 or do not hold client money at all when they conduct insurance mediation? If not, why not?

RMAR

7.14 Most insurance intermediaries need to complete and submit the RMAR. Section C of the RMAR (Section C) contains questions around the firm's holdings of client money.

7.15 We have concerns around the accuracy and consistency of the data which is being submitted, as firms may use different methods to calculate the figures required. As such, we expect that the content and/or guidance of Section C will be assessed in the future.

8

Section 53 Marine Insurance Act 1906

8.1 The Law Commission has recently examined the operation of Section 53 of the Marine Insurance Act 1906 and concluded that there may be issues with the interpretation of how this section operates. If the statute operates as described by the Law Commission, it establishes a debt obligation between the broker and the insurer with regard to premiums for insurance written in accordance with Section 53. On that basis, and on the basis of the current interpretation of Section 53 by the Law Commission, we think that there may be potential inconsistencies between Section 53(1) and CASS 5.

8.2 We would closely monitor the Law Commission's development on Section 53 and would consider making consequential amendments to our rules if necessary depending on the outcome of such development.

9

Commencement date and structure of the draft rules

9.1 We are considering delaying commencement of the rules for 12 months from the publication of the final rules for all provisions except for the proposal on unclaimed client money. For the proposal on unclaimed client money we are proposing that it comes into force after the credit write back provisions expire, as our focus is to enable firms to clear up their pre-2005 legacy balances first. For details of the proposals relating to unclaimed client money and credit write back, please refer to Chapter 6, 'Enhancing the requirements on segregation and placement of client money'. The delayed commencement serves to give firms sufficient time to implement the relevant changes.

9.2 While we are considering having the same period of delayed commencement for all the draft rules (except for the proposal on unclaimed client money, as noted above), we welcome views on whether a different delayed commencement date should be applied to any particular proposal(s).

Q30: Do you agree with the proposed delayed commencement of the draft rules, or do you think that a different date should be applied to any particular proposal(s)? Please provide reasons.

9.3 We also propose to delete existing CASS 5 and replace it with a new CASS 5A. We believe the proposed new chapter is clear, simple and easy to apply.

Q31: Do you agree with this approach of replacing the existing CASS 5 with a new CASS 5A?

Annex 1

Cost benefit analysis

1. When proposing new rules, we are obliged under section 155 of FSMA to publish a cost benefit analysis (CBA), unless we consider that the proposed rules will give rise to no costs or to an increase in costs of minimal significance. The market and regulatory failure analysis and CBA in relation to the proposals are presented in this section.

Market/regulatory failure analysis

2. Market/regulatory failure analysis is part of the process by which we determine if regulatory action is necessary. In this CP, we have considered what types of problems, arising from our current rules or from a market failure, would merit intervention. We have identified two types of issues:

   a) a market failure related to asymmetric information between insurance intermediaries and their clients, which may not be properly addressed by our current rules; and

   b) in some cases our current rules create unnecessary complexity or could be improved to lead to better outcomes both for insurance intermediaries and their customers.

Asymmetric information between firms and clients

3. Various types of legal arrangements can be made between insurance intermediaries and the insurer regarding the money that the intermediary receives and holds for its clients. In general, a client may not pay particular attention to the terms in the relevant contractual documents which describe the treatment of their client money, so they do not sufficiently understand how their client money is held.

4. In relation to firms' holding client money in non-statutory trusts (NSTs), our experience shows that most clients are unlikely to be aware that their client money could be used to advance credit to other clients of the firm, and that if the broker fails, clients might share in any loss to the client money pool generally. There is also a general perception that client money is segregated and can be returned to clients immediately following the failure of a firm. However, this is not always the case in practice.

5. Also, most clients are not able to monitor the care and diligence exercised by the insurance intermediary regarding their client money. This results in weak market discipline in this area, as firms do not have sufficient incentive to ensure that their client money arrangements are appropriate.

Regulatory failures

6. We have identified a number of areas where the CASS 5 rules could be simplified to make compliance easier for firms or be improved to lead to better outcomes for protecting client money. These include: improving the effectiveness of segregation and using risk transfer, simplifying the distribution and transfer of client money, improving diversification of client money, enhancing record keeping and reconciliations, enhancing the requirements on segregation and placement of client money, and improving governance and reporting to the FSA.

Scope and markets affected

7. These proposals will apply to all firms that are covered by the scope of the current CASS 5 rules. There are approximately 12,000 firms that conduct an activity covered by CASS 5. There are approximately 6,000 firms who have general insurance mediation as their primary authorisation category and these are the firms who will be most affected by our proposals. Of these core firms, approximately 3,000 operate solely under risk transfer, and 3,000 firms operate with permission to hold client money. Of those firms that hold client money, we distinguish for the purposes of our cost benefit analysis between small, medium and large firms based on client money holdings from Retail Mediation Activities Returns (RMARs) between 1 April 2011 and 31 March 2012.[1]

   a) Small firms: less than £250,000 in client money. They represent around 75% of the 3,000 firms and hold 2% of total client money.

   b) Medium firms: between £250,000 and £10m in client money. They represent 22% of the 3,000 firms and hold 16% of total client money.

   c) Large firms: more than £10m in client money. They represent 3% of the 3,000 firms and hold 82% of total client money.

8. The remaining 6,000 firms conduct insurance mediation as a small part of their business. Approximately 2,000 of these firms are doctors, vets, car salespersons and other trades that occasionally fill out application forms for insurance as part of their service. We consider these outside the scope of these proposals.

1 Where a firm has submitted more than 1 RMAR during that period, we have used the average of all submissions to size the firm.

Cost benefit analysis

9. In this section, we look at the benefits, compliance costs and other costs of our proposals. We provide a qualitative explanation of the benefits, relating to the market and regulatory failure analysis above. We base the compliance costs to firms in the market on a survey carried out in May 2012 (the 'cost survey'), where we asked respondent firms to estimate the cost to them of our proposals. In the cost survey, we asked firms to identify the one-off and ongoing costs to their firms of each proposal.

10. For the cost benefit analysis, we first summarise the total compliance cost of the total package of all mandatory proposals. The survey showed that the cost of proposals vary greatly depending on firm size. So we have split these compliance costs by firm size, and report the median cost in each size band. For each proposal, we then provide more information regarding the costs and benefits that arise from the proposal, and a breakdown of the costs split by firm size. Throughout the CBA, we only present the incremental costs that flow from that particular proposal, and present these as the costs to the median firm.

11. 49 firms responded to our survey. Unfortunately, despite the high number of small firms in the marketplace, only six responded to our survey. The results of the compliance cost survey raise concerns about the impact of the proposal on small insurance intermediaries (with holdings of client assets of less than £250,000). This, combined with the low response rate from small firms, mean that we are cautious regarding the accuracy and concerned about the potential impact. Therefore, we would welcome feedback and evidence on the potential costs for firms.

Q32: Are the costs outlined in the CBA realistic, especially for small firms? Please provide any explanations or evidence you have to support your view.

Summary of all proposals

12. We briefly summarise the compliance costs of all of the proposals here, for reference. To avoid doubt, proposals that impose indirect economic costs, costs to the FSA, or those that are optional are not included in this table. The rest of the CBA then looks at each proposal in turn, outlining the costs and benefits of each, and highlighting areas of interest.

Table 1: Summary of firm characteristics and compliance cost estimates

	Small firms	Medium firms	Large firms
Size of firm (in client money)	< £250,000	£250,000 - £10m	>£10m
Proportion of firms	75%	22%	3%
Proportion of client money holdings	2%	16%	82%
Firms in our cost survey sample	6	23	20
One-off costs	£7,000	£48, 000	£684,000
Ongoing costs	£40,000	£63,000	£632,000

Improving the effectiveness of segregation and use of risk transfer

Increasing the frequency of client money calculations for NSTs and bank reconciliations

Benefits

13. One of our concerns around the use of NSTs is that advances of credit from the NST could result in a client money shortfall in the event of firm failure. This proposal is intended to reduce the risk that such shortfalls occur or, where they do occur, ensure that there is a clear record.

14. Our preferred approach is for client money calculations to be performed on a daily basis. However, as this would give rise to significant issues in relation to firms' accounting and ledger systems, and having regard to proportionality, we are proposing that firms operating an NST should conduct client money calculations at least every seven business days.

15. We are, however, proposing an exception to this for firms that do not hold significant amounts of client money but require the flexibility of operating an NST. If the value of money held in the NST during the firm's last financial year was less than £250,000, we are proposing that the firm must conduct a client money calculation at least every 14 business days or less.

16. Our proposal on more frequent bank reconciliations serves as an important tool to prevent the misuse of client money and to check for fraud. We propose that firms must conduct bank reconciliations two days after client money calculations.

17. More frequent client money calculations and bank reconciliations also enables firms to obtain timely records of the client transactions involving client money and to monitor properly their client money balance, which is particularly important for firms that can advance credit out of the client money pool via an NST.

Compliance costs

18. The cost survey showed that currently, around 40% of respondents conduct client money calculations more often than the minimum (every 25 business days). Of those firms that conduct money calculations more frequently than the minimum standard, over 70% of them do so at least every 14 business days.

19. In terms of bank reconciliations, around 60% of respondents conduct bank reconciliations more often than the minimum standard of within ten business days of performing their client money calculation. Of those firms that conduct bank reconciliations more often than the minimum standard required, half of them suggested that they conducted bank reconciliations on a daily basis.

20. Table 2 sets out the estimated total one-off and ongoing compliance costs that more frequent client money calculations and bank reconciliations for NST are likely to impose on firms. It presents the compliance costs reported by the median firm, split between small, medium and large firms.

Table 2: Estimate total one-off and ongoing compliance costs to firms affected by the proposals on more frequent client money calculations for NST and bank reconciliations

Proposal	Small firm		Medium firm		Large firm	
	One-off	Ongoing	One-off	Ongoing	One-off	Ongoing
Client money calculations every seven days	n/a	n/a	£2,000	£9,000	£64,000	£32,000
Client money calculations every 14 days	£1,000	£5,000	n/a	n/a	n/a	n/a
Perform reconciliations within two days of client money calculations	Zero	£7,000	£19,000	£10,000	£29,000	£43,000

Restricting the period of funding for NSTs

Benefits

21. Limiting the time that firms can advance credit out of an NST reduces the risk of a significant shortfall in the client money pool on the failure of a firm due to irrecoverable and/or prolonged credit advanced from the NST.

22. We are proposing that firms can only advance credit from an NST for a client (i.e. where a debt is due to the NST from a client) for a maximum period of 45 days. For a debt due to the NST from an insurer (for example in relation to advances of credit in respect of premium refunds or claims) then this credit can be advanced for a maximum period of 90 days.

23. We are also proposing that firms should monitor the amount of credit on a weekly basis, topping up the client money bank account on a weekly basis following the relevant periods described above.

Compliance costs

24. Around a third of respondents to the cost survey said they did not extend credit, and therefore that this would not impose costs on them. For those respondents that indicated that this proposal would impose costs on them, they reported estimated total one-off costs of £900 for small firms, £6,500 and £18,000 for large firms. This was split between monitoring funding times and setting up a reporting structure to do this.

25. Ongoing compliance costs relate to the monitoring and reporting mentioned above, and the lost earnings from firm money used to cover client money extended beyond the limit. As an approximate upper-bound estimate of this ongoing cost, we multiply the average client money holdings by a rate of return (7%) and then multiply by the 45 days of credit extended. From our survey, firms that did extend credit usually did so for a period of 30 days, so this is a conservative assumption to base our cost estimates on.

26. We believe that ongoing compliance costs relating to monitoring and reporting are particularly high, and this may have been a result of double-counting (between monitoring costs and reporting costs) or over-estimates. As part of Q32 we would welcome feedback on these costs, particularly for small firms.

Table 3: Estimated one-off and ongoing compliance costs imposed on firms affected by the proposal to set a limit to the maximum number of days firms can extend funding from an NST

Proposal	Small firm		Medium firm		Large firm	
	One-off	Ongoing	One-off	Ongoing	One-off	Ongoing
Costs of monitoring funding times	£300	£4,500	£1,500	£4,500	£3,000	£15,000
Cost of using firm money (upper bound based on average firm client holdings x 7% x 45 days)	n/a	£275	n/a	£6,000	n/a	£244,000
Costs associated with creating a reporting structure	£400	£14,000	£5,000	£7,000	£15,000	£15,000

Prohibiting conditional risk transfer

27. We understand that currently, in some instances, risk transfer agreements make the appointment of the intermediary as agent conditional on certain events, casting into doubt whether or not the agency appointment has taken place. This could lead to the insurer refusing to honour the insurance if the intermediary failed to comply with minor requirements or cause confusion on a failure, as clients might not know whether they have valid insurance.

28. We are therefore proposing to address this concern by prohibiting conditional risk transfer. The grant of risk transfer must be clear and unequivocal. We acknowledge the risk that having such a prohibition might discourage insurers from granting risk transfer.

Benefits

29. For insurance intermediaries, this proposal provides the necessary clarity of their contractual relationship with insurers on how intermediaries treat client money – in particular, whether a valid risk transfer has been granted. Most of the respondents to our survey agreed that the proposal would provide some benefits by making the risk transfer relationship between an intermediary and an insurer much clearer.

30. For clients, this proposal increases client protection and transparency by ensuring that risk transfer arrangements are clear and unconditional. It could also avoid the considerable expense and delay that may otherwise be caused on the failure of a firm if the validity of the risk transfer arrangement is called into question.

Compliance costs

31. From our cost survey, roughly half of firms said that this proposal would impose costs on them. On a cost-per-firm basis, the estimate total one-off costs are likely to be between £1,500 for small firms, up to £20,000 for large firms.

32. Estimated ongoing costs are £7,000 for small firms and £26,000 for large firms. With reference to Q32, we would like your views on why this proposal will give rise to considerable on going costs, particularly when compared to the estimated one-off costs, as we believe that the main cost drivers for this proposal should only be the one-off repapering costs.

Table 4: Estimated one-off and ongoing compliance costs imposed on firms affected by the proposal to prohibit conditional risk transfer

Proposal	Small firm		Medium firm		Large firm	
	One-off	Ongoing	One-off	Ongoing	One-off	Ongoing
Prohibiting conditional risk transfer	£1,500	£7,000	£3,000	£6,000	£20,000	£26,000

Simplifying the distribution and transfer of client money

Changing insolvency practitioner's focus to complete open transactions and facilitating the transfer of client business to other firms after a pooling event

33. We believe that these proposals will not give rise to incremental costs to firms because:

1) the proposed transfer of client money post failure is an optional mechanism and should be done on a reasonable endeavour basis; and

2) the proposed transfer of client money post failure is not more expensive to reconcile and sell the client book than it would have been to reconcile and distribute the client money.

34. The fundamental task for the insolvency practitioner (IP) remains the same, that is, to reconcile the client money and establish whether there is a deficit or not and what should be paid to who.

Clarifying the deduction of costs of distributing post failure client money following a pooling event

35. Currently an IP must return any client money received after the primary pooling event (PPE), except in limited specified circumstances. There are currently no provisions in the rules relating to the costs of this exercise. If client money has to be returned to clients following a PPE we consider that an IP should be able to deduct their reasonable costs of distributing the client money from the money itself.

36. We are proposing to introduce rules to this effect giving the IP the option of deducting reasonable costs of distribution from the post failure client money either equally across each client or, if relevant, the actual costs of distributing to each client (although these must be reasonable costs limited to the costs actually incurred in returning the relevant payment).

37. We do not believe that this proposal would give rise to costs to firms or clients given that we are simply clarifying the role and costs that the IP can deduct in the event of failure.

'Pre-consent' for transfer of business

38. We understand that there are frequent sales of books of business between firms. In some cases the client money held in relation to that book is transferred to the purchaser. To move client money between firms, the firm who is holding the client money must first obtain consent to this move from all the relevant clients. This often proves to be problematic and we are often approached for waivers of the requirement to obtain consent.

39. To avoid unnecessary problems we are proposing a mechanism whereby firms may obtain 'pre-consent' from clients to such a transfer. This would be one option available to firms if they wished to transfer client money as a going concern.

Benefits

40. This proposal serves to facilitate the transfer of business from one insurance intermediary to another when specified conditions are met. It will also potentially remove the need for a large number of waiver requests from firms to the FSA in the transfer of business scenarios. However, since including a pre-consent for transfer is optional, it is not clear how widely this option will be taken up and therefore the extent of benefits that accrue.

Compliance costs

41. 35% of respondents indicated that this proposal is likely to incur costs on them. Of those firms that reported costs, the median firm reported an estimate one-off cost of £1,000 for small firms, £5,000 for medium-sized firms and £37,000 for large firms.

42. If firms decide to include pre-consent in their terms of business, there will be one-off costs involved with re-papering existing contracts and updating the standard contract to be used going forward – we do not believe that there should be any ongoing costs as a result of the proposal. As part of Q32 we would welcome feedback on whether firms believe there are in fact ongoing costs.

43. We also note that since the proposal to allow pre-consent is optional, firms will only adopt it where it is in their commercial interests to do so. In such cases, benefits to individuals firms will outweigh costs. The costs presented in Table 5 are therefore costs of setting up the optional 'pre-consent', and are not included in the overall compliance cost of proposals.

Table 5: Estimated one-off costs if firms choose to adopt a 'pre-consent' clause in their terms of business

Proposal	Small firm		Medium firm		Large firm	
	One-off	Ongoing	One-off	Ongoing	One-off	Ongoing
Allowing 'pre-consent' for transfer	£1,000	Zero	£5,000	Zero	£37,000	Zero

Improving the diversification of client money

Amount of client money held in a bank in the same group as the firm

Benefits

44. The proposal improves diversification of client money by limiting the amount of client money that a firm can hold in a group bank.

Compliance costs

45. The majority of firms (75%) in our survey did not hold client money in the same group as them. Those that do hold 53% to 100% of their client money in their group banks. The amount of client money held in group banks ranged from £2,500 to £10m.

46. We believe that there will be minimal compliance costs involved in placing client money in banks that are not in the firm's own group. These costs relate to one-off costs of arranging new accounts with external banks (which the survey showed would be minimal).

47. This proposal also has some indirect economic costs. These are the loss of discretion in diversifying client assets, increased funding costs (via reduced liquidity) for the group banks, potential aggregate effects on the banking system and potential impact on competition. We believe the last two effects will be minimal, given the size of the client money held by CASS 5 firms.

Enhancing record keeping and reconciliations

48. Under CASS 5.5.69R, firms are required to be able to reconcile down to individual client balances for the majority of their clients if they use the accruals accounting method to do their client money calculation. We understand there are differing practices within the industry about whether firms do in fact conduct this reconciliation.

49. The rationale for this rule is that if a firm fails, the IP has to match all the client money down to individual client level. If the firm has already been doing such matching and the systems are still running on the firm's failure, there should be no significant delay for the IP to establish who the client money is held for.

50. We are therefore proposing that firms are required to reconcile down to individual client balances on an annual basis. They must do this within a specified period of one calendar month. This can be conducted at any point during the firm's client money year. Firms must attempt to reconcile down to individual client balances for all the money they hold.

Improving the rate of reconciliation

Benefits

51. This proposal could significantly reduce the time for the IP to trace the client money down to individual client level if a firm becomes insolvent. It also makes it clear what the minimum frequency is and the percentage of client money that firms are required reconcile down to individual client balances, thereby avoiding different interpretations of this rule by firms and supervisors.

Compliance costs

52. 67% of firms that responded to the survey questions for this proposal indicated that they already fulfil this proposed requirement. As such, the incremental cost of this proposal on these firms should be minimal.

53. For the remaining 33% of respondents, the reported estimate total one-off costs are £1,000 for small firms, £5,000 for medium firms and £250,000 for large firms. Costs are driven by updating internal and external systems and retraining staff.

54. These 33% of firms also reported ongoing costs of £2,000 for small firms, £11,000 for medium firms and £33,000 for large firms. These costs relate to using external consultants, extra staff on a permanent basis and ongoing monitoring to ensure the requirement is met.

Table 6: Estimated one-off and ongoing costs for those firms affected by the proposal to increase the rate of reconciliation

Proposal	Small firm		Medium firm		Large firm	
	One-off	Ongoing	One-off	Ongoing	One-off	Ongoing
Increasing the rate of reconciliation	£1,000	£2,000	£5,000	£11,000	£250,000	£33,000

Increasing the speed of resolution after a failure through the use of a resolution pack

Benefits

55. A resolution pack containing documents would assist an IP on the failure of the firm. These are required to be retrievable within 48 hours of the firm's failure and can help promote the speedy return of client money back to the clients after the firm's insolvency, enhancing client protection.

Compliance costs

56. 55% of the respondents noted that they are likely to incur costs from this proposal. Respondents suggested they would incur an estimated total one-off costs that fall between £2,000 for small firms and £1,000 for large firms. The counter-intuitive costs may be because large firms already have the systems and documents ready to put in place a resolution pack. Survey respondents highlighted repapering, updating internal systems and staff costs as the main drivers of one-off costs.

57. Ongoing costs range between £1,000 for medium firms, to £4,000 for large firms. Staff costs and maintenance of up-to-date records for the resolution pack drove these costs estimates according to our survey.

Table 7: Estimated one-off and ongoing costs for those firms affected by the proposal to introduce a resolution pack to be used in the event of firm failure

Proposal	Small firm		Medium firm		Large firm	
	One-off	Ongoing	One-off	Ongoing	One-off	Ongoing
Increasing the speed of resolution after a failure	£2,000	£2,000	£600	£1,000	£1,000	£4,000

Enhancing the requirements on segregation and placement of client money

Credit write backs and unclaimed client money

58. There are varying standards across the industry about the amount of scrutiny that firms give to balances that they then take as credit write backs. We are proposing to put in the rules a procedure under which firms may take credit write backs in relation to any balances which were grandfathered into the CASS 5 regime and have been held by these firms as client money since 14 January 2005, when the regime began. We are doing this to encourage firms to investigate these legacy balances and to deal with them appropriately.

59. We are proposing to make this procedure available to firms for a limited period of 13 months, during which firms may take credit write backs in accordance with the rules. After this period firms may not take credit write backs – if the money is held by the firm as client money after the expiry of the period then the money can only be dealt with in accordance with the rules on how firms should deal with unclaimed client money.

60. Our proposal on unclaimed client money provides a mechanism whereby firms can deal with the balances that the firms hold and have been unable to return to the clients. Under this proposal, firms can pay those balances to charity after the requisite efforts have been made to return the money to the clients. If firms do this, they would still have to undertake to make good any valid claims in the future from clients for these balances.

Benefits

61. This proposal could ensure that firms perform significantly robust due diligence on the balances in question before they take any balances as credit write backs.

62. We understand that there may be considerable amounts of money held in client bank accounts across the industry that are not due to clients or insurers and should be removed from the client bank accounts. This proposal should encourage firms to deal with their legacy balances that were grandfathered into the CASS 5 regime in January 2005.

63. Further, by evaluating their legacy client money balances and dealing with these balances properly according to the requirements, insurance intermediaries could avoid incurring the expenses of administering these balances going forward.

64. For clients and insurers, this proposal could potentially facilitate the return of their money to them.

Indirect costs

65. The costs associated with investigating legacy write backs and for returning unclaimed client money can be borne by the client balances concerned. As a result, such investigations do not constitute a compliance cost to firms, but they are an economic cost. We assess these costs by looking at the estimates that firms have given us for investigating and returning legacy client balances.

66. We assess that investigating legacy credit write backs has only one-off costs. These are estimated from our cost survey as £1,000 for small firms, £10,000 for medium firms and £84,000 for large firms. The increase in cost likely reflects larger client money balances and more complicated systems to investigate. However, as noted above, these costs can be borne by the legacy balances themselves, so do not constitute a cost to the firm.

67. Dealing with unclaimed money will have compliance cost implications going forward according to firms who responded to our cost survey. These range from £4,000 a year for small firms, £7,000 for medium firms and £60,000 for large firms.

Table 8: Estimate cost imposed on firms as a result of the proposal on unclaimed client money

Proposal	Small firm		Medium firm		Large firm	
	One-off	Ongoing	One-off	Ongoing	One-off	Ongoing
Investigating legacy credit write backs	£1,000	n/a	£10,000	n/a	£84,000	n/a
Dealing with unclaimed money	£1,000	£4,000	£2,000	£7,000	£40,000	£60,000

Unmatched and unallocated cash

68. We are proposing rules to require firms to match cash to either specific clients or specific transactions within a maximum period of 90 days or to return the cash to the sender or, if this is not possible, to the remitting bank.

Benefits

69. If firms have sums for which they have no records of what or to whom these sums relate, in the first instance the implication is that a firm has not complied effectively with the intention of the CASS rules. Firms may also be in breach of the firms' obligations as a fiduciary under trust law. This proposal could drive positive behaviour in the industry by requiring firms to match the client money they receive to either specific clients or specific transactions within a maximum period of 90 days, or the firms would have to return the cash to the sender or, if this is not possible, to the remitting bank.

Compliance costs

70. The estimated compliance costs of restricting the period where firms can hold unallocated cash were limited to medium and large firms. Small firms reported that the proposal would have no effect on them, presumably because they have unmatched cash rarely.

71. For medium firms, the cost survey showed that there would be no one-off costs, but £8,000 per year in ongoing costs. For larger firms, estimated one-off costs were £54,000 and ongoing costs were £7,000 a year.

72. The key drivers of the costs identified by the respondents are: bank charges, increase in refund issues (given that costs often depend on number of refunds issued), the requirement on staff to continuously monitor the ageing of unmatched cash and system changes.

Table 9: Estimate cost imposed on firms as a result of the proposal to deal with unmatched and unallocated client money within 90 days

Proposal	Small firm		Medium firm		Large firm	
	One-off	Ongoing	One-off	Ongoing	One-off	Ongoing
Returning unmatched and unallocated client money within 90 days	Zero	Zero	Zero	£8,000	£54,000	£7,000

Notification of money held at third parties

73. We are proposing that firms who accept money as third party brokers from other UK authorised firms are required to send monthly statements to the originating brokers detailing the money they hold for that broker and when it is paid to a different broker, to a broker with risk transfer or to the insurer. This statement would cover all monies paid by the originating broker to the third party broker. This will enable firms to clearly monitor and document where all the monies over which they retain fiduciary duties are held.

74. In relation to overseas brokers, we are proposing that the current '12 month rule' remains, whereby firms must use reasonable endeavours to discover when monies passed to overseas brokers en route to overseas insurers have been paid to the relevant insurer and after 12 months if there is no reason to believe otherwise, may assume that the money has reached the insurer. We are considering linking the period after which the firm may assume that the money has reached the insurer to the period of the insurance itself.

Benefits

75. This proposal enables firms, as trustees of the client money they pass on to other brokers in a chain, to identify monies for which they have fiduciary duties. In the event of a firm's failure, this would enable the IP to establish in a timely fashion where all the monies over which the firm has fiduciary duties are located, thereby reducing the delay and costs involved in tracing client money. This proposal also reminds insurance intermediaries of their fiduciary duties in relation to the client money which is en-route to the insurers.

Compliance costs

76. Just over half of the respondents to our cost survey suggested that they would be affected by this proposal. Small firms reported that they would not be affected by the proposal since they did not hold money as third-party brokers.

77. For medium and large firms, the estimated one-off median costs were £5,000 and £178,000 respectively. Estimated ongoing costs were £5,000 and £84,000 respectively.

Table 10: Estimated cost of requiring third party brokers to send statements on client money holdings

Proposal	Small firm		Medium firm		Large firm	
	One-off	Ongoing	One-off	Ongoing	One-off	Ongoing
Notification of money held at third parties	Zero	Zero	£5,000	£5,000	£178,000	£84,000

More clarity regarding prudent over-segregation

Benefits

78. Our proposal on providing guidance about when a firm may maintain a prudent over-segregation within the client bank account should standardise the differing practices in the industry on how and why firms hold prudent over-segregations within client bank accounts. It should also ensure that prudent over-segregation is properly documented by firms so that, if firm fails, the extra costs and delay in dealing with prudent over-segregation can be avoided.

Compliance costs

79. Just under a third of respondents suggested that they would be affected by this proposal. Of those firms that did respond, the median one-off costs were between £400 for small firms, and £29,000 for large firms. The ongoing costs were between £300 for medium firms and £70,000 for large firms.

Table 11: Estimated reported cost of guidance on prudent over-segregation

Proposal	Small firm		Medium firm		Large firm	
	One-off	Ongoing	One-off	Ongoing	One-off	Ongoing
Guidance on prudent over-segregation	£400	£15,000	£800	£300	£29,000	£70,000

80. We believe these cost figures to be somewhat overestimated and that some firms may have misinterpreted the proposal. Firstly, the proposal is to allow optional over-segregation – firms are not obliged to take up that option and would only do so where it provided them or their clients with commensurate benefits. Secondly, we do not believe that ongoing costs would be significant, even in the case where firms decide to adopt a prudent over-segregation policy. All that would be required is a yearly confirmation of the agreed policy.

81. On this basis, we believe there would be some one-off costs for firms who choose to adopt the approach, and from our cost survey these would be £500, £800 and £29,000 for small, medium and large firms respectively. Ongoing costs would be negligible. As part of feedback on Q32, we would welcome further views on the likely impact of this proposal.

Restricting the type of investments for client money

Benefits

82. This proposal substantially reduces the risk of client money being invested in investments that we believe are inappropriate in light of the volatility of the current financial market and the potential detriment to clients brought about by the failure of a firm.

Compliance costs

83. We expect this proposal to impose minimal costs on firms as our cost survey indicated that firms do not hold client money in prohibited forms of investments.

Money due to a client from a firm

84. This proposal specifies the time within which a firm must return client money to its client upon the client's request, thereby ensuring that clients would be able to get their money back within a specified reasonable period of time.

Benefits and costs

85. The cost survey revealed that all firms are already fulfilling this requirement, and therefore we do not believe that there will be any incremental costs or benefits from this proposal.

Restricting the period under which client money can be held by an appointed representative

Benefits

86. The proposal limiting the period client money can be held by an appointed representative to no more than three calendar months should enable better and more frequent reconciliations, thereby ensuring that client money is properly segregated at the firm level.

Compliance costs

87. It is expected that this proposal will impose minimal costs (both one-off and ongoing costs) on firms. Only one respondent suggested that this proposal would impose costs on them. Although this respondent did not quantify the cost, they suggested that costs would flow from their need to carry out additional reconciliations and agreements of the relevant amount held by their appointed representative(s).

Improving governance and reporting to the FSA

88. To improve governance and reporting to the FSA, the following proposals have been put forward: to allocate to an existing approved person the responsibility for CASS oversight; and requiring the submission of client money audit reports to FSA. The costs and benefits of each proposal are discussed below in more detail.

Appointed an existing CF or SIF to have the responsibility for CASS oversight

Benefits

89. This proposal could enhance firms' focus on client money protection by ensuring that there is a sufficiently senior individual within a firm to have the dedicated responsibility for CASS oversight. We believe that this can enhance firms' compliance with the rules, and thereby promote client protection.

Compliance costs

90. For those respondents that stated in the cost survey that this proposal would impose costs on them, small firms reported one-off costs of £300 and ongoing costs of £600. Medium firms reported one-off costs of £5,000 and ongoing costs of £2,000. Large firms reported one-off costs of £8,000 and ongoing costs of £50,000. Compliance training, monitoring CASS-related activities and increased compensation for the CASS oversight individual were the main drivers of costs.

Table 12: Estimated reported compliance cost of requiring CASS oversight from a CF or SIF

Proposal	Small firm		Medium firm		Large firm	
	One-off	Ongoing	One-off	Ongoing	One-off	Ongoing
Requiring a CF or SIF to be responsible for CASS oversight	£300	£600	£5,000	£2,000	£8,000	£50,000

Requiring the submission of client money audit reports to the FSA

91. In our CP we are seeking views on a range of potential options regarding the submission of client money audit reports to the FSA. For the purposes of the CBA we have looked at the most stringent proposal option to require mandatory submission from all firms.

Benefits

92. By requiring firms to submit their client money audit reports to us, we can drive positive behaviour in the market in terms of better compliance with our rules by firms as well as better quality of these audit reports. We also consider that the information provided in client money audit reports is a useful supervisory tool both on firm-specific and thematic levels.

Compliance costs

93. 41% of respondents suggested that this proposal will have a material compliance cost. Small firms indicated that one-off and ongoing costs of the proposal would be £300 or the equivalent to one full workday. Medium firms reported that one-off costs would be £900 and ongoing costs would be £500. The cost estimates from larger firms were somewhat bigger. These firms estimated that one-off costs would be £11,000 and ongoing costs £44,000.

94. These costs are mainly driven by additional audit fees (although there should be no additional audits, since firms are required to undertake these audits under current rules), increase in staff costs, and cost of submitting the reports to the FSA.

Table 13: Estimated reported compliance cost of requiring submission of client money audit reports to the FSA

Proposal	Small firm		Medium firm		Large firm	
	One-off	Ongoing	One-off	Ongoing	One-off	Ongoing
Submission of client money audit reports to the FSA	£300	£300	£900	£500	£11,000	£44,000

Cost to the FSA

95. We are also aware that this proposal will have some resource implications for us in managing the collection and analysis of client money audit reports. We will consider these costs, alongside responses to the potential options when developing our policy proposal.

Q33: What are your views on the benefits and costs of the proposed policy measures?

Annex 2

Compatibility statement

Introduction

1. In this section we set out our views on how the proposals and draft rules in this Consultation Paper (CP) are compatible with our general duties under Section 2 of the Financial Services and Markets Act 2000 (FSMA) and our regulatory objectives set out in Sections 3 to 6 of FSMA. This section also outlines how our proposals are consistent with the principles of good regulation (also in Section 2 of FSMA) to which we must have regard.

Compatibility with our statutory objectives

2. The proposals outlined in this CP mainly contribute to our statutory objectives of consumer protection and, to a certain extent, the reduction of financial crime.

3. Broadly, our proposals in this CP aim to secure an appropriate level of consumer protection through the CASS 5 regime. These proposals will improve the effectiveness of the regime by removing inappropriate practices and enhancing the protection of client money in the hand of insurance intermediaries, both on an ongoing basis and at the point an intermediary fails. In addition, simplifying and clarifying the CASS 5 regime to firms is likely to improve compliance with the rules by firms, which in turn further promotes consumer protection.

4. Our proposals, particularly the ones on requiring a firm to perform more frequent bank reconciliations and to appoint an existing CF or SIF to have the responsibility for CASS oversight of the firm, can also contribute to the reduction of financial crime in two main ways. Firstly, by reducing the risk that a firm will attempt to use clients' money to prevent the firm from failing when it is approaching insolvency. Secondly, by reducing the risk that individuals in the firm may illegally appropriate client money for the purposes of financial crime.

Compatibility with the principles of good regulation

5. Section 2(3) of FSMA requires that, in carrying out our general functions, we have regard to the principles of good regulation. In formulating these proposals we have had regard to these principles, in particular the following.

The need to use our resources in the most efficient and economic way

6. We are of the view that the proposals in this CP will not directly affect our resources, apart from the proposal requiring firms to submit their client money audit reports to us. However, we consider this proposal an efficient and economic use of our resources given that these reports serve as a valid and useful supervisory tool, and we wish to make use of the data included in these reports.

7. We have set out a number of options in the main body of the CP regarding the submission of audit reports to the FSA, to seek respondents' view on whether all client money audit reports should be required to be submitted to the FSA, or whether only reports that fall into certain categories would need to be submitted. We also explore the possibility of electronic submission of these reports, and seek consultation responses on this.

The responsibilities of those who manage the affairs of authorised persons

8. Our proposed changes will bring an increased focus on the systems and controls firms rely on to achieve client money protection and will ensure that a sufficiently senior individual within the firm would have the responsibility for CASS oversight. These will generally improve the oversight of CASS in many firms, enhancing consumer protection.

The principle that a burden or restriction which is imposed should be proportionate to the benefits

9. We have had regard to the proportionality of the proposals by conducting a cost benefit analysis. Based on this analysis, and on the compliance cost survey that we sent to firms, we have some concerns regarding the significant compliance costs that fall on small firms. With due regard to proportionality, we are seeking further information on the costs of our proposals to small firms.

The desirability of facilitating innovation

10. To ensure that our proposals do not stifle innovation, we allow flexibility for a number of them in the conduct of certain affairs of the firm, for example, the proposal allowing a firm to obtain pre-consent for the transfer of business, and the proposal providing an IP with an optional mechanism to transfer the business of the firm on the firm's primary pooling event, both subject to the compliance with the requirements of the rules.

The desirability of facilitating competition

11. We have considered the impact of our proposals on the competitive environment for firms. We note in our cost benefit analysis that one-off costs are high, particularly for small firms, and this could have a further impact on competition by creating barriers to entry. However, we also note that there is already a very large number of firms active in the market. We are requesting further information on the cost implications for small firms, and will use this to assess the impact on competition.

Why our proposals are most appropriate for the purpose of meeting our statutory objectives

12. We believe that, given the aim to enhance the protection of client money as held by insurance intermediaries, our proposals are the most appropriate response available to us. We explain the alternative options considered and our reasons for preferring our proposals in various parts of this paper.

Annex 3

List of questions

Q1: Do you agree with the proposed frequency of client money calculation?

Q2: Do you agree with the proposed frequency of bank reconciliation?

Q3: Do you agree with our proposal in relation to limiting the period where credit can be advanced in a NST including the weekly funding review?

Q4: Do you agree with our proposal to move the £50,000 requirement from CASS to MIPRU?

Q5: Do you agree with our proposal in prohibiting conditional risk transfer?

Q6: Do you agree with our proposals relating to primary pooling events, including the period of no longer than three months for the optional mechanism whereby an IP can transfer a firm's business after its failure?

Q7: Do you agree with the proposed clarifications in relation to the secondary pooling event rules?

Q8: Do you agree with our proposal on introducing rules to give the IP the option of deducting their reasonable costs of distribution from the post failure client money?

Q9: Do you agree with our proposal on pre-consent for the transfer of business?

Q10: Do you agree with our proposal on limiting the amount of client money which can be held in a group bank to a total of 20 per cent of the total amount of client money held by the firm?

Q11: Do you agree that the term 'designated bank account' should be replaced with 'designated client bank account' as defined in the Glossary?

Q12: Do you agree with our proposal in relation to reconciliation down to individual client balances on an annual basis?

Q13: Do you agree with our proposal on resolution pack?

Q14: Do you agree with the proposal relating to credit write back, in particular, do you agree that the Rules should allow firms to take credit write back for unknown balances?

Q15: Do you agree with our proposal on unclaimed client money?

Q16: Do you agree with our proposal in relation to returning small amounts of client money in the form of postage stamps?

Q17: Do you agree with our proposal on unallocated client money?

Q18: Do you agree with our proposal in relation to client money held at third parties?

Q19: Do you agree that the '12 month rule' should remain or do you think that it is more appropriate to link the period after which the firm may assume that the money has reached the insurer to the period of the insurance itself? Please provide reasons.

Q20: Do you agree with our proposal on prudent over-segregation?

Q21: Do you agree with our proposal on allowing client money to be held only in client bank accounts or money market funds?

Q22: Under Chapter 7 of the Client Assets Sourcebook, firms can, on receiving any client money, promptly place this money into an account open with a qualified money market fund. Do you think that we should change money market funds under CASS 5 to qualified money market fund (as defined in the Glossary) in order to be in line with CASS 7? The rules for this proposal are currently drafted with reference to money market funds.

Q23: Do you agree with our proposal on clarifying the Rules in relation to commission?

Q24: Do you agree with our proposal in relation to same day draw down?

Q25: Do you agree with our proposal on money due to a client from a firm?

Q26: Do you agree with that the maximum period should be no longer than three calendar months for firms to perform the reconciliation in relation to periodic segregation?

Q27: Do you agree with our proposal on CASS oversight?

Q28: Which of the above options in relation to the submission of client money audit reports would you support and why? If you support the option of setting a threshold below which firms do not have to submit their client money audit reports to us, which of our proposed thresholds would you think is appropriate and why? If neither, what threshold would you suggest?

Q29: Do you agree with the actions that we are proposing to require firms to do in relation to client money audit reports if they hold client money in an ST not exceeding £30,000 or do not hold client money at all when they conduct insurance mediation? If not, why not?

Q30: Do you agree with the proposed delayed commencement of the draft rules, or do you think that a different date should be applied to any particular proposal(s)? Please provide reasons.

Q31: Do you agree with this approach of replacing the existing CASS 5 with a new CASS 5A?

Q32: Are the costs outlined in the CBA realistic, especially for small firms? Please provide any explanations or evidence you have to support your view

Q33: What are your views on the benefits and costs of the proposed policy measures?

Appendix 1

Draft Handbook text

CLIENT ASSETS SOURCEBOOK (INSURANCE MEDIATION ACTIVITY) INSTRUMENT 2012

Powers exercised

A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 59 (Approved persons);
(2) section 138 (General rule-making power);
(3) section 139 (Miscellaneous ancillary matters);
(4) section 149 (Evidential provisions);
(5) section 156 (General supplementary powers); and
(6) section 157(1) (Guidance).

B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on [*date*].

Amendments to the Handbook

D. The modules of the FSA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (MIPRU)	Annex B
Client Assets sourcebook (CASS)	Annex C
Supervision manual (SUP)	Annex D

Citation

E. This instrument may be cited as the Client Assets Sourcebook (Insurance Mediation Activity) Instrument 2012

By order of the Board
[*date*]

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text.

CASS resolution pack	(1)	(in *CASS* 5A.9) those documents and records which are specified in *CASS* 5A.9.4R and *CASS* 5A.9.5R.
	(2)	(in *CASS* 10) those documents and records which are specified in *CASS* 10.2 and *CASS* 10.3.
client bank account	(1)	(other than in *CASS* 7 and *CASS* 7A and principally in *CASS* ~~5~~ 5A) …
client money	…	
	(2)	(in *CASS* ~~5~~ 5A) subject to the *client money rules*, *money* of any currency which, in the course of carrying on *insurance mediation activity*, a *firm* holds on behalf of a *client* or which a *firm* treats as *client money* in accordance with the *client money rules*.
	…	
client money (insurance) distribution rules	the rules in *CASS* ~~5.6~~ 5A.8 (Client money distribution).	
client money rules	(1)	…
	(2)	(in *CASS* 5) *CASS* ~~5.1~~ 5A.1 to *CASS* ~~5.5~~ 5A.7 and *CASS* 5A.9.
	…	
commercial customer	(in *ICOBS* ~~and *CASS* 5~~) a *customer* who is not a *consumer*.	
customer	(1)	(except in relation to *ICOBS*~~,~~ and *MCOBS* 3 ~~and *CASS* 5~~) a *client* who is not an *eligible counterparty* for the relevant purposes.
	…	
	(4)	~~(in relation to *CASS* 5) a *client*.~~ [deleted]
exempt insurance intermediary	an *insurance intermediary*:	
	…	
	(b)	which, in relation to *insurance mediation activity* (but disregarding *money* or other assets held in relation to other

activities) either:

…

(ii) holds *client money* as trustee under a statutory trust imposed by *CASS* ~~5.3~~ 5A.3 (statutory trust) but does not otherwise hold *client money*; and

(c) which (when aggregating the amount calculated in accordance with *CASS* ~~5.5.65R~~ 5A.5.88R) does not in relation to *insurance mediation activity* hold *client money* in excess of ~~?30,000~~ £30,000 at any time during a *financial year*.

…

insurance client money chapter	*CASS* ~~5~~ 5A.	
insurance undertaking	(1)	(except in *COBS*) an undertaking, or (in *CASS* ~~5~~ 5A and *COMP*) a *member*, whether or not an *insurer*, which carries on *insurance business*.
	…	
premium	(1)	(except in *ICOBS* and *CASS* ~~5~~ 5A) (in relation to a *general insurance contract*) the consideration payable under the contract by the *policyholder* to the *insurer*.
	(2)	(except in *ICOBS* and *CASS* ~~5~~ 5A) (in relation to a *long-term insurance contract*) the consideration payable under the contract by the *policyholder* to the *insurer*….
	…	
	(2A)	(in *ICOBS* and *CASS* ~~5~~ 5A) as in (1) and (2)….
	…	
primary pooling event	(1)	…
	(2)	(in *CASS* ~~5~~ 5A) an event that occurs in the circumstances described in ~~*CASS* 5.6.5R~~ *CASS* 5A.8.5R (Failure of the authorised firm: primary pooling event).
reinsurance contract	(in *COBS* 21, *ICOB*, *CASS* ~~5~~ 5A and *COMP*) a *contract of insurance* covering all or part of a risk to which a *person* is exposed under a *contract of insurance*.	
secondary pooling event	(1)	…
	(2)	(in *CASS* ~~5~~ 5A) an event that occurs in the circumstances

described in *CASS* ~~5.6.14R~~ 5A.9.31R (Failure of a bank, other broker or settlement agent: secondary pooling events).

…

Annex B

Amendments to the Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (MIPRU)

In this Annex, underlining indicates new text.

...

2.2 Allocation of the responsibility for insurance mediation activity

…

2.2.3 G ...

(4) A *firm* to which the *insurance client money chapter* applies should also have regard to *CASS* 5A.7.2R when allocating the responsibility for *insurance mediation activity* under *MIPRU* 2.2.1R.

…

4.2 Capital resources requirements

…

Capital resources requirement: mediation activity only

4.2.11 R (1) ….

(2) If a *firm* carrying on *insurance mediation activity* or *home finance mediation activity* (and no other *regulated activity*) holds *client money* or other *client* assets in relation to these activities, its capital resources requirement is the higher of:

(a) £10,000, unless (3) applies; and

(b) …

(3) If a *firm* carrying on *insurance mediation activity* holds *client money* subject to *CASS* 5A.4, and under the terms of the non-statutory trust it is to handle *client money* for *retail customers*, the amount in (2)(a) is £50,000.

Annex C

Amendments to the Client Assets sourcebook (CASS)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

1.2 General application: who? what?

…

1.2.13 G A *firm* may opt to hold under a single chapter *money* that would otherwise be held under different chapters (see *CASS* ~~5.1.1R(3)~~ 5A.1.10R and *CASS* 7.1.3R).

…

1.4 Application: particular activities

…

1.4.9 R Where a *firm* carries on *auction regulation bidding* it may elect to comply with *CASS* (but not *CASS* ~~5~~ 5A) in respect of this activity, subject to the general modifications in *CASS* 1.4.10R.

…

1.4.11 R The effect of *CASS* 1.4.10R is that when a *firm* makes an election in accordance with *CASS* 1.4.9R:

(1) a *two-day emissions spot* falls within the scope of each chapter in *CASS* (save for *CASS* ~~5~~ 5A), for example:…

…

1A CASS firm classification and operational oversight

…

1A.1.1 R (1) …

(2) In relation to a *firm* to which *CASS* ~~5~~ 5A(Client money: insurance mediation activity) and *CASS* 7 (Client money rules) apply, this chapter does not apply in relation to *client money* that a *firm* holds in accordance with *CASS* ~~5~~ 5A.

…

…

1A.2.2 R …

(2) For the purpose of determining its 'CASS firm type' in accordance with *CASS* 1A.2.7R, a *firm* must:

…

(c) in either case, exclude from its calculation any *client money* held in accordance with *CASS* ~~5~~ 5A (client money: insurance mediation activity).

…

Delete all of CASS 5 (Client money: insurance mediation activity). The deleted text is not shown.

After CASS 5 [deleted] insert the following new chapter. The text is not underlined.

5A Client money: insurance mediation activity

5A.1 Purpose and application

Purpose of these rules

5A.1.1 G The purpose of the *insurance client money chapter* is to ensure that *client money* held by a *firm* is protected in accordance with *Principle* 10 of the *FSA's* Principles for Business. The *insurance client money chapter* also gives effect to article 4.4 of the *Insurance Mediation Directive* which requires *clients* to be protected against the inability of the *insurance intermediary* to transfer *client money* as it has agreed with the *client*.

Application

5A.1.2 R The *insurance client money chapter* applies to a *firm* which receives or holds *money* in the course of, or in connection with, its *insurance mediation activity*.

5A.1.3 R The *insurance client money chapter* applies as soon as the *firm* receives *money* or holds *money* for *clients* in the course of or in connection with its *insurance mediation activity*.

5A.1.4 G This *money* could, for example, be received from *clients*, *insurance undertakings* or other *insurance intermediaries* and could relate to any aspect of the firm's *insurance mediation activities*.

5A.1.5 G When a *firm* receives or holds *money* in the course of, or in connection with, its *insurance mediation activity* it may comply with the *insurance client money chapter* in the following manner:

(1) in compliance with *CASS* 5A.2 and by holding *money* in relation to its *insurance mediation activity* as agent for the *insurance undertaking*; or

(2) by holding *client money* under the statutory trust (see *CASS* 5A.3); or

(3) by holding *client money* under the non-statutory trust (see C*ASS* 5A.4); or

(4) by holding *client money* under a combination of these arrangements.

5A.1.6 G *Money* received from a third party *premium* finance provider on the *client's* behalf should be treated as *client money* (unless the provisions of *CASS* 5A.2 apply).

When the client money rules do not apply

5A.1.7 R *CASS* 5A.1 to *CASS* 5A.9 do not apply to:

(1) a *firm* which holds all *client money* in accordance with *CASS* 7 (see *CASS* 5A.1.8R and *CASS* 5A.1.9R below); or

(2) a *firm* when carrying on an *insurance mediation activity* which is in respect of a *reinsurance contract* (although such a *firm* can elect to comply with the *insurance client money chapter* in accordance with *CASS* 5A.1.10R); or

(3) a *managing agent* when acting as such.

MiFID business or designated investment business: election to comply with CASS 7 or CASS 5

5A.1.8 G In accordance with *CASS* 7.1.3R, a *firm* may elect to comply with *CASS* 7 instead of *CASS* 5A in respect of the *client money* it holds in connection with its *insurance mediation activity*.

5A.1.9 G A *firm* which carries on *MiFID business* or *designated investment business* in relation to life assurance business may, in accordance with *CASS* 7.1.15BR and in relation to that business only, either comply with *CASS* 7 or elect to comply with the *insurance client money chapter*.

Electing to comply with the client money rules

5A.1.10 R A *firm* may elect to comply with *CASS* 5A.1 to *CASS* 5A.9 in respect of *client money* which it receives or holds in the course of or in connection with carrying on *insurance mediation activity* in respect of *reinsurance contracts*.

5A.1.11 R A *firm* may elect to comply with *CASS* 5A.1, *CASS* 5A.2 and *CASS* 5A.4 to *CASS* 5A.9 in respect of *money* which it receives or holds in the course of carrying on an activity which would be an *insurance mediation activity*, and which *money* would be *client money*, but for article 72D of the *Regulated*

Activities Order (Large risks contracts where risk situated outside the EEA).

5A.1.12 R If a *firm* elects to comply with the relevant sections of the *insurance client money chapter* in accordance with *CASS* 5A.1.10R or *CASS* 5A.1.11R, it must do so in respect of all *money* received or held in the course of or in connection with the relevant activity.

5A.1.13 R A *firm* must keep a record of any election under *CASS* 5A.1.10R or *CASS* 5A.1.11R (including the content of and reasons for that election) for six years after it has ceased to use it.

5A.1.14 R On ceasing to use an election made in accordance with *CASS* 5A.1.10R or *CASS* 5A.1.11R, any *client money* that the *firm* holds as a result of the election must be paid in accordance with *CASS* 5A.5.113R (regulatory discharge of fiduciary duty).

Approved banks: the banking exemption

5A.1.15 R *CASS* 5A.1 to *CASS* 5A.9 do not apply with respect to *money* held by a *firm* which is an *approved bank* in an account for the *client* with itself. The *approved bank* must have requisite capital under article 4(4)(b) of the *Insurance Mediation Directive*.

5A.1.16 R Before using the exemption in *CASS* 5A.1.15R, the *firm* must notify the *client* in writing that the *money* held in the account will be held by the *firm* as banker and not as trustee (or in Scotland as agent) in accordance with the *insurance client money chapter*.

5A.1.17 G A *firm* that is an *approved bank*, and relies on the exemption under *CASS* 5A.1.15R, should be able to account to all of its *clients* for amounts held on their behalf at all times. Such a *firm* should consider client entitlements in accordance with *CASS* 5A.5.35R and allocate any entitlements to the relevant account within the time period set out in *CASS* 5A.5.8R and *CASS* 5A.5.38R.

Authorised Professional Firms: deemed compliance with the client money rules

5A.1.18 R An *authorised professional firm* regulated by the Solicitors Regulation Authority (England and Wales), the Law Society of Scotland or the Law Society of Northern Ireland, that with respect to its *regulated activities* is subject to, and complies with, the latest published rules of its *designated professional body* with regard to holding *client money*, must comply with those rules and if it does so, it will be deemed to comply with *CASS* 5A.2 to *CASS* 5A.8 and it will not be required to comply with *CASS* 5A.9.

5A.1.19 R A *firm* will be deemed to comply with *CASS* 5A.3 to *CASS* 5A.8 and it will not be required to comply with *CASS* 5A.9 if it receives or holds *money* which is *client money* for the purposes of the current Royal Institution of Chartered Surveyors' Rules of Conduct (RICS Rules) and it complies with the requirement to segregate and account for such *money* in accordance with the RICS Rules.

5A.1.20 R A *firm* will be deemed to comply with *CASS* 5A.3 to *CASS* 5A.8 and it will not be required to comply with *CASS* 5A.9 or *CASS* 5A.10 if, in relation to a service charge, it complies with the requirement to segregate such *money* in accordance with section 42 of the Landlord and Tenant Act 1987 (the 1987 Act).

5A.1.21 R *CASS* 5A.1.20R also applies to a *firm* in Scotland or in Northern Ireland if when acting as a property manager the *firm* receives or holds a service charge, part of which is *client money*, and complies (so far as is practicable) with section 42 of the 1987 Act as if the requirements of that provision applies to it.

5A.1.22 R In addition to complying with *CASS* 5A.1.19R or *CASS* 5A.1.20R, a *firm* must ensure that any account in which *money* is held pursuant to the trust fund mentioned in section 42(3) of the 1987 Act, or an account maintained in accordance with the RICS Rules, is covered by a written acknowledgement which satisfies the requirements of *CASS* 5A.5.64R.

5A.1.23 G For the avoidance of doubt, *money* held or received by a *firm* which acts in accordance with *CASS* 5A.1.18R to *CASS* 5A.1.21R will be *client money* under the *insurance client money chapter*, but (except to the extent *CASS* 5A.1.22R applies) the *firm* only needs to comply with the relevant professional standards rather than all of the *insurance client money chapter*.

5A.1.24 R Subject to *CASS* 5A.2.15R *money* is not *client money* when:

(1) it becomes properly due and payable to the *firm*:

(a) for its own account; or

(b) in its capacity as agent of an *insurance undertaking* where the *firm* acts in accordance with *CASS* 5A.2; or

(2) it is otherwise received by the *firm* pursuant to an arrangement made between an *insurance undertaking* and another *person* (other than a *firm*) by which that other *person* has authority to underwrite risks, settle claims or handle refunds of *premiums* on behalf of that *insurance undertaking* outside the *United Kingdom* and where the *money* relates to that business.

5A.2 Holding money as agent of an insurance undertaking: Risk Transfer

Purpose of risk transfer

5A.2.1 G A risk transfer agreement is a mechanism for the transfer of the risk of loss of *money* on a *firm's failure* from the *client* to the *insurance undertaking*.

Introduction

5A.2.2 G If a *firm* receives or holds *money* as agent of an *insurance undertaking* then the *firm's clients* will be adequately protected from the risk of loss of *client money* on the *firm's failure* as the *premiums* which it receives are treated as

being received by the *insurance undertaking* when they are received by the *firm*, and claims and *premium* refunds will only be treated as received by the *client* when they are actually paid to the *client*.

5A.2.3 G An agreement for the transfer of risk in this way can take various forms, often described as a risk transfer agreement or, where the *firm* is given contractual authority to commit the *insurance undertaking* to risk or the authority to settle claims or handle *premium* refunds, this may be referred to as a binding authority.

5A.2.4 G If *money* is subject to an agreement for the transfer of risk on the basis described above then, subject to *CASS* 5A.2.8R and *CASS* 5A.2.15R, this *money* is not *client money* for the purposes of the *insurance client money chapter*.

Requirement for a written agreement

5A.2.5 R Before a *firm* receives or holds *money* as agent of an *insurance undertaking* in the course of, or in connection with, its *insurance mediation activity*, it must have entered into a written agreement with the *insurance undertaking* setting out the terms on which it receives or holds *money* as agent of the *insurance undertaking*. This appointment as agent must not be conditional on any other circumstances prevailing.

5A.2.6 R If a *firm* has agreed to receive or hold *money* as agent of an *insurance undertaking* in the course of, or in connection with, its *insurance mediation activity*, the written agreement must contain terms:

(1) stating that, notwithstanding any other term of that agreement or any other agreement between the *firm* and the *insurance undertaking*, the *insurance undertaking* has appointed the *insurance intermediary* unconditionally to act as agent and to receive and hold all specified *money* as agent of the *insurance undertaking*; and

(2) specifying the extent of the agency arrangements and whether it applies to *premiums*, claims *monies* and/or *premium* refunds or other monies.

5A.2.7 G The *FSA* considers that a *firm* will meet the requirements of *CASS* 5A.2.6R if the written agreement includes terms which are adapted from *CASS* 5A.2.6R, provided that no contrary terms appear anywhere else in that written agreement or any other agreements between the *firm* and the relevant *insurance undertaking*.

5A.2.8 R To the extent that the written agreement does not contain provisions achieving the effect described in *CASS* 5A.2.6R, or such provisions cease to have effect, then the *money* will be subject to the *insurance client money chapter* and must be held in accordance with *CASS* 5A.3 or *CASS* 5A.4.

5A.2.9 R A *firm* must be satisfied on reasonable grounds that the terms of the policies issued by the *insurance undertaking* to the *firm's clients* are likely to be

compatible with the written agreement referred to in *CASS* 5A.2.6R.

5A.2.10 R The *firm* must retain a copy of any written agreement entered into pursuant to *CASS* 5A.2.6R for a period of at least six years from the date on which it is terminated.

5A.2.11 R Where a *firm* receives or holds *money* as agent for an *insurance undertaking*, it must ensure that it informs in writing those of its *clients* whose transactions may be affected by the arrangement that it will receive or hold their *money* as agent of the *insurance undertaking* and, if relevant, the extent of that agency and whether it extends to *premiums*, claims *monies* and/or *premium* refunds.

5A.2.12 G *Clients* may be informed that their *money* will be received or held by the *firm* as agent in their *terms of business* or client agreements or otherwise in writing by the *firm*.

5A.2.13 R Subject to the consent of the relevant *insurance undertaking,* the *firm* may include in the written agreement referred to in *CASS* 5A.2.6R specific provision for *money* received by its *appointed representatives*, *field representatives* and other agents to be held as agent for the *insurance undertaking*. The written agreement granting this agency must be between the *firm* and the relevant *insurance undertaking*. The *firm* must ensure that the *representative* or agent provides the information to *clients* required by 5A.2.10R.

5A.2.14 R If a *firm* wishes to appoint its *appointed representative*, *field representative* or other agent as an agent of the *insurance undertaking* for the purposes of *CASS* 5A.2.5R, this must be:

(1) with the consent of the *insurance undertaking* on the basis of express terms in the written agreement referred to in *CASS* 5A.2.6R between the *firm* and the *insurance undertaking*; and

(2) achieved through a written agreement between the *firm* and the representative which contains terms providing that, notwithstanding any other term of that or any other agreement, the *firm* is authorised by the *insurance undertaking* to appoint the other party unconditionally to act as the *insurance undertaking's* agent and to receive and hold all *premium*, *premium refund* and/or claims *money* or other monies as agent of the *insurance undertaking*.

Co-mingling of risk transfer money with client money

5A.2.15 R If a *firm* has agreed to receive and hold *money* as agent for the *insurance undertaking*, the *insurance undertaking* may agree that the *firm* will treat *money* which it receives or holds as agent of the *insurance undertaking* as *client money* in accordance with the terms of the provisions of *CASS* 5A.4 to *CASS* 5A.9.

5A.2.16 R This agreement must be in writing and expressly state that the *insurance*

undertaking consents to its interests in the trust in *CASS* 5A.3 and/or *CASS* 5A.4 (as the case may be) (or in Scotland agency) being subordinated to the interests of the *firm's* other *clients* (except other *insurance undertakings*).

5A.2.17 R In agreeing that the *firm* may treat *money* as *client money* in accordance with *CASS* 5A.2.15R then in respect of this *client money*, the *insurance undertaking* will be treated as a *client* of the *firm* for the purposes of the *insurance client money chapter*.

5A.2.18 G A *firm* should note that if the *insurance undertaking* has agreed that the *money* received and held as agent for the *insurance undertaking* may be held as *client money* then this *money* must then at all times be treated as *client money* in accordance with the *insurance client money chapter*.

5A.3 Statutory trust

5A.3.1 G (1) Section 139(1) of the *Act* provides that *rules* may make provision which results in *client money* being held by a *firm* on trust (in England and Wales and Northern Ireland) or as agent (in Scotland). The creation of this trust means that the *firm* holds *client money* on trust for its *clients* (or the *insurance undertaking* when the *money* is received or held as agent for the *insurance undertaking* and where the *insurance undertaking* has agreed that its money be co-mingled in accordance with *CASS* 5A.2.15R). The *client money* is legally owned by the *firm* but the *client* (or *insurance undertaking* as relevant) remains the beneficial owner.

(2) The trust imposed by *CASS* 5A.3 is limited to a trust in respect of *client money* which a *firm* receives and holds. The consequential and supplementary requirements in *CASS* 5A.5 are designed to secure the proper segregation and maintenance of adequate *client money* balances. In particular, *CASS* 5A.5 does not permit a *firm* to use *client money* balances to provide credit for *clients* (or potential *clients*) such that, for example, their *premium* obligations may be met in advance of the *premium* being remitted to the *firm*. A *firm* wishing to provide credit for *clients* may however do so out of its own funds.

5A.3.2 R A *firm* which receives or holds *client money* (other than a *firm* acting in accordance with *CASS* 5.4) receives or holds the *client money* as trustee (or in Scotland as agent) on the following terms:

(1) for the purposes of and on the terms of *CASS* 5A.3, *CASS* 5A.5, the applicable provisions of *CASS* 5A.6 and the *client money (insurance) distribution rules*;

(2) subject to (4), for *clients* (other than *clients* which are *insurance undertakings* when acting as such) for whom that *money* is held, according to their respective interests in it;

(3) after all valid claims in (2) have been met, for *clients* which are *insurance undertakings*, according to their respective interests in it;

(4) on the *failure* of the *firm*, for the payment of the costs properly attributable to dealing with the *client money*, in accordance with (2) to (3); and

(5) after all valid claims and costs under (2) to (4) have been met, for the *firm* itself.

5A.4 Non-statutory client money trust

Introduction

5A.4.1 G *Firms* may in addition, or as an alternative, to the statutory trust hold *client money* in accordance with a non-statutory trust.

5A.4.2 R If a *firm* uses a combination of statutory and non-statutory trusts the *client money* for each trust must be kept and dealt with separately whilst the *firm* is a going concern and on its *failure*.

5A.4.3 G The terms of the non-statutory trust may expressly authorise the *firm*, as trustee, to advance credit to the *firm's clients*. This credit may be advanced by the *firm*, as trustee, to enable, for example, a *client's premium* obligations to be met before the *premium* is remitted to the *firm* and for claims and *premium* refunds to be paid to the *client* before receiving remittance of those *monies* from the *insurance undertaking*.

5A.4.4 G This credit is described in this chapter as 'pre-funded' items.

5A.4.5 R This *rule* applies where a debt obligation arises between a *firm*, as trustee, and a *client* because credit has been advanced from the non-statutory trust in respect of pre-funded items. When *money* representing the repayment of the pre-funded item is received or segregated by the *firm* into the *client bank account* it will extinguish the debt obligation and will be held on trust in accordance with the non-statutory trust.

5A.4.6 R A *firm* is not permitted to make advances of credit to itself out of the non-statutory trust.

Conditions for using the non-statutory client money trust

5A.4.7 R If a *firm* wishes to hold *client money* in accordance with a non-statutory trust the following conditions must be satisfied:

(1) the *firm* must have and maintain resources, systems and controls which are adequate to ensure that the *firm* is able to monitor and manage its *client money* transactions and any credit risk arising from the operation of the non-statutory trust. If the *firm* operates both a

statutory trust and a non-statutory trust then the systems and controls must extend to both arrangements;

(2) the *firm* must obtain on an annual basis written confirmation from its auditor that it has in place adequate systems and controls;

(3) the *firm* must designate a *manager* with responsibility for overseeing the *firm*'s day-to-day compliance with the systems and controls in (1) and the *rules* in this section;

(4) the *firm* must maintain appropriate capital in accordance with *MIPRU* 4.2 and Threshold Condition 4 (see *COND* 2.4);

(5) in relation to each of the *clients* for whom the *firm* holds *money* in a non-statutory trust, the *firm* must ensure that its *terms of business* or other *client* agreements adequately explain the risks posed by using the non-statutory trust (especially on the *failure* of the *firm*), and adequately explain, and obtain the *client's* consent to, the *firm* holding the *client money* under a non-statutory trust. *Firms* must also ensure that agreements in which *insurance undertakings* have consented to *money* being held by the *firm* as agent of the *insurance undertaking* is held as *client money* include notification that the *client money* will be held in a non-statutory trust if that is the case.

5A.4.8 R Before a *firm* starts acting as a trustee (or, in Scotland, as agent) under a non-statutory trust, it must properly execute a trust deed (or equivalent formal document) setting out the terms of the trust in accordance with *CASS* 5A.4.12R.

5A.4.9 R The trust deed (or equivalent formal document) must be signed by an appropriate senior individual within the *firm* and dated.

5A.4.10 G The appropriate senior individual within the *firm* could be the individual appointment under *CASS* 5A.7 or someone of equivalent seniority.

5A.4.11 R All non-statutory trust deeds (or equivalent formal document) must be retained by the *firm* for a period of six years after the *firm* has ceased holding money subject to a non-statutory trust.

Contents of the trust deed

5A.4.12 R The deed (or equivalent formal document) referred to in *CASS* 5A.4.8R must provide that *client money* is received and held:

(1) for the purposes and on the terms of *CASS* 5A.4, the applicable provisions of *CASS* 5A.5 and *CASS* 5A.6 and the *client money (insurance) distribution rules*;

(2) subject to (4), for *clients* (other than *clients* which are *insurance undertakings* when acting as such) for whom that *money* is held according to their respective interests in it;

(3) after all valid claims in (2) have been met, for *clients* which are *insurance undertakings* according to their respective interests in it;

(4) on the *failure* of the *firm*, for the payment of the costs properly attributable to dealing with the *client money* in accordance with (2) to (3); and

(5) after all valid claims and costs under (2) to (4) have been met, for the *firm* itself.

5A.4.13 G Where a *firm* wishes to handle *client money* for *retail customers* under the terms of its non-statutory trust, it must have, and at all times maintain, capital resources of not less than £50,000 in accordance with *MIPRU* 4.2.11R.

5A.4.14 R The deed (or equivalent formal document) referred to in *CASS* 5A.4.8R may provide that:

(1) the *firm* acting as trustee (or in Scotland as agent) has the power to make advances or give credit to *clients* or *insurance undertakings* from *client money*, provided that it also states that any debt or other obligation of a *client* or resulting obligation of an *insurance undertaking*, in relation to an advance or credit, is held on the same terms as *CASS* 5A.4.12R; and

(2) the benefit of a letter of credit or unconditional guarantee provided by an *approved bank* on behalf of a *firm* to satisfy any shortfall in the *firm's client money* resource when compared with the *firm's client money* requirement is held on the same terms as *CASS* 5A.4.12R.

Moving from a non-statutory trust to a statutory trust

5A.4.15 R (1) A *firm* is permitted to transfer all *client money* balances held in accordance with a non-statutory trust arrangement into a statutory trust arrangement (*CASS* 5A.3) provided that it complies with:

(a) any obligations arising from its fiduciary duty to *clients* for whom that *client money* is held; and

(b) the requirements in (2).

(2) The requirements referred to in (1)(b) are that the *firm* must ensure that:

(a) there are no outstanding prefunded items under the terms of that non-statutory trust to *clients* or *insurance undertakings* from *client money* held under that non-statutory trust; and

(b) it has sought and obtained the consent of all *clients* (including *insurance undertakings*) for whom *client money* is held that they agree to the revocation of the non-statutory trust and the transfer of the relevant *client money* balances to a statutory

trust (*CASS* 5A.3).

5A.4.16 R Where a *firm* transfers *client money* balances from a non-statutory trust to a statutory trust (*CASS* 5A.4.15R) it must ensure that it:

(1) makes and retains a record that *client money* balances held in a non-statutory trust are now held in accordance with the statutory trust;

(2) retains the non-statutory trust deed for a period of six years after the relevant *client money* balances have been transferred to the statutory trust;

(3) notifies the bank at which the *client money* balances are held that the relevant *client money bank accounts* are subject to the statutory trust; and

(4) has adequate systems and controls to ensure that no funding will be advanced from the statutory trust and that appropriate systems and controls are in place to monitor this.

5A.4.17 R In the event of there being any discrepancy between the actual terms of the non-statutory trust deed and the provisions of *CASS* 5A.4R the latter shall apply to the extent the terms of the non-statutory trust deed permit.

5A.5 Segregation and operation of client money accounts

Application

5A.5.1 R Unless otherwise stated, each of the provisions in *CASS* 5A.5 applies equally to a *firm* operating a statutory trust, a non-statutory trust or both.

Purpose of the requirement to segregate client money

5A.5.2 G One purpose of this section is to ensure that, unless otherwise permitted, *client money* is kept separate from the *firm's* own *money*.

Requirement to segregate

5A.5.3 R (1) A *firm* must place *client money* in one or more *client bank accounts* or, where the *firm* has the appropriate *Part IV permission*, in a money market fund. This must be done promptly, in accordance with *CASS* 5A.5.8R, following the receipt of the *client money* or following *money* becoming *client money*.

(2) For the purposes of the *insurance client money chapter* a money market fund is an *authorised fund* or *recognised scheme* with a minimum credit and risk rating of Aaa and MR1+ respectively by Moody's Investors Services; or AAAm by Standard and Poor's or AAA and V1+ respectively by Fitch.

5A.5.4 R The *client bank account* must be in the *firm's* own name and it must be clear from the name of the account that the *client bank account* contains *client money*.

5A.5.5 G *Client bank accounts* can be *general client bank accounts* or *designated client bank accounts*. *General client bank accounts* are accounts in which *client money* is held on trust (or in Scotland agency) in accordance with *CASS* 5A.3 or *CASS* 5A.4 for *clients* of the *firm* in general. *Designated client bank accounts* hold *client money* for an individual identified *client*.

5A.5.6 R A *firm* must, except as otherwise permitted by the *insurance client money chapter*, hold *client money* separate from the *firm's* own *money* or *money* held by the *firm* for any other purpose.

5A.5.7 R A *firm* must not hold *money* other than *client money* (including *money* which is treated as *client money* under the *insurance client money chapter*) in a *client bank account* unless it is:

(1) a minimum sum required to open the account, or to keep it open; or

(2) *money* temporarily in the account in accordance with *CASS* 5A.5.12R or *CASS* 5A.5.13R; or

(3) interest credited to the account which exceeds the amount due to *clients* as interest and has not yet been withdrawn by the *firm*.

5A.5.8 R The *firm* must pay *client money* into a *client bank account* no later than the *business day* following the *day* on which it is received or on which *money* held by the *firm* becomes *client money*.

5A.5.9 G Cheques received by the *firm*, made out to the *firm*, representing *client money* or a mixed remittance must be treated as *client money* from receipt by the *firm*.

5A.5.10 R A *firm* may segregate *client money* in a different currency from that of receipt. If it does so, the *firm* must ensure that the amount held is adjusted no later than the next *client money* calculation to an amount at least equal to the original currency amount (or the currency in which the *firm* has its liability to its *clients*, if different), converted at the previous day's closing spot exchange rate.

5A.5.11 R If *client money* is received by the *firm* in the form of an automated transfer, the *firm* must take reasonable steps to ensure that:

(1) the *money* is received directly into a *client bank account*; and

(2) if the *money* is received directly into the *firm's* own account, the *client money* is transferred into a *client bank account* no later than the *business day* following the *day* on which it is received.

Mixed remittance

5A.5.12 R If a *firm* receives a mixed remittance (a payment which is part *client money* and part other *money*), it must:

(1) pay the full sum into a *client bank account* in accordance with *CASS* 5A.5.3R; and

(2) pay the *money* that is not *client money* out of the *client bank account* as soon as reasonably practicable and in any event by not later than the next *client money* calculation in accordance with *CASS* 5A.5.85R.

5A.5.13 R *Firms* may treat *commission* only remittances as *client money* until the *commission* is appropriately removed from the *client bank account* in accordance with *CASS* 5A.5.16R.

Unmatched and unallocated money

5A.5.14 R If a *firm* is unable to match a remittance with a transaction, it may be unable to immediately determine whether the payment comprises a mixed remittance, is *client money* or is the *firm's* own *money*. In such cases the entire remittance must be treated as *client money* while the *firm* takes steps to match the remittance to a transaction.

5A.5.15 R Remittances which a *firm* is unable to match to a *client* or to an existing or future transaction within 90 *days* must be returned to the sender or, if that is not possible, to the *bank* which transmitted the money to the *firm*.

Commission

5A.5.16 R A *firm* may only draw down *commission* from the *client bank account* at the next *client money* calculation it performs if:

(1) it has received the *premium* from the *client* (or from a third party *premium* finance provider on the *client's* behalf); and

(2) this is consistent with the *firm's terms of business* which it maintains with the relevant *client* and the *insurance undertaking* to whom the *premium* will become payable.

5A.5.17 R If the *firm's terms of business* with the relevant *client* and *insurance undertaking* to whom the *premium* will become payable are not consistent then the *firm* may not draw down *commission* until the later time specified in the *terms of business*.

5A.5.18 R If either of the relevant *terms of business* are silent on when *commission* can be drawn down by the *firm*, or when *commission* becomes due and payable to the *firm*, then the *firm* may assume that it would be consistent with those *terms of business* to draw down *commission* once it has received the *premium* from the *client* (or from a third party *premium* finance provider on the *client's* behalf). This will also be the case where no *terms of business* have been produced unless otherwise agreed with the *client* or *insurance undertaking* as appropriate.

5A.5.19 R Where a *client* makes payments of *premium* to a *firm* in instalments, *CASS* 5A.5.16R applies in relation to each instalment.

Appointed Representatives

5A.5.20 R (1) Subject to (4), a *firm* must in relation to each of its *appointed representatives*, *field representatives* and other agents comply with *CASS* 5A.5.21R to *CASS* 5A.5.24R (immediate segregation) or with *CASS* 5A.5.25R to *CASS* 5A.5.28R (periodic segregation and reconciliation).

(2) A *firm* must in relation to each *appointed representative*, *field representative* or other agent keep a record of whether it is complying with *CASS* 5A.5.21R to *CASS* 5A.5.24R or with *CASS* 5A.5.25R to *CASS* 5A.5.28R.

(3) A *firm* is, but without affecting the application of *CASS* 5A.5.21R to *CASS* 5A.5.25R, to be treated as the recipient of *client money* which is received by any of its *appointed representatives*, *field representatives* or other agents.

(4) Paragraphs (1) to (3) do not apply in relation to an *appointed representative*, *field representative* or other agent to which (if it were a *firm) CASS* 5A.1.20R or *CASS* 5A.1.21R would apply, but subject to the *appointed representative*, *field representative* or agent maintaining an account which satisfies the requirements of *CASS* 5A.5.64R to the extent that the *representative* or agent will hold *client* money on trust or otherwise on behalf of its *clients*.

Immediate segregation

5A.5.21 R A *firm* must establish and maintain procedures to ensure that *client money* received by its *appointed representatives*, *field representatives* or other agents of the *firm* is:

(1) paid into a *client bank account* of the *firm* in accordance with *CASS* 5A.5.3R (requirement to segregate); or

(2) forwarded to the *firm*, or in the case of a *field representative* forwarded to a specified business address of the *firm*, so as to ensure that *money* arrives at that specified business address by the close of the third *business day*.

5A.5.22 G For the purposes of *CASS* 5A.5.21R, the *client money* received on *business day* one should be forwarded to the *firm*, or the specified business address of the *firm*, no later than the next *business day* after receipt (*business day* two) in order for it to reach that *firm* or specified business address by the close of the third *business day*. Procedures requiring the *client money* to be sent to the *firm* or the specified business address of the *firm* by first class post no later than the next *business day* after receipt would meet the requirements of

CASS 5A.5.21R.

5A.5.23 R If *client money* is received in accordance with *CASS* 5A.5.21R, the *firm* must ensure that its *appointed representatives*, *field representatives* or other agents keep *client money* (whether in the form of *premiums*, claims *money* or *premium* refunds) separately identifiable from any other *money* (including that of the *firm*) until the *client money* is paid into a *client bank account* or sent to the *firm*.

5A.5.24 R A *firm* which complies with *CASS* 5A.5.21R to *CASS* 5A.5.23R need not comply with *CASS* 5A.5.25R to *CASS* 5A.5.28R.

Periodic segregation and reconciliation

5A.5.25 R (1) A *firm* must, on a regular basis and at reasonable intervals, ensure that it holds in its *client bank account* an amount which (in addition to any other amount which it is required by the *client money rules* to hold) is not less than the amount which it reasonably estimates to be the aggregate of the amounts held at any time by its *appointed representatives*, *field representatives*, and other agents.

(2) A *firm* must, not later than ten business days following the expiry of each period in (1):

(a) carry out, in relation to each such *appointed representative*, *field representative* or other agent, a reconciliation of the amount paid by the *firm* into its *client bank account* with the amount of *client money* actually received and held by the *appointed representative*, *field representative* or other agent; and

(b) make a corresponding payment into, or withdrawal from, the account.

5A.5.26 G *CASS* 5A.5.25R allows a *firm* with *appointed representatives*, *field representatives* and other agents to avoid the need for such representative or agent to forward *client money* on a daily basis but instead requires a *firm* to segregate into its *client bank accounts* amounts which it reasonably estimates to be sufficient to cover the amount of *client money* which the *firm* reasonably expects its representatives or agents to receive and hold over a given period. At the end of that period, the *firm* must obtain information about the actual amount of *client money* received and held by its representatives or agents.

5A.5.27 R Where a *firm* operates on the basis of *CASS* 5A.5.25R, the *money* which is segregated into its *client bank account* is *client money*. *Clients* of a *firm's appointed representatives*, *field representatives* or other agents will be treated for the purpose of the *insurance client money chapter* as the *firm's clients*.

5A.5.28 R A *firm* which acts in accordance with *CASS* 5A.5.25R to *CASS* 5A.5.27R

need not comply with *CASS* 5A.5.21R to *CASS* 5A.5.24R.

Prudent oversegregation of client money

5A.5.29 R If a *firm* considers it prudent to do so to ensure that *client money* is protected it may pay *money* of its own into a *client bank account*, or keep it there, and that *money* will then become *client money* for the purposes of the *insurance client money chapter* and the *client money (insurance) distribution rules*.

5A.5.30 R If a *firm* wishes to maintain a prudent oversegregation of *client money* in accordance with *CASS* 5A.5.29R it must first:

(1) set out in writing a policy detailing when and in what circumstances it would be prudent to protect *client money* in this way and have this policy approved by its Board or equivalent *governing body*;

(2) in each instance demonstrate that the prudent oversegregation relates to a specific anticipated expense or liability;

(3) demonstrate in a written record that the amount of the *firm's* own *money* which is paid into or maintained in the *client bank account* as prudent oversegregation us a reasonable estimate of the expense or liability set out in (2); and

(4) clearly document the origin and purpose of the *money* held as a prudent oversegregation within the *client bank account*, and that such *money* has become *client money*.

5A.5.31 R *Firms* should retain records relating to any prudent oversegregation of *client money* for a period of six years after the *money* held as a prudent oversegregation has been removed from the *client bank account*.

5A.5.32 [not used]

5A.5.33 [not used]

5A.5.34 [not used]

Client entitlements

5A.5.35 R A *firm* must take reasonable steps to ensure that it promptly identifies any receipt of *client money* in the form of *client* entitlements.

5A.5.36 R *Client* entitlements refer to any kind of payment which the *firm* receives in the course of its *insurance mediation activity* on behalf of a *client* and which are due and payable to the *client*.

5A.5.37 R When a *firm* receives a *client* entitlement on behalf of a *client*, it must pay any part of it which is *client money* as follows:

(1) for *client* entitlements received in the *United Kingdom*, into a *client bank account* in accordance with *CASS* 5A.5.8R; or

(2) for *client* entitlements received outside the *United Kingdom*, into any bank account operated by the *firm*, provided that such *client money* is:

(a) paid to, or in accordance with the instructions of, the *client* concerned; or

(b) paid into a *client bank account* in accordance with *CASS* 5A.5.8R as soon as possible and no later than 5 *business days* after receipt by the *firm*.

5A.5.38 R A *firm* must take reasonable steps to ensure that a *client* entitlement which is *client money* is allocated within a reasonable time after receipt by the *firm*.

Interest

5A.5.39 [not used]

5A.5.40 R Unless a *firm* notifies a *consumer* in writing whether or not interest is to be paid on *client money* and, if so, on what terms and at what frequency, it must pay that *client* all interest earned on that *client mon*ey. Any interest due to a *client* will be *client money*.

5A.5.41 R *CASS* 5A.5.40R does not apply if a *firm* has reasonable grounds to be satisfied that in relation to *insurance mediation activities* carried on with or for a *consumer* the amount of interest earned will be not more than £20 per transaction.

5A.5.42 [not used]

Client bank accounts

5A.5.43 G *Firms* are generally required to place *client money* in a *client bank account* which will be either held at an *approved bank* or in a money market fund. However, a *firm* which is an *approved bank* must not (subject to use of the banking exemption in accordance with *CASS* 5A.1.15R) hold *client money* in an account with itself.

5A.5.44 R Unless otherwise permitted in the *insurance client money chapter*, a *firm* must ensure that *client money* is held in a *client bank account* at one or more *approved banks* or held with a money market fund.

5A.5.45 R A *firm* may open one or more *client bank accounts* in the form of a *designated client bank account*.

5A.5.46 R *Designated client bank accounts* must have the following features:

(1) the account holds *client money* in respect of one or more *clients*;

(2) the account includes in its title the word ‘designated’;

(3) the *clients* whose *client money* is in the account have each consented in writing to the use of the *bank* with which the *client money* is to be held; and

(4) in the event of the *failure* of that bank, the account is not pooled with any other type of account unless a *primary pooling event* occurs.

5A.5.47 G In the event of the failure of the *bank* at which a *designated client bank account* is held, the account is not pooled with any other type of account (*client bank account* or otherwise) unless a *primary pooling event* also occurs.

5A.5.48 G A *firm* may operate as many *client bank accounts* as it wishes.

5A.5.49 G A *firm* is not obliged to offer its *clients* a *designated client bank account*.

Banks that are not approved banks

5A.5.50 R A *firm* may hold *client money* with a bank which is not an *approved bank* if all the following conditions are met:

(1) the *client money* relates to one or more insurance transactions which are subject to the law or market practice of a jurisdiction outside the *United Kingdom*;

(2) because of the applicable law or market practice of that overseas jurisdiction, it is not possible to hold the *client money* in a *client bank account* with an *approved bank*;

(3) the *firm* holds the *client money* with such a bank for no longer than is necessary to effect the transactions;

(4) the *client money* will be held in a *designated client bank account* at the relevant bank; and

(5) the *firm* notifies each relevant *client* in writing and adequately explains to the *client* that:

(a) *client money* may not be held with an *approved bank*;

(b) in such circumstances, the legal and regulatory regime applying to the bank with which the *client money* is held will be different from that of the *United Kingdom* and, in the event of a failure of the bank, the *client money* may be treated differently from the treatment which would apply if the *client money* were held by an *approved bank* in the *United Kingdom*; and

(c) if this is the case, the particular bank has not accepted that it has no right of set-off or counterclaim against *money* held in a *client bank account* in respect of any sum owed on any other

account of the *firm*, notwithstanding the *firm's* request to the bank as required by *CASS* 5A.5.64R.

5A.5.51 [not used]

5A.5.52 [not used]

5A.5.53 [not used]

5A.5.54 [not used]

Selecting a bank at which to hold client money

5A.5.55 R A *firm* owes a duty of care to its *clients* when it decides where to hold *client money* because it is trustee of that *client money*.

5A.5.56 R Before a *firm* opens a *client bank account*, and as often as is appropriate on a continuing basis (such frequency being no less than once in each financial year), it must take reasonable steps to establish that it is appropriate for the *firm* to hold *client money* at that bank.

5A.5.57 G The steps a *firm* must go through to establish this depends on, for example:

(1) the amount of *client money* held by the *firm*;

(2) the amount of *client money* the *firm* anticipates holding at the bank;

(3) the capital of the bank;

(4) the amount of *client money* held at the bank as a proportion of the bank's capital and deposits;

(5) the credit rating of the bank (if available); and

(6) to the extent that the information is available, the level of risk in the investment and loan activities undertaken by the bank and its affiliated companies.

5A.5.58 G [not used]

Diversification

5A.5.59 R A *firm* must consider the risks of holding too much *client money* with one bank and should consider whether it would be appropriate to hold *client money* in *client bank accounts* at a number of different banks.

5A.5.60 G [not used]

Group banks

5A.5.61 R Subject to *CASS* 5A.5.59R, a *firm* that holds or intends to hold *client money* at a bank which is in the same *group* as the *firm* must:

(1) undertake regular reviews of that bank which are at least as rigorous as the review of any bank which is not in the same *group*, in order to ensure that the decision to use an account at a *group* bank to hold *client money* is appropriate;

(2) disclose in writing to its *client* at the outset of the *client* relationship (whether by way of a client agreement, *terms of business* or otherwise in writing) or, if later, not less that 20 *business days* before it begins to hold *client money* with that bank:

(a) the fact that it intends to hold *client money* with a bank in the same *group* as the *firm*; and

(b) the identity of the bank concerned.

5A.5.62 R A *firm* must limit the amount of *client money* that it deposits or holds with a bank within the same *group* of the *firm* so that those deposits do not at any point in time exceed 20 per cent of the total amount of *client money* held by the *firm*.

5A.5.63 R If the *client* has notified a *firm* in writing that it does not wish its *money* to be held with a bank in the same *group* as the *firm*, the *firm* must either:

(1) place that *client money* in a *client bank account* with another bank; or

(2) return that *client money* to, or pay it to the order of, the *client*.

Notification and acknowledgment of trust for client bank accounts – trust letters

5A.5.64 R When a *firm* opens a *client bank account*, the *firm* must give or have given written notice to the bank requesting the bank to acknowledge to it in writing:

(1) that all *money* standing to the credit of the account is held by the *firm* as trustee (or if relevant in Scotland, as agent) and that the bank is not entitled to combine the account with any other account or to exercise any right of set-off or counterclaim against *money* in that account in respect of any sum owed to it on any other account of the *firm*; and

(2) that the title of the account sufficiently distinguishes that account from any account containing *money* that belongs to the *firm* and is in the form requested by the *firm*.

5A.5.65 G The acknowledgement required by *CASS* 5A.5.64R should contain the words set out in *CASS* 5A.5.64R(1) and (2).

5A.5.66 R In the case of a *client bank account* in the *United Kingdom*, if the bank does

not provide the acknowledgment referred to in *CASS* 5A.5.64R within 20 *business days* after the *firm* dispatched the notice, the *firm* must withdraw all *money* standing to the credit of the account and deposit it in a *client bank account* with another bank as soon as possible.

5A.5.67 R In the case of a *client bank account* outside the *United Kingdom*, if the bank does not provide the acknowledgement referred to in *CASS* 5A.5.64R within 20 *business days* after the *firm* dispatched the notice, the *firm* must notify the *client* of this fact as set out in *CASS* 5A.5.74R. In this case, the *firm* must retain records of its request for acknowledgement and any response from the bank.

5A.5.68 R A *firm* must review the written acknowledgments required under *CASS* 5A.5.64R on a regular basis (no less that once every financial year) to ensure that they cover all *client bank accounts* in which the *firm* holds or may hold *client money*.

5A.5.69 R A *firm* must keep the written acknowledgments for a period of six years after it has closed a *client bank account*.

5A.5.70 R A *firm* must ensure that it has a written acknowledgement for all *client bank accounts* in which the *firm* may hold *client money*, even if the balance in the account at any time is nil.

5A.5.71 R A *firm* must ensure that the written acknowledgement clearly shows the relevant account number and account name.

5A.5.72 R A *firm* must ensure that the written acknowledgment is appropriately completed and, as far as possible, must ensure that it is signed by an individual authorised to sign such documents on behalf of the bank.

5A.5.73 R A *firm* must be clear that the written acknowledgment covers all *money* held in the *client bank account*.

Notification to consumers: use of an approved bank outside the United Kingdom

5A.5.74 R A *firm* must not hold *client money* for a *consumer* in a *client bank account* outside the *United Kingdom*, unless the *firm* has previously disclosed to the *consumer* in writing:

(1) that his *money* may be deposited in a *client bank account* outside the *United Kingdom*, but that the *client* may notify the *firm* that he does not wish his *client money* to be held in a particular jurisdiction;

(2) that in such circumstances, the legal and regulatory regime applying to the *approved bank* will be different from that of the *United Kingdom* and, in the event of a *failure* of the *approved bank*, the *client money* may be treated in a different manner from that which would apply if the *client money* were held by an *approved bank* in the *United Kingdom*; and

(3) if this is the case, that particular *approved bank* has not accepted that it has no right of set-off or counterclaim against *money* held in a *client bank account* in respect of any sum owed in any other account of the *firm*, notwithstanding the *firm's* request to the bank as required by *CASS* 5A.5.64R.

5A.5.75 [not used]

5A.5.76 R There is no need for a *firm* to make a separate disclosure under *CASS* 5A.5.74R in relation to each jurisdiction.

5A.5.77 G *Firms* are reminded of the provisions of *CASS* 5A.5.50R which sets out the notification and consents required when using a bank that is not an *approved bank*.

5A.5.78 R If a *client* has notified a *firm* in writing before entering into a transaction that *client money* is not to be held in a particular jurisdiction, the *firm* must either:

(1) hold the *client money* in a *client bank account* for the *client* in a jurisdiction to which the *client* has not objected; or

(2) return the *client money* to, or to the order of, the *client.*

Notification to consumers: use of a third party such as a broker or settlement agent outside the United Kingdom

5A.5.79 R A *firm* must not undertake any transaction for a *consumer* that involves *client money* being passed to a third party such as another broker or settlement agent located in a jurisdiction outside the *United Kingdom*, unless the *firm* has previously disclosed to the *consumer* in writing that:

(1) his *client money* may be passed to a *person* outside the *United Kingdom*, but the *client* may notify the *firm* that he does not wish his *client money* to be passed to a third party in a particular jurisdiction; and

(2) in such circumstances, the legal and regulatory regime applying to the broker or settlement agent will be different from that of the *United Kingdom* and, in the event of a *failure* of that third party the *client money* may be treated in a different manner from that which would apply if the *client money* were held by a third party in the *United Kingdom*.

5A.5.80 G There is no need for a *firm* to make a separate disclosure in relation to each jurisdiction.

5A.5.81 R If a *client* has notified a *firm* before entering into a transaction that he does not wish his *client money* to be passed to a third party such as another broker or settlement agent located in a particular jurisdiction, the *firm* must either:

(1) hold the *client money* in a *client bank account* and pay its own *money*

to the *firm's* own account with such third party; or

(2) return the *money* to, or to the order of the *client*.

Notification to the FSA: failure of bank, broker or settlement agent

5A.5.82 R On the *failure* of a third party with which *client money* is held (including a bank, other broker or settlement agent with which a *firm* has placed, or to whom it has passed, *client money*), a *firm* must notify the *FSA*:

(1) as soon as it becomes aware, of the *failure* of that third party; and

(2) as soon as reasonably practical, whether it intends to make good any shortfall that has arisen or may arise and of the amount involved.

Client money calculation and reconciliation

5A.5.83 G In order that a *firm* may check that it has sufficient *money* segregated in its *client bank accounts* (and held by third parties) to meet its obligations to *clients* it is required periodically to calculate the amount which should be segregated (the *client money* requirement) and to compare this with the amount it actually holds (the *client money* resource). This calculation is based upon the *firm's* accounting records and is followed by a reconciliation with its banking records and confirmations received from third parties holding *client money* for the *firm*. A *firm* is required to make a payment into the *client bank* account if there if there is a shortfall or to remove any *money* which is not required to meet the *firm's* obligations.

5A.5.84 G For the purpose of calculating its *client money* requirement two alternative calculation methods are permitted, but a *firm* must use the same method in relation to all *client money* held in accordance with the *insurance client money chapter*. The first refers to individual *client* cash balances; the second to aggregate amounts of *client money* recorded on a *firm's* business ledgers.

5A.5.85 R (1) A *firm* must, as often as is necessary to ensure the accuracy of its records and at least at the relevant intervals set out in (2):

(a) check whether its *client money* resource, as determined by *CASS* 5A.5.88R or *CASS* 5A.5.90R on the previous *business day*, was at least equal to the *client money* requirement, as determined by *CASS* 5A.5.94R or *CASS* 5A.5.97R as at the close of business on that day;

(b) ensure that:

(i) an irrevocable instruction is given to the bank to pay any shortfall into a *client bank account* on the day the calculation is performed, and the payment is made by the end of the following *business day*; or

(ii) any excess is withdrawn within the same time period;

and

(c) include in any calculation of its *client money* requirement any amounts attributable to *client money* received by its *appointed representatives*, *field representatives* or other agents and which, as at the date of the calculation, it is required to segregate in accordance with *CASS* 5A.5.21R.

(2) The relevant intervals referred to in (1) are:

(a) not more than 7 *business days* for *client money* held in accordance with *CASS* 5A.4 where the *firm* held more than £250,000 of *client money* in the non-statutory trust at any time during the calendar year prior to the year the calculation is made;

(b) not more than 14 *business days* for *client money* held in accordance with *CASS* 5A.4 where the firm held less than or equal to £250,000 of *client money* in the non-statutory trust at any time during the calendar year prior to the year the calculation is made; and

(c) not more than 25 *business days* in respect of *client money* held in accordance with *CASS* 5.3.

(3) A *firm* must within two *business days* of the calculation in (1)(a) reconcile the balance on each *client bank account* as recorded by the *firm* with the balance on that account set out in the statement or other form of confirmation used by the bank with which the account is held.

(4) A *firm* must reconcile the balances held in each *client bank account* even if the *firm's* records show that the balance on a *client bank account* is nil.

(5) When any discrepancy arises as a result of the reconciliation carried out in (3), the *firm* must identify the reason for the discrepancy and correct it as soon as possible, unless the discrepancy arises solely as a result of timing differences between the account systems of the party providing the statement or confirmation and those of the *firm*.

(6) While a *firm* is unable to resolve a difference arising from a reconciliation, and one record or a set of records examined by the *firm* during its reconciliation indicates that there is a need to have a greater amount of *client money* than is in fact the case, the *firm* must assume, until the matter is finally resolved, that the record or set of records is accurate and within one *business day* of establishing that there is difference either pay its own money into a relevant *client bank account* or make a withdrawal of any excess.

5A.5.86 R A *firm* must keep a record of whether it calculates its *client money*

requirement in accordance with *CASS* 5A.5.94R to *CASS* 5A.5.96R or *CASS* 5A.5.97R and may only use one method during each annual accounting period (which method must be the same in relation to all *client money* held in accordance with the *insurance client money chapter*). This record must be maintained for six years after the *firm* has ceased to hold *client money*.

5A.5.87 G *Firms* are reminded that sums held in the *client bank account* in relation to unmatched balances in accordance with *CASS* 5A.5.14R, and prudent oversegregations in accordance *CASS* 5A.5.29R are to be treated as *client money* and included in the *client money* requirement as such.

Calculating the client money resource

5A.5.88 R The *client money* resource for *client money* held in accordance with *CASS* 5A.3 is:

(1) the aggregate of the balances on the *firm's client money bank accounts*, as at the close of business on the previous *business day*;

(2) *client money* held by third parties in accordance with *CASS* 5A.5.124R; and

(3) *client money* due from insurance debtors shown in the *firm's* business ledgers as amounts due from *clients*, *insurance undertakings* and other *person*s, but this cannot include any pre-funded items (*client money* recorded as being advanced to a *client* or *insurance undertaking* before it is received).

5A.5.89 G When using a statutory trust a *firm* may not pre-fund any items.

5A.5.90 R *Client money* resource for *client money* held in accordance with *CASS* 5A.4 is:

(1) the aggregate of the balances on the *firm's client money bank accounts*, as at the close of business on the previous *business day*;

(2) *client money* held by third parties in accordance with *CASS* 5A.5.124R;

(3) *client money* due from insurance debtors shown in the *firm's* business ledgers as amounts due from *clients*, *insurance undertakings* and other *person*s (this should include any pre-funded items which have not been made good in accordance with *CASS* 5A.5.100R to *CASS* 5A.5.107G); and

(4) the amount of any letter of credit or unconditional guarantee provided by an *approved bank* and held on the terms of the trust (or, in Scotland, agency), limited to:

(a) the maximum sum payable by the *approved bank* under the letter of credit or guarantee; or

(b) if less, the amount which would, apart from the benefit of the letter of credit or guarantee, be the shortfall of the *client money* resource compared with the *client money* requirement.

5A.5.91 R *Client money* held by third parties located in the *United Kingdom* must be calculated in accordance with the *firm's* own records and the *client money* must continue to be recorded as such until the *firm* has confirmation that the transaction is complete in accordance with *CASS* 5A.5.128R.

5A.5.92 R A *firm* may treat a transaction with an *insurance undertaking* which is not a *UK domestic firm* as complete, and accordingly may disregard any items of *client money* transferred to an intermediate broker based outside the *United Kingdom* relating to such a transaction, if:

(1) it has taken reasonable steps to ascertain whether the transaction is complete;

(2) it has no reason to consider the transaction has not been completed; and

(3) a period of at least 12 *months* has elapsed since the *client money* was transferred to the *intermediate broker* for the purpose of the transaction.

Client money (client balance) requirement (both statutory and non-statutory trust)

5A.5.93 G A *firm's client money* (client balance) requirement is the sum of, for all *clients*, the individual *client* balances calculated in accordance with *CASS* 5A.5.94R but excluding any individual balances which are negative (that is, uncleared *client* funds). Once this figure has been calculated the *firm* must add any amounts held in accordance with *CASS* 5A.5.14A (unmatched balances) and *CASS* 5A.5.29R (prudent oversegregation) which are treated as *client money* in accordance with the *client money rules*.

5A.5.94 R The individual *client* balance for each *client* must be calculated as follows:

(1) the amount paid by a *client* to the *firm* (to include all *premiums*); plus

(2) the amount due to the *client* (to include all claims and *premium* refunds); plus

(3) the amount of any interest due to the *client*;

less:

(4) the amount paid to *insurance undertakings* for the benefit of the *client* (to include all *premiums*);

(5) the amount of *commission* due to the *firm* but not yet removed from the *client bank account*;

(6) the amount paid by the *firm* to the *client* (to include all claims and *premium* refunds).

The individual *client* balance is determined by the following calculation: ((1) + (2) + (3)) – ((4)+(5)+(6)).

5A.5.95 R In the case of *insurance undertakings* for whom *client money* is held in accordance with *CASS* 5A.2.15R the individual *client* balance must be calculated as follows:

(1) the amount paid by a *client* to the *firm* received by the *firm* pursuant to a written agreement which complies with *CASS* 5A.2.16R; plus

(2) the amount paid by the insurance undertaking to the *firm* in respect of claims and *premium* refunds if appropriate; plus

(3) any other monies held by the *firm* on behalf of the *insurance undertaking* covered by a written agreement which complies with *CASS* 5A.2.16R.

5A.5.96 R Once the individual *client* balance has been calculated the *firm* must add to the requirement any amounts held in accordance with *CASS* 5A.5.29R which are treated as *client money* in accordance with the *insurance client money chapter*.

Client money (accruals) requirement (both statutory and non-statutory trust)

5A.5.97 R A *firm's client money* (accruals) requirement is the sum of the following:

(1) all insurance creditors shown in the *firm's* business ledgers as amounts due to *insurance undertakings*, *clients* and other *persons*; plus

(2) unearned commission being the amount of commission shown as accrued (but not shown as due and payable) as at the date of the calculation (a prudent estimate must be used if the *firm* is unable to produce an exact figure at the date of the calculation); plus

(3) any amounts held in accordance with *CASS* 5A.5.14A (unmatched balances) *CASS* 5A.5.29R (prudent oversegregation) which are treated as *client money* in accordance with the *insurance client money chapter*.

5A.5.98 G Insurance creditors could include *premiums* received from *clients* and not yet paid to *insurance undertaking* 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, for example, *insurance undertakings*, third parties or *clients* which have not been presented and cleared.

5A.5.99 G When calculating the *client money* requirement by using either the method in

CASS 5A.5.94R to *CASS* 5A.5.96R or *CASS* 5A.5.97R the amount of *client money* held at third parties in accordance with *CASS* 5A.5.124R will be included in the entry for insurance creditors or as part of the *money* paid by the *client* to the *firm*.

Weekly funding review

5A.5.100 R A *firm* that pre-funds items from a *client bank account* in accordance with *CASS* 5A.4 must review these items in accordance with *CASS* 5A.5.102R on a weekly basis.

5A.5.101 G The *firm* should maintain a prudent bad debt policy as well as completing a weekly funding review.

5A.5.102 R The weekly funding review should identify:

(1) any items which the *firm* has pre-funded on behalf of a *client* which have remained outstanding for a period of 45 *days*. These items could represent advance *premiums* paid to *insurance undertakings* on behalf of the *client*; and

(2) any items which the *firm* has pre-funded on behalf of an *insurance undertaking* which have remained outstanding for a period of 90 *days*. These items could, for example, represent *premium* refunds or claims monies paid to *clients* on behalf of *insurance undertakings*.

5A.5.103 R At the next weekly funding review after the time periods set out in *CASS* 5A.5.102R(1) and *CASS* 5A.5.102R(2) have expired the *firm* must ensure that the relevant pre-funded item is paid into the *client bank account*.

5A.5.104 R If the *firm* is unable to identify whether, in respect of certain item, pre-funding has been made on behalf of an *insurance undertaking* or a *client*, the *firm* must treat those items as pre-funded in respect of a *client* and comply with the relevant time frame.

5A.5.105 G Payments in accordance with *CASS* 5A.5.103R may be made as a result of the debt being collected from the relevant *insurance undertaking* or *client*, alternative funding for the advance of credit being received (for example *premium* credit), or the *firm* may make good the debt from its own funds.

5A.5.106 R The funding review obligation in *CASS* 5A.5.100R must be carried out every five *business days* and if a payment is required in accordance with *CASS* 5A.5.103R then it must be paid into the *firm's client bank account* within one *business day* after the review.

5A.5.107 G (1) Where a *firm* has made a payment in accordance with *CASS* 5A.5.103R and subsequently the *firm* receives repayment for the pre-funded item from the relevant *insurance undertaking* or *client,* this repayment will be monies due and payable to the firm and so should be removed from the *client bank account* following the next *client money* calculation.

(2) *Money* cannot be removed from the *client bank account* purely as a result of the weekly funding review. *Money* may only be removed from the *client bank account* to the extent this is permitted elsewhere in the *insurance client money chapter* or following a *client money* calculation.

Annual reconciliation

5A.5.108 R A *firm* which calculates its *client money* requirement in accordance with *CASS* 5A.5.97R must:

(1) at least every 12 *months,* match its *client money* resource to its *client money* requirement by reference to individual clients;

(2) as a minimum reconcile at least 95% of all the *client money* it holds to the individual *clients* it holds the *client money* for; and

(3) ensure that all *money* treated as *client money* in accordance with the *insurance client money chapter* is also being reconciled.

5A.5.109 R A *firm* must complete the annual reconciliation in accordance with *CASS* 5A.5.108R within one calendar month.

Failure to perform calculations or reconciliation

5A.5.110 R A *firm* must notify the *FSA* immediately if it is unable to, or does not perform the calculation required by *CASS* 5A.5.85R(1).

5A.5.111 R A *firm* must notify the *FSA* immediately it becomes aware that it may not be able to make good any shortfall identified by *CASS* 5A.5.85R(1) by the close of business on the *business day* following the day on which the calculation is performed, or if applicable, when the reconciliation is completed.

Regulatory discharge of fiduciary duty and transfer of client money

5A.5.112 G The purpose of *CASS* 5A.9.113R to *CASS* 5A.9.116R is to set out those situations in which a *firm* will have fulfilled its contractual and fiduciary obligations in relation to any *client money* held by the *firm* or in relation to the *firm's* ability to require repayment of that *money* from a third party.

5A.5.113 R Money ceases to be *client money* if it is paid:

(1) to the *client*, or a duly authorised representative of the *client*; or

(2) to a third party on the instruction of or with the specific consent of the *client*, but not if it is transferred to a third party in the course of effecting a transaction in accordance with *CASS* 5A.5.124R; or

(3) into a bank account of the *client* (not being an account which is also in the name of the *firm*); or

(4) to the *firm* itself, when it is due and payable to the *firm* in accordance with *CASS* 5A.1.24; or

(5) to the *firm* itself, when there is an excess in the *client money account* held by the *firm* as set out in *CASS* 5A.5.85R(1)(b)(ii).

5A.5.114 R A *firm* which pays professional fees (for example to a loss adjuster or valuer) on behalf of a *client* may do so in accordance with *CASS* 5A.5.113R(2) where this is done on the instruction of or with the consent of the *client*.

5A.5.115 E (1) To demonstrate compliance with *CASS* 5A.5.113R(2) a *firm* must obtain an instruction or specific consent of the *client*. This could include, for example, a written, verbal or electronic instruction or confirmation. The *firm* must retain evidence of and be able to demonstrate that an instruction or specific consent was received from the *client* for a period of six years.

(2) Contravention of (1) may be relied upon as tending to establish contravention of *CASS* 5A.5.113R(2)

5A.5.116 R When a *firm* draws a cheque or other payable order to discharge its fiduciary duty under *CASS* 5A.5.113R, it must continue to treat the sum concerned as *client money* until the cheque or order is presented and paid by the bank.

Records

5A.5.117 R A *firm* must ensure that proper records, sufficient to show and explain the *firm's* transactions and commitments in respect of its *client money*, are made and retained for a period of six years after they were made.

Money due to a client from a firm

5A.5.118 R If a *firm* is liable to pay *money* to a *client*, it must as soon as possible and no later than one *business day* after the *money* is due and payable:

(1) pay it into a *client bank account*; or

(2) pay it to, or to the order of, the *client*.

5A.5.119 R A *firm* must make arrangements for any *money* held as *client money* which is due and payable to a *client* to be paid to that *client* within a reasonable period following a request from the *client* for payment of that *money*.

5A.5.120 G The reasonable period referred to in *CASS* 5A.5.119R should be no longer than 5 *business days*.

Returning small amounts of client money in the form of postage stamps

5A.5.121 R If less than £5 of *client money* is owed to a *client* or third party, a *firm* may satisfy its obligation to pay *client money* held for or on behalf of the *client*, *insurance undertaking* or third party by sending it to them in the post in the

form of postage stamps. The *firm* must have no reason to believe that the relevant *client*, *insurance undertaking* or third party has changed their postal address.

5A.5.122 G If the *client* or third party has become untraceable, the *firm* should not send postage stamps but should follow the steps set out in *CASS* 5A.6.21E.

Transfer of client money to a third party

5A.5.123 G *CASS* 5A.5.124R sets out the requirements a *firm* must comply with when it transfers *client money* to another person without discharging its fiduciary duty owed to that *client*. Such circumstances arise when, for example, a *firm* passes *client money* to another broker so that the *client's* transaction can be carried out. A *firm* can only discharge itself from its fiduciary duty by acting in accordance with, and in the circumstances permitted by *CASS* 5A.5.113R.

5A.5.124 R A *firm* may allow another person, such as another broker to hold or control *client money*, but only if:

(1) the *firm* transfers the *client money* for the purpose of a transaction for a *client* through or with that person; and

(2) in the case of a *consumer*, that *consumer* has been notified in writing (whether through a client agreement, *terms of business* or otherwise) that the *client money* may be transferred to another *person*.

5A.5.125 G In relation to the notification required by *CASS* 5A.5.124R(2), there is no need for a *firm* to make a separate disclosure in relation to each transfer made.

5A.5.126 R A *firm* should not hold excess *client money* with another broker. It should be held by the *firm* in a *client bank account*.

5A.5.127 R If a *firm* receives *money* from another *firm* in accordance with *CASS* 5A.5.124R, it must treat that *money* as *client money* unless in relation to the transaction for which the money was provided to the *firm* it has agreed to operate in accordance with *CASS* 5A.2 in which case it must only be treated as *client money* if the *firm* and the relevant *insurance undertaking* has agreed for the *money* to be co-mingled.

5A.5.128 R A *firm* receiving *client money* from another *firm* in accordance with *CASS* 5A.5.124R must promptly notify that other *firm* on a monthly basis whether, in relation to every transaction:

(1) the receiving *firm* is still holding the *client money* on behalf of the remitting firm; or

(2) it is acting as agent of the relevant *insurance undertaking*; or

(3) the *client money* has been passed on to another *firm* for the purposes of the transaction; or

(4) the *client money* has reached the relevant *insurance undertaking* or another *firm* acting as agent of the relevant *insurance undertaking*.

5A.5.129 R A *firm* which allows another person to hold or control *client money* must keep records relating to all transfers of *client money* and must monitor when the *client money* has reached the *insurance undertaking* or a *firm* acting as agent of the *insurance undertaking*.

Transfers of business to another firm

5A.5.130 R If a *firm* wishes to transfer all or part of its *insurance mediation activity* business to another *person*, it cannot transfer *client money* held in relation to that business unless it either:

(1) obtains the specific consent of all *clients* with an interest in the *client money* that is sought to be transferred in accordance with *CASS* 5A.5.113R(2); or

(2) complies with the mechanism for obtaining prior consent from its *clients* set out in *CASS* 5A.5.132R to *CASS* 5A.5.134R.

5A.5.131 G (1) If a *firm* complies with *CASS* 5A.5.132R to *CASS* 5A.5.134R, it will have discharged its fiduciary duty in accordance with CASS 5A.5.113R(2).

(2) If a *firm* wishes to transfer *client money* to a third party in the course of effecting a transaction, it must comply with *CASS* 5A.5.124R and will retain its fiduciary duty in respect of that *client*.

5A.5.132 R A *firm* seeking to rely on *CASS* 5A.5.130(2) must set out in a written agreement with each of its *clients* the terms on which *client money* held for that *client* may be transferred to another *person*. These terms must provide for the following:

(1) that the *firm* may transfer the *client's client money* to another *IMD insurance intermediary* ('the transferee');

(2) That, subject to (3), where the transferee is a *firm* to which *CASS* 5A applies then, *following* the transfer:

(a) the *money* will continue to be held on trust for the *client* (or in Scotland agency);

(b) if the *client money* was held by the *firm* in accordance with *CASS* 5A.4, the transferee may hold the *money* in accordance with either *CASS* 5A.4 or in accordance with *CASS* 5A.3.

(c) if the *client money* was held by the *firm* in accordance with *CASS* 5A.3 then it must be held by the transferee in accordance with that section unless the *client* is notified,

and consents, at the time of the transfer, that the *money* can be held in accordance with *CASS* 5A.4;

(3) that where the transferee is an *IMD insurance intermediary* that is not subject to *CASS* 5A, the *firm* will use best endeavours to ensure that the transferee will apply equivalent protections in relation to the relevant *client money* in accordance with the *IMD*; and

(4) the *client* will be notified within 7 *days* after the transfer and be given the option of having its *client money* returned by the transferee as soon as practicable.

5A.5.133 G The effect of *CASS* 5A.5.132R(4) is that the *firm* must either comply with this *rule* itself or ensure that the transferee undertakes, as part of the terms of the transfer, to notify *clients* and grant them the option of returning their *client money*.

5A.5.134 R Where a *firm* wishes to make a transfer in accordance with *CASS* 5A.5.132R, it must notify the *FSA* of its intention to do so at least 7 *days* before the transfer takes place.

5A.6 Credit write back and unclaimed client money

Credit write back

5A.6.1 R (1) Subject to (2), if a *firm* holds *client money* in *client bank accounts* in accordance with *CASS* TP1(3) and does not know the identity of the *client*, *insurance undertaking* or other third party for which the *money* is held, it may cease to treat the *money* as *client money* provided it acts in accordance with the applicable procedure set out in *CASS* 5A.6.3R to *CASS* 5A.6.15R.

(2) In all cases, but in particular where *client money* is held under a non-statutory trust, the *firm* must consider whether its obligations under law (including trust law, or agency law in Scotland) or any agreement (including the terms of a non-statutory trust) permit it to apply the provisions in *CASS* 5A.6.3R to *CASS* 5A.6.15R.

(3) The *rules* and *guidance* in *CASS* 5A.6.1R to *CASS* 5A.6.15R cease to have effect on [13 months after coming into force].

5A.6.2 G (1) The balances referred to in *CASS* 5A.6.3R are those which were held by *firms* before 14 January 2005 and which were subsequently held as of that date subject to the *client money rules.*

(2) A *firm* holding *client money* under a statutory or non-statutory arrangement is deemed to have fiduciary obligations to its *clients*. For arrangements constituted under a non-statutory trust the extent to which a *firm* may exercise the procedure set out in *CASS* 5A.6.3R to *CASS* 5A.6.15R may depend on the extent to which it is permitted to

do so under the terms of the non-statutory trust deed.

(3) As *client bank accounts* are formal trust accounts, a *firm's* liability to restore *client money* wrongly transferred to a *firm's* own account from its *client bank account* is strict and is not mitigated by the transfer being done in good faith. Therefore the decision for the transfer must also be based on persuasive evidence and the *firm* will need to take into account applicable trust law and accountancy standards.

(4) *Firms* are reminded that the exemption in the Limitation Act 1980 which states that a *firm's* liability to an unsecured creditor ceases after the expiry of six years does not apply to trust accounts. Therefore a *firm* may remain liable for a breach of trust if it improperly takes *client money* to its own account.

Investigation of balances

5A.6.3 R A *firm* must investigate relevant balances to establish whether the *money* is held for a *client*, an *insurance undertaking* or a third party, or whether the *money* is due and payable to the *firm*.

5A.6.4 G If it is not possible for a *firm* to establish who is entitled to the *money* in accordance with *CASS* 5A.6.3R, the *firm* should deal with the *monies* in accordance with *CASS* 5A.6.12R and *CASS* 5A.6.13R.

5A.6.5 E (1) The investigation referred to in *CASS* 5A.6.3R must be carried out thoroughly and should include the following as a minimum:

(a) a review of all documentation relating to the individual balances;

(b) interrogation of all systems (electronic or otherwise) on which information relating to the balances may be held;

(c) where possible, a review of records held by previous *firms* if such *monies* have been transferred from another *firm* to the *firm* carrying out the investigation; and

(d) communications with *insurance undertakings*, third parties or *clients* which are relevant to establishing the nature of the balances.

(2) Compliance with (1) may be relied on as tending to establish compliance with *CASS* 5A.6.3R.

(3) Contravention of (1) may be relied on as tending to establish contravention of *CASS* 5A.6.3R.

Costs of investigation

5A.6.6 R Unless the situation described in *CASS* 5A.6.15R arises, a *firm* which carries out an investigation in accordance with *CASS* 5A.6.3R may, to the extent it is

permitted under the statutory trust or the non-statutory trust, as relevant, deduct reasonable costs from each balance to cover the costs of this investigation. The *firm* may either:

(1) deduct the reasonable costs of investigating each balance from that balance; or

(2) deduct the reasonable costs of investigating all the balances rateably from all the balances.

5A.6.7 G To the extent that a *firm* is operating a statutory trust arrangement, the effect of *CASS* 5A.3.2R(1) is that a *firm* is permitted to deduct the expenses referred to in *CASS* 5A.6.6R.

Client money held for clients, insurance undertakings or other identifiable third parties

5A.6.8 R If, following the investigation referred to in *CASS* 5A.6.3R, the *firm* identifies that it holds *client money* balances for *clients*, *insurance undertakings* or other third parties the *firm*:

(1) must use best endeavours to determine the current contact details for the relevant *client*, *insurance undertaking* or third party;

(2) must contact the *client*, *insurance undertaking* or third party in writing using current contact details, or failing that the *client's*, *insurance undertaking's* or third party's last known address, and inform them of the *firm's* intention to no longer treat the *client money* balances identified following the investigation referred to in *CASS* 5A.6.3R as *client money* and give the *client*, *insurance undertaking* or third party 28 *days* in which to make a claim for, or refuse to accept the return of, the *client money* balance;

(3) must pay the relevant *client money* balance to the *client*, *insurance undertaking* or third party where a claim is made for that balance within the 28 *days* referred to in (2); or

(4) may, where the *client*, *insurance undertaking* or third party refuses to accept payment of the relevant balance within the 28 *days* referred to in (2), (and the *firm* has given appropriate consideration to any reason given for this) deal with these balances as if they are due and payable to the *firm* in accordance with *CASS* 5A.1.24(1); or

(5) must after the 28 *days* has passed, and provided no claim is made, write to the *client*, *insurance undertaking* or third party again confirming that they have not received a claim from the *client*, *insurance undertaking* or third party and state that the *firm* will from the date of the letter cease to treat the *money* as *client money*; and

(6) must pay the *money* referred to in (5) to a registered charity of the *firm's* own choosing within 28 *days* of the letter referred to in (5).

5A.6.9 R A *firm* must make and retain records for six years of all balances:

(1) retained by the *firm* under *CASS* 5A.6.8R(4); and

(2) paid to charity under *CASS* 5A.6.8R(6).

5A.6.10 G If a *client* or *insurance undertaking* has returned balances to the *firm* and the *firm* wishes to rely on *CASS* 5A.6.8R(4), it must have actively engaged with the *client* and cannot, for example, rely only on cheques returned in the post.

5A.6.11 G If, for example, a *client* has ceased to exist or, in the case of a natural person, has died, it is possible that the Crown is entitled to *money* held on their behalf under the doctrine of Bona Vacantia. *Firms* looking to return *monies* to *clients* or *insurance undertakings*, as relevant, should consider whether this is relevant in their particular circumstances.

Money held as client money where the firm is not able to identify the beneficiary

5A.6.12 R If, following an investigation in accordance with *CASS* 5A.6.3R, the *firm* is unable to identify the *client*, *insurance undertaking* or third party for whom the *firm* is holding the *client money*, then the *firm* may cease to treat it as *client money* and arrange for it to be paid into its own account in accordance with relevant accounting standards.

5A.6.13 R If a *firm* either pays *money* to charity in accordance with *CASS* 5A.6.8R(4) or pays *mone*y into its own account in accordance with *CASS* 5A.6.12R, the *firm* must unconditionally undertake to make good any valid claim in respect of this *money* paid away from the *client bank account*.

5A.6.14 G When making an undertaking in accordance with *CASS* 5A.6.13R, a *firm* may wish to purchase insurance to cover any valid claims from *clients* in respect of *money* paid away from the *client bank account*. The *firm* should pay for such insurance from its own funds.

Money held as client money which is due and payable to the firm

5A.6.15 R If, after the investigation referred to in *CASS* 5A.6.3R is completed, the *firm* concludes that the *client money* balances are due and payable to it, these balances should be removed from the *client bank account* at the next client money calculation.

Editor's Note: Subject to consultation, it is intended that CASS 5A.6.16G to 5A.6.25G would come into effect 13 months after CASS 5A.6.1R to CASS 5A.6.15R come into force. The latter would cease to have effect on that date, by virtue of CASS 5A.6.1R(3).

Allocated but unclaimed client money

5A.6.16 G The purpose of *CASS* 5A.6.18R is to allow a *firm*, in the normal course of its business, to cease to treat balances allocated to a *client*, *insurance undertaking* or third party as *client money* when those balances remain

unclaimed.

5A.6.17 G *Firms* are reminded of their obligations in relation to unmatched and unallocated money in accordance with *CASS* 5A.5.14R.

5A.6.18 R (1) A *firm* may cease to treat as *client money* any unclaimed *client money* balances which the *firm* has held for a minimum of 6 years following the last movement on the account (disregarding any payment of interest), if this is consistent with the *firm's* contract with the *client* and if the *firm* can demonstrate that it has taken reasonable steps to trace the *client*, *insurance undertaking* or third party concerned and to return the balance.

(2) Where the *firm* has taken reasonable steps to return the balance but is unable to do so, it must pay the money to a registered charity of the *firm's* choice.

5A.6.19 R In all cases, but in particular where *client money* is held under the terms of a non-statutory trust, the *firm* must consider whether its obligations under law (including trust law, or agency law in Scotland) or any agreement (including the terms of a non-statutory trust) permit it to apply the provisions in *CASS* 5A.6.18R and *CASS* 5A.6.21E to *CASS* 5A.6.25G.

5A.6.20 G (1) A *firm* holding *client money* under a statutory or non-statutory arrangement is deemed to have fiduciary obligations to its *clients*. For arrangements constituted under a non-statutory trust the extent to which a *firm* may apply the provisions in *CASS* 5A.6.18R and *CASS* 5A.6.21E to *CASS* 5A.6.25G will depend on the extent to which it is permitted to do so under the terms of the non-statutory trust deed.

(2) As *client money accounts* are formal trust accounts, a *firm's* liability to restore *client money* wrongly transferred to a *firm's* own account from its *client money account* is strict and is not mitigated by the transfer being done in good faith. Therefore the decision for the transfer must also be based on persuasive evidence and the *firm* will need to take into account applicable trust law and accountancy standards.

(3) *Firms* are reminded that the exemption in the Limitation Act 1980 which states that a *firm's* liability to an unsecured creditor ceases after the expiry of six years does not apply to trust accounts. Therefore a *firm* may remain liable for a breach of trust if it improperly takes client account monies to its own account.

5A.6.21 E Reasonable steps in accordance with *CASS* 5A.6.18R(1) include:

(1) as far as possible, finding current contact details for the relevant *client*, *insurance undertaking* or third party;

(2) writing to the *client*, *insurance undertaking* or third party at their last known address either by post or by electronic mail or using other

means to inform them of the *firm's* intention to no longer treat that balance as *client money* and giving the *client*, *insurance undertaking* or third party 28 *days* in which to make a claim;

(3) after the 28 *days* referred to in (2) has passed, writing to the *client*, *insurance undertaking* or third party again confirming that the *firm* has not received a claim from the *client*, *insurance undertaking* or third party and stating that the *firm* will, from the date of that letter, cease to treat the *money* as *client money*.

(4) Compliance with (1) to (3) may be relied on as tending to establish compliance with *CASS* 5A.6.18R(1).

(5) Contravention of (1) to (3) may be relied on as tending to establish contravention of *CASS* 5A.6.18R(1).

5A.6.22 R A *firm* which carries out the reasonable steps referred to in *CASS* 5A.6.21E may deduct reasonable costs from each balance to cover the costs of this investigation. The *firm* may either:

(1) deduct the reasonable costs of investigating each balance from that balance; or

(2) deduct the reasonable costs of investigating all the balances rateably from all the balances.

5A.6.23 G In respect of the deduction of costs referred to in CASS 5A.6.22R, *firms* are reminded of the *guidance* in *CASS* 5A.6.20G.

5A.6.24 R If a *firm* ceases to treat allocated but unclaimed *client money* as *client money* in accordance with *CASS* 5A.6.18R(2), the *firm* must unconditionally undertake to make good any valid claim in respect of this *money* paid away from the *client bank account*.

5A.6.25 G When making an undertaking in accordance with *CASS* 5A.6.24R, a *firm* may wish to purchase insurance to cover any valid claims from *clients* in respect of *money* paid away from the *client bank account*. The *firm* should pay for such insurance from its own funds.

5A.7 Governance

5A.7.1 R A *firm*, other than a sole trader, must allocate to a *director* performing a *significant influence function* or a *senior manager* performing a *significant influence function* responsibility for:

(1) oversight of the *firm's* operational compliance with *CASS*;

(2) reporting to the *firm's* governing body in respect of that oversight.

5A.7.2 R A *firm* must allocate the responsibilities described in *CASS* 5A.7.1R(1) and

(2) to:

(1) a *director* or *senior manager* allocated responsibility for *insurance mediation activity* under *MIPRU* 2.2.1R, but only if this person also performs a significant influence function; or

(2) another *director* or *senior manager* performing a significant influence function, but only in circumstances where overall responsibility for *insurance mediation activity* is retained by the person to whom such responsibility has been allocated under *MIPRU* 2.2.1R.

5A.7.3 G If a *firm* chooses to allocate responsibilities in accordance with *CASS* 5A.7.2R(2*)*, it should ensure that the person that retains overall responsibility *for insurance mediation activity* for the purposes of *MIPRU* 2.2.1R is not of a lower seniority than the person allocated the responsibilities described in *CASS* 5A.7.1R(1) and (2). The seniority of individuals within a *firm* will depend upon the organisational arrangements in place at each individual *firm*.

5A.7.4 R A *firm* must make and retain, for a period of six years after it is made, an appropriate record of the person to whom responsibility is allocated in accordance with *CASS* 5A.7.1R.

5A.7.5 R A *firm* should review the allocation pursuant to *CASS* 5A.7.1R on no less than an annual basis to ensure that the allocation remains appropriate. Should the individual to whom responsibility is allocated in accordance with *CASS* 5A.7.1R be unable to perform this role or ceases to be a *director* or *senior manager* of the *firm* then the *firm* must, within two months of this event allocate to an alternative individual the responsibilities set out in *CASS* 5A.7.1R.

5A.8 Client money distribution

Application

5A.8.1 G The *client money (insurance) distribution rules* apply to a *firm* that is holding *client money* subject to *CASS* 5A.3 or *CASS* 5A.4 when a *primary pooling event* or a *secondary pooling event* occurs.

5A.8.2 R In the event of there being any discrepancy between the terms of the trust as required by *CASS* 5A.4.12R(1) and the provisions of *CASS* 5A.8 the latter shall apply to the extent the terms of the non-statutory trust deed (or equivalent formal document) allow.

5A.8.3 G (1) The *client money (insurance) distribution rules* apply to any *firm* that holds *client money* in accordance with *CASS* 5A.3 or *CASS* 5A.4. Therefore they may apply to a *UK branch* of a *non-EEA firm*. In this case, the *UK branch* of the *firm* may be treated as if the *branch* itself is a free-standing entity subject to the *client money (insurance)*

distribution rules.

(2) *Firms* that act in accordance with the non-statutory trust are reminded that the *client money (insurance) distribution rules* should be given effect in the terms of trust required by *CASS* 5A.4.

Purpose

5A.8.4 G The *client money (insurance) distribution rules* seek, on the event of the *failure* of the *firm* or third party at which the *firm* holds *client money*, to:

(1) facilitate the timely completion of insurance transactions whether by the *firm* itself or by another *firm* after a transfer of *insurance mediation activity* business to that *firm* in accordance with *CASS* 5A.8.11R to *CASS* 5A.8.22G; or

(2) where (1) is not practicable, the timely return of *client money* to a *client*.

Primary pooling event

5A.8.5 R A *primary pooling event* occurs:

(1) on the *failure* of the *firm*; or

(2) on the vesting of assets in a trustee in accordance with an 'assets *requirement*' imposed under section 48(1)(b) of the *Act*; or

(3) when the *firm* notifies, or is in breach of its duty to notify, the *FSA* in accordance with *CASS* 5A.5.111R that it is unable to identify and allocate in its records all valid claims arising as a result of a *secondary pooling event*.

5A.8.6 R *CASS* 5A.8.5R(3) does not apply so long as:

(1) the *firm* is taking steps, in consultation with the *FSA*, to establish those records; and

(2) there are reasonable grounds to conclude that the records will be capable of rectification within a reasonable period.

Pooling and distribution

5A.8.7 R If a *primary pooling event* occurs:

(1) all *client money* held pursuant to the statutory trust is treated as pooled together;

(2) all *client money* held pursuant to the non-statutory trust is treated as pooled together;

(2A) the *firm* must, as trustee, liquidate any money market fund investments made in accordance with *CASS* 5A.5.3R(2) and apply the proceeds to the relevant pool referred to in (1) or (2).

(3) the *firm* must then calculate the amount of *client money* each *client* or *insurance undertaking* is entitled to in accordance with *CASS* 5A.5.94R and establish the amount held in the *client money* pool for each *client* and, if appropriate, *insurance undertaking* in accordance with *CASS* 5A.3.2R or *CASS* 5A.4.12R;

(4) the *firm* must then use reasonable endeavours to complete any insurance transactions that have not been completed at the time of the *primary pooling event* using the relevant *client's* entitlement calculated in accordance with (3);

(5) to the extent that the *firm* cannot complete insurance transactions in accordance with (4) it must decide whether it is in the best interests of its *clients* to transfer all or part of its *insurance mediation activity* business, along with the relevant *client money*, to another *firm* in accordance with *CASS* 5A.8.11R;

(6) to the extent it is not practicable to either complete insurance transactions in accordance with (4) or transfer the whole or part of the business in accordance with (5), the *firm* must distribute the remaining *client money* in accordance with the amounts calculated in (3); and

(7) the *firm* must, as trustee, call in and make demand in respect of any debt due to the *firm* as trustee and under any letter of credit or guarantee upon which it relies for meeting any *shortfall* in its *client money* and the proceeds must be pooled together with other *client money* as in (2) and distributed in accordance with (3).

5A.8.8 G (1) If a *firm* held *client money* in accordance with both the statutory trust and the non-statutory trust, then *clients* for whom the *firm* held *client money* under each of *CASS* 5A.3 and *CASS* 5A.4 will have two separate *client money* entitlements in respect of two *client money* pools.

(2) The *firm* may wish to consider the possibility of transferring the business in accordance with (5) at the same time as it seeks to complete open insurance transactions in accordance with (4).

(3) In respect of a *client's client money* entitlement which is not used to complete an insurance transaction in accordance with *CASS* 5A.8.7R(4) nor transferred under *CASS* 5A.8.11R, the *client's* main claim is for the return of *client money* held in a *client bank account* or with a third party. A *client* may claim for any *shortfall* against *money* held in a *firm's* own account. For that claim, the *client* will be an unsecured creditor of the *firm*.

5A.8.9 G Where *money* is held for *insurance undertakings* in accordance with *CASS* 5A.2.15R, the *insurance undertaking's* claim to *client money* is subordinated to claims of *clients*.

Transfer of client money to another firm

5A.8.10 G Following a *primary pooling event*, if the business or part of the business of a *firm* ('the transferor') is to be transferred to another *firm* ('the transferee') then the transferor may also move the *client money* associated with that business to the transferee. The purpose of this would be to enable the transferee to complete open insurance transactions for former *clients* of the transferor and to continue *insurance mediation activity* for those *clients* using the *client money* held by the transferor for those *clients*.

5A.8.11 R If the transferor transfers all or part of its *insurance mediation activity* business to the transferee, it must either transfer:

(1) each of the relevant *client's client money* entitlement calculated in accordance with *CASS* 5A.8.7R(3); or

(2) all of the remaining *client money* held by it in relation to its *insurance mediation activities*.

5A.8.12 R (1) If all the remaining *client money* is transferred in accordance with *CASS* 5A.8.11R(2), then, unless (2) or (3) applies, it must be held by the transferee on the same basis it was held by the transferor; either in accordance with the statutory trust or the non-statutory trust.

(2) If the transferor held the *client money* in accordance with the non-statutory trust then the transferee may hold the *client money* in accordance with the statutory trust provided *clients* give their consent.

(3) Where the transferee is an *IMD insurance intermediary* that is not subject to *CASS* 5A, the transferor will use best endeavours to ensure that the transferee will apply equivalent protections in relation to *client's money* in accordance with the *IMD*.

5A.8.13 R If there is a *shortfall* in the *client money* transferred in accordance with *CASS* 5A.8.11R(2) then this *shortfall* must be allocated equally to all the *clients* for whom the *client money* was held by the transferor. This calculation may be done by either transferor or transferee in accordance with the terms of any transfer.

5A.8.14 R If following the transfer of *client money* in accordance with *CASS* 5A.8.11R(2) to the transferee, the transferor receives money in respect of debts due to it as trustee in accordance with *CASS* 5A.8.7R(7) then these sums must be passed on to the transferee without delay and allocated to *clients* accordingly.

5A.8.15 R Unless *CASS* 5A.8.16R applies, the transferee must, within 7 *days* after the transfer of *client money* in accordance with *CASS* 5A.8.11R notify *clients*:

(1) that their *money* has been transferred to the transferee; and

(2) that they have the option of having *client money* returned to them or to their order by the transferee, otherwise the transferee will hold the *client money* for the *clients* and conduct *insurance mediation activities* for those clients.

5A.8.16 R Where the transferee is an *IMD insurance intermediary* that is not subject to *CASS* 5A, the transferor must ensure that the transferee undertakes to notify the relevant *clients* within 7 *days* after the transfer that their *client money* has been transferred to it and that they have the option of having *client money* returned to them or to their order by the transferee, otherwise the transferee will hold the *client money* for the *clients* and conduct *insurance mediation activities* for those clients.

5A.8.17 R If there is a *shortfall* in the *client money* then the *firm* must make arrangements to ensure that the *clients* have the option of:

(1) having the *client money* returned to them; or

(2) the transferee continuing to hold the *client money* on behalf of the *client* and conducting *insurance mediation activity* for that *client*; or

(3) if appropriate, providing additional *money* to complete transactions which were not completed at the time of the *primary pooling event* where this would be required for the transferee to complete those transactions.

5A.8.18 G *Clients* may be eligible for compensation in respect of any *shortfall* in *client money* from the *FSCS*. The relevant eligibility criteria are set out in *COMP*.

5A.8.19 R Transfers of *client money* in accordance with *CASS* 5A.8.11R must occur as soon as possible following the *primary pooling event* and in any event no later than three *months* following the *primary pooling event*.

5A.8.20 R If any *client money* transferred was held for *insurance undertakings* pursuant to *CASS* 5A.2.15R is transferred in accordance with CASS 5A.8.11R, then following the transfer this *money* must be transferred to the relevant *insurance undertaking*.

5A.8.21 R The reasonable costs of transferring the *client money* to the transferee may be deducted from the *client money* transferred in accordance with *CASS* 5A.3.2R(4) or (to the extent permitted by the non-statutory trust deed (or equivalent formal document) *CASS* 5A.4.12R(4).

5A.8.22 G If *client money* is held by a *firm* as agent for an *insurance undertaking* then the entitlements of those *insurance undertakings* will be subordinated to claims of clients in accordance with *CASS* 5A.2.16R. This means that the *insurance undertakings* which have agreed to co-mingling will suffer the *shortfall*, including the allocation of reasonable costs of the transfer, before *clients* suffer any *shortfall*.

Client money received after a primary pooling event

5A.8.23 R A *firm* must open a new *client bank account* following a *primary pooling event* and ensure that *client money* received after a *primary pooling event* is held separately from *client money* held by the *firm* at the time of the *primary pooling event*.

5A.8.24 G A *firm* may transfer all *client money* it holds at the time of a *primary pooling* event into the new *client bank* account and use the *firm's* existing *client bank accounts* to hold *client money* received after the *primary pooling event*.

5A.8.25 R *Client money* received after a *primary pooling event* is held on trust by the *firm* in accordance with the *client money rules*, and must be returned to the relevant *client* without delay, except to the extent that:

(1) it is *client money* relating to a transaction that has not completed at the time of the *primary pooling event*; or

(2) it is *money* relating to a *client* for whom the *client money* requirement, calculated in accordance with *CASS* 5A.5.94R or *CASS* 5A.5.97R, shows that *money* is due from the *client* to the *firm*, including in its capacity as trustee under the non-statutory trust at the time of the *primary pooling event*.

5A.8.26 G *Client money* received after the *primary pooling event* relating to an incomplete transaction should be used to complete that transaction.

5A.8.27 R If a *firm* receives a *mixed remittance* after a *primary pooling event*, it must:

(1) pay the full sum into the *client bank account* in which it holds *client money* received after the *primary pooling event*; and

(2) pay the *money* that is not *client money* out of that *client bank account* into the *firm's* own bank account within one *business day* of the *day* on which the remittance is cleared and identified.

5A.8.28 G Whenever possible the *firm* should seek to split a *mixed remittance* before the relevant accounts are credited.

5A.8.29 G Where appropriate the reasonable costs of distributing *client money* received by a *firm* after a *primary pooling event* to each of the *clients* in respect of whom *client money* was received may be deducted from the *money* before distribution in respect of either:

(1) the reasonable costs of distributing the *client money* to that *client*; or

(2) the reasonable costs of distributing all the *money* back to all the *clients* entitled to it, with each *client* suffering the *shortfall* caused by these reasonable costs equally.

Interest on client money following a pooling event

5A.8.30 R Any interest earned on *client money* following a *primary* or *secondary pooling event* will be due to *clients* if *clients* are entitled to interest in accordance with *CASS* 5A.5.40R (Interest). In all other circumstances any interest earned will be first used to reduce any *shortfall* (including any *shortfall* caused by the deduction of reasonable costs); if there is no *shortfall* then the interest may be taken by the *firm*.

Failure of a bank, other broker or settlement agent: secondary pooling event

5A.8.31 R If both a *primary pooling event* and a *secondary pooling event* occur, the provisions of this section relating to a *primary pooling event* apply.

5A.8.32 G A *secondary pooling event* occurs on the *failure* of a *bank* at which the *firm* holds *client money* in a *client bank account* or on the *failure* of a third party to which *client money* held by the *firm* has been transferred under *CASS* 5A.5.124R.

5A.8.33 R *CASS* 5A.8.35R to CASS 5A.8.49R do not apply if, on the *failure* of the *bank* or third party, the *firm* repays to its *client* or pays into a *client bank account* at an unaffected *bank*, an amount equal to the amount of *client money* which would have been held if a *shortfall* had not occurred at that third party.

5A.8.34 G When *client money* is transferred to a third party, a *firm* continues to owe a fiduciary duty to the *client*. However, consistent with a fiduciary's responsibility (whether as agent or trustee) for third parties under general law a *firm* will not be held responsible for a *shortfall* in *client money* caused by a third party failure if it has complied with those duties.

Failure of a bank: pooling

5A.8.35 R If a *secondary pooling event* occurs as a result of the *failure* of a bank where one or more *general client bank accounts* are held then:

(1) in relation to every *general client bank account* of the *firm*, the provisions of *CASS* 5A.8.36R to *CASS* 5A.8.38R and *CASS* 5A.8.42R to *CASS* 5A.8.45G will apply;

(2) in relation to every *designated client bank account* held by the *firm* with the *failed* bank, the provisions of *CASS* 5A.8.39R to *CASS* 5A.8.41R and *CASS* 5A.8.42R to *CASS* 5A.8.45G will apply; and

(3) any *client money* held in *designated client bank accounts* at a bank that has not *failed* will not be pooled with any other *client money*.

General client bank accounts

5A.8.36 R *Money* held in each *general client bank account* of the *firm* must be treated as pooled and:

(1) any *shortfall* in *client money* held, or which should have been held, in

general client bank accounts, that has arisen as a result of the *failure* of the bank, must be borne by all *clients* whose *client money* is held in a *general client bank account* of the *firm*, rateably in accordance with their entitlements;

(2) a new *client money* entitlement must be calculated for each *client* by the *firm*, to reflect the requirements in (1), and the *firm's* records must be amended to reflect the reduced *client money* entitlement;

(3) the *firm* must make and retain a record of each *client's* share of the *client money* shortfall at the *failed* bank until the *client* is repaid; and

(4) the *firm* must use the new *client* entitlements, calculated in accordance with (2), when performing the *client money* calculation in accordance with *CASS* 5A.5.85R to *CASS* 5A.5.109R.

5A.8.37 R The term 'which should have been held' is a reference to the failed bank's failure (and elsewhere, as appropriate, is a reference to the other failed third party's failure) to hold the *client money a*t the time of the pooling event.

5A.8.38 R For the avoidance of doubt, when calculating new *client money* entitlements in accordance with *CASS* 5A.8.36R(2), entitlements must be calculated in accordance with *CASS* 5A.2.16R so that entitlements of *clients* who are *insurance undertakings* will be subordinated to entitlements of *clients* who are not *insurance undertakings*.

Designated client bank accounts

5A.8.39 R For each *client* with a *designated client bank account* held at the *failed* bank:

(1) any *shortfall* in *client money* held, or which should have been held, in the *designated client bank accounts* that has arisen as a result of the *failure*, must be borne by all the *clients* whose *client money* is held in a *designated client bank account* of the *firm* at the *failed* bank, rateably in accordance with their entitlements;

(2) a new *client money* entitlement must be calculated for each of the relevant *clients* by the *firm*, and the *firm's* records must be amended to reflect the reduced *client money* entitlement;

(3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed* bank until the *client* has been repaid; and

(4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), when performing the periodic *client money* calculation in accordance with *CASS* 5A.5.85R to *CASS* 5A.5.109R.

5A.8.40 R A *client* whose *money* was held, or which should have been held, in a *designated client bank account* with a bank that has *failed* is not entitled to claim in respect of that *money* against any other *client bank account* of the

firm.

5A.8.41 R For the avoidance of doubt, when calculating new *client money* entitlements in accordance with *CASS* 5A.8.39R(2), entitlements must be calculated in accordance with *CASS* 5A.2.16R so that entitlements of *clients* who are insurance undertakings will be subordinated to entitlements of *clients* who are not insurance undertakings.

Client money received after the failure of a bank

5A.8.42 R *Client money* received by the *firm* after the *failure* of a bank, that would otherwise have been paid into a *client bank account* at that bank:

(1) must not be transferred to the *failed* bank unless specifically instructed by the *client* in order to settle an obligation of that *client* to the *failed* bank; and or

(2) must be, subject to (1), placed in a *client bank account* opened at a bank other than the one that has *failed*.

5A.8.43 R If the *client* had a *designated client bank account* at the bank which has *failed* and the *firm* receives *client money* following a *secondary pooling event*, the *firm* must either:

(1) on the written instruction of the *client*, transfer the *money* to a *designated client bank account* or a *general client bank account* at a bank other than the one that has *failed*; or

(2) return such *client money* to the *client* as soon as possible.

5A.8.44 R If a *firm* receives a *mixed remittance* after a *secondary pooling event* which consists of *client money* that would have been paid into a *general client bank account* or a *designated client bank account* maintained at the bank that has *failed*, it must:

(1) pay the full sum into a *client bank account* other than one operated at the bank which has *failed*; and

(2) pay the *money* that is not *client money* out of that *client bank account* within one *business day* of the *day* on which the remittance is cleared.

5A.8.45 G Wherever possible the *firm* should seek to split a *mixed remittance* before the relevant accounts are credited.

Failure of an intermediate broker or settlement agent: pooling

5A.8.46 R If a *secondary pooling event* occurs as a result of the *failure* of another broker or *settlement agent* to whom the *firm* has transferred *client money* then, in relation to every *general client bank account* of the *firm*, the provisions of *CASS* 5A.8.42R to *CASS* 5A.8.45G and *CASS* 5A.8.47R will apply.

5A.8.47 R *Money* held in each *general client bank account* of the *firm* must be treated as pooled and:

(1) any *shortfall* in *client money* held, or which should have been held, by the *failed* broker or *settlement agent*, must be borne by all the *clients* whose *client money* is held in *general client bank accounts* of the *firm*, rateably in accordance with their entitlements;

(2) a new *client money* entitlement must be calculated for each *client* by the *firm*, to reflect the requirements of (1) and the *firm's* records must be amended to reflect the reduced *client money* entitlement;

(3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* until the *client* is repaid; and

(4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2) when performing the periodic *client money* calculation, in accordance with *CASS* 5A.5.85R to *CASS* 5A.5.109R.

5A.8.48 R For the avoidance of doubt, when performing the calculation in accordance with *CASS* 5A.8.47R(2), entitlements must be calculated in accordance with *CASS* 5A.2.16R so that entitlements of any clients who are *insurance undertakings* will be subordinated to entitlements of *clients* who are not *insurance undertakings*.

Client money received after the failure of a broker or settlement agent

5A.8.49 R *Client money* received by the *firm* after the *failure* of a broker or *settlement agent*, to whom the *firm* has transferred *client money* that would otherwise have been paid into a *client bank account* at that broker or *settlement agent*:

(1) must not be transferred to the *failed* broker or *settlement agent* unless specifically instructed by the *client* in order to settle an obligation of that *client* to the *failed* broker or *settlement agent*; and

(2) must be, subject to (1), placed in a separate *client bank account* that has been opened after the *secondary pooling event* and either:

(a) on the written instruction of the *client*, transferred to a third party other than the one that has failed; or

(b) returned to the *client* as soon as possible.

5A.8.50 G If a *client* suffers a loss as a result of a *secondary pooling event* then the *client* may be able to make a claim on the *FSCS*. *Clients* should refer to *COMP* for details regarding eligibility and conditions.

Notification on the failure of a bank, other broker or settlement agent

5A.8.51 R The provisions of *CASS* 5A.5.82R apply to the notification of the failure of a bank, other broker or settlement agent.

5A.9 Resolution pack

Purpose of a CASS resolution pack

5A.9.1 G The purpose of the *CASS resolution pack* is to ensure that a *firm* maintains and is able to retrieve information that would, in the event of its insolvency, assist an insolvency practitioner in dealing with *client money* in a timely manner.

General provisions

5A.9.1 R A *firm* which holds *client money* must maintain at all times and be able to retrieve, in the manner described in this section, a *CASS resolution pack*.

5A.9.2 R In relation to each document in a *firm's CASS resolution pack*, a *firm* must:

(1) put in place adequate arrangements to ensure that an administrator, receiver, trustee, liquidator or analogous officer appointed in respect of it or any material part of its property is able to retrieve each document as soon as practicable and in any event within 48 hours of that officer's appointment; and

(2) ensure that it is able to retrieve each document as soon as practicable, and in any event within 48 hours, where it has taken a decision to do so or as a result of an *FSA* request.

5A.9.3 R (1) A *firm* must ensure that it reviews the content of its *CASS resolution pack* on an ongoing basis to ensure that it remains accurate.

(2) In relation to any change of circumstance that has the effect of rendering inaccurate, in any material respect, the content of a document specified in CASS 5A.9.5R, a *firm* must ensure that any inaccuracy is corrected promptly and in any event no more than five *business days* after the change of circumstance arose.

5A.9.4 R A *firm* must notify the *FSA* in writing immediately if it has not complied with, or is unable to comply with, *CASS* 5A.9.2R and CASS 5A.9.3R.

5A.9.5 R A firm must include within its *CASS resolution pack*:

(1) a master document containing information sufficient to retrieve each document in the *firm's CASS resolution pack*;

(2) a document which identifies all the institutions with which *client money* may be held, including *approved banks*, money market funds or other third parties to whom *client money* may be passed;

(3) a document which identifies each *appointed representative*, *field representative* or other agent of the *firm* which may receive *client*

money in its capacity as the *firm's* agent;

(4) a document which identifies each *senior manager* and *director* and any other individual and the nature of their responsibility within the *firm* who is critical or important to the performance of operational functions related to any of the obligations imposed on the *firm* under the *insurance client money chapter*; and

(5) for all institutions identified in (2), the written acknowledgement or notification of trust letters sent and received in accordance with •;

Existing records forming part of the CASS resolution pack

5A.9.6 R A *firm* must include, as applicable, within its *CASS resolution pack* the records required under:

(1) *CASS* 5A.5.85R (client money calculation and reconciliation);

(2) *CASS* 5A.5.108R (Annual reconciliation);

(3) *CASS* 5A.4.8R (requirement to properly execute a trust deed).

5A.10 Safe keeping of client's documents and other assets

Application

5A.10.1 R This chapter applies to a *firm* which, in the course of *insurance mediation activity*, takes into its possession for safekeeping any *client policy documents*, other *documents* (but not including *documents* of no value) or other assets belonging to *clients*.

5A.10.2 R This chapter does not apply to a *firm* when:

(1) carrying on an *insurance mediation activity* which is in respect of a *reinsurance contract*; or

(2) acting in accordance with *CASS* 6 (Custody Rules).

Purpose

5A.10.3 G *Principle* 10 requires a *firm* to arrange adequate protection for *clients'* assets when it is responsible for them. *Firms* carrying on *insurance mediation activities* may hold, on a temporary or longer basis, client *policy documents*, other *documents* (other than *documents* with no value) or other assets if, for example, a *firm* arranges for a valuation. The *rules* in this chapter are intended to ensure that *firms* make adequate arrangements for the safekeeping of these assets.

5A.10.4 R A *firm* which has in its possession or control *policy documents* or other *documents* (other than *documents* of no value), or takes into its possession or

control other assets belonging to the *client*, must take reasonable steps to ensure that any such *documents* or assets:

(1) are kept safe until they are delivered to the *client*;

(2) are not delivered or given to any other *person* except in accordance with the *client's* instructions; and

that a record is kept as to the identity of any such *documents* or assets and the dates on which they were received by the *firm* and delivered to the *client* or other *person* in accordance with the *client's* instructions.

5A.10.5 R A *firm* must retain the record required in *CASS* 5A.10.4R for a period of 3 years after the document or other asset is delivered to the *client* or other *person*.

Amend the following as shown.

7.1.3 R (1) A *firm* that receives or holds *money* to which this chapter applies …

…

and holds *money* in respect of which *CASS* ~~5~~ 5A applies, may elect…

…

8.1.1 R This chapter applies to a *firm* (including in its capacity as trustee under *CASS* ~~5.4~~ 5A.4) in respect of any written authority from a *client* under which the *firm* may control a *client's* assets or liabilities in the course of, or in connection with, the *firm's*…

…

TP 1.1

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
…					
3	~~*CASS* 5.1 to 5.6~~ *CASS* 5A.1 to *CASS* 5A.9		Apply in relation to *money* (and where appropriate *designated investments*) held by a *firm* on 14 January 2005 (being *money* or *designated investments* to which ~~*CASS* 5.1~~ *CASS* 5A.1 to ~~*CASS* 5.6~~ *CASS* 5A.9 would not otherwise	…	…

			apply) to the extent that such *money* (or *designated investments*) relate to business carried on before 14 January 2005 and which would, if conducted on or after 14 January 2005, be an *insurance mediation activity*.		

…

Sch 1 Record keeping requirements

…

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
...				
~~*CASS* 5.1.1R(4)~~ <u>*CASS* 5A.1.10R</u>	…			
~~*CASS* 5.2.3R(2)~~ ~~*CASS* 5A.2.10R~~	…			
~~*CASS* 5.4.4R(2)~~ <u>*CASS* 5A.4.7R(2)</u>	…			
~~*CASS* 5.5.84R~~ <u>*CASS* 5A.5.117R</u>	…	Whether the *firm* calculates its *client money* requirements according to ~~*CASS* 5.5.84R~~ <u>5A.5.93R</u> or ~~*CASS* 5.5.84R~~ <u>*CASS* 5A.5.97R</u>		
~~*CASS* 5.5.84R~~ <u>*CASS* 5A.5.117R</u>	…			
~~*CASS* 5.8.3R(1)~~ <u>*CASS* 5A.10.4R</u>	…	…		
…				

Annex D

Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text.

3.10.5 R Client assets report

Whether in the auditors opinion	
(1)	the *firm* has maintained systems adequate to enable it to comply with the *custody rules*, the *collateral rules*, the *client money rules* (except *CASS* ~~5.2~~ 5A.2) and the *mandate rules* throughout the period;
(2)	the *firm* was in compliance with the *custody rules*, the *collateral rules*, the *client money rules* (except *CASS* ~~5.2~~ 5A.2) and the *mandate rules*, at the date as at which the report has been made;
(3)	…
(4)	if there has been a *secondary pooling event* during the period, the *firm* has complied with the *rules* in *CASS* ~~5.6~~ 5A.9 and CASS 7A (Client money distribution) in relation to that pooling event.

…

3.10.8 R (1) If an auditor expects that it will fail to comply with *SUP* 3.10.7R or *SUP* 3.10.8AR(2)(a), whichever is applicable, it must no later than the end of the four month period in question, in respect of *SUP* 3.10.7R, or no later than the end of the seven month period in question, in respect of *SUP* 3.10.8AR(2)(a):

(a) …

(b) ensure that the notification in (a) is accompanied by a full account of the reasons for its expected failure to comply with *SUP* 3.10.7R or *SUP* 3.10.8AR(2)(a), whichever is applicable.

(2) If an auditor fails to comply with *SUP* 3.10.7R or *SUP* 3.10.8AR(2)(a), whichever is applicable, it must promptly:

(a) …

(b) ensure that the notification in (a) is accompanied by a full account of the reasons for its failure to comply with *SUP* 3.10.7 R or *SUP* 3.10.8AR(2)(a), whichever is applicable.

3.10.8A R The auditor of a *firm* falling within category (10) of *SUP* 3.1.2R must deliver a report under *SUP* 3.10.4R:

(1) …

(2) to the *FSA*: ~~upon request within six years of the end of the period covered.~~

(a) within seven months from the end of each period covered; and

(b) in any other case, upon request within six years of the end of the period covered.

…

Appendix 2

Designation of Handbook Provisions

FSA Handbook provisions will be 'designated' to create a FCA Handbook and a PRA Handbook on the date that the regulators exercise their legal powers to do so. Please visit our website[1] for further details about this process.

We plan to designate the Handbook Provisions which we are proposing to create and/or amend within this Consultation Paper as follows:

Handbook Provision	Designation
CASS 5A	FCA
MIPRU 4.2.11R	FCA PRA
MIPRU 2.2.3G	FCA PRA
SUP 3.10	FCA

1 One-minute guide http://media.fsahandbook.info/latestNews/One-minute%20guide.pdf

PUB REF: 002987

The Financial Services Authority
25 The North Colonnade Canary Wharf London E14 5HS
Telephone: +44 (0)20 7066 1000 Fax: +44 (0)20 7066 1099
Website: www.fsa.gov.uk