

20 March 2009

Dear Compliance Officer

### **Arranging adequate protection of clients' assets and money**

We are writing to the compliance officers of all firms which hold relevant client money permissions, to remind them of their responsibility under FSA Principle 10:

*'A firm must arrange adequate protection for clients' assets when it is responsible for them.'*

### **Background**

Protecting assets and money belonging to clients has been a cornerstone of the UK regulatory regime since 1988. The segregation regime is provided in the [Client Assets Sourcebook \(CASS\)](#). Market events during the past 12 months, and particularly those experienced during the past six months, have highlighted the importance of the segregation regime.

Consistent with our [Financial Risk Outlook](#), we are basing our view in this letter on the premise of a global and domestic recession in 2009 and recovery in 2010. During this time, and in this context, it is likely that we will see further corporate insolvencies involving clients' assets and money. We are also concerned that as the recession deepens, there is an increasing risk of financial crime involving clients' assets and money.

In this economic environment, the protection of a client's entitlement is of paramount importance and firms should be paying due regard to the requirements we place on their systems and controls as outlined in CASS.

### **Considerations for senior management**

Recent firm visits we have conducted found that, in some instances, firms failed to comply with basic CASS requirements. A considerable number of policy objectives underlying the CASS regime only become apparent upon the insolvency of a firm. So it is important for compliance departments to recognise that while certain requirements may not bestow any protections whilst the firm is a going concern, they are designed to minimise the loss to clients upon insolvency and equip an insolvency practitioner with relevant, timely information.

Whilst not an exhaustive list, senior management should be mindful of the following requirements in the context of an insolvency scenario.

### **Records**

There are specific record-keeping requirements contained in CASS. We expect firms to be able to produce, or have systems capable of producing, the supporting

documentation specified in the sourcebook.

In particular, we highlight CASS 6.5.1 R and 7.6.1 R. These provide that a firm must keep such records and accounts as necessary to enable it - at any time and without delay - to distinguish safe custody assets/client money held for one client, from safe custody assets/client money held for any other client, and from the firm's own applicable assets/client money. CASS 5.5.84 R contains a similar provision for general insurance intermediaries. Compliance with these provisions is essential to equip an insolvency practitioner appointed to a firm in the event of default with timely information.

Further, client agreements and terms of business documentation must be executed with signed copies retained on file, and audit trails must be maintained particularly when:

- clients contact the firm to request the protection afforded by the regime (or conversely provide the firm with a right to use); and
- firms operate a buffer in the client money account under CASS 5.5.10 R and CASS 7.4.21 R.

We consider that best practice firms will maintain a central file including client assets and money policy and procedures documentation, letters of acknowledgement of trust arrangements, a copy of all record-keeping requirements, a copy of the most recent regulatory audit report (together with steps to address breaches if any), the breaches register for the current period and relevant management information reports.

### **Acknowledgement of trust**

Under CASS 5.5.49 R and CASS 7.8.1 R, when a firm opens a client bank account, it must give written notice to the bank requesting the bank to acknowledge that all money is held by the firm as trustee. The bank is not entitled to combine the account with any other account or 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. Further, the title of the account must sufficiently distinguish that account from any account containing money that belongs to the firm, and is in the form requested by the firm.

Recent firm visits suggest that many firms do not have the appropriate trust acknowledgements in place. Where these are placed on file, we found instances where the documentation had not been executed in the name of the relevant bank or with appropriate authority on behalf of the bank. Creating and operating these accounts are of paramount importance in establishing trust status for the benefit of the underlying clients, the purpose of which again is only apparent upon insolvency.

### **Due diligence and diversification**

CASS 7.4.7 R provides that a firm must exercise all due skill, care and diligence in the selection, appointment and periodic review of the credit institution, bank or qualifying money market fund where the money is deposited, and the arrangements for the holding of this money. Similar provisions are contained in CASS 5.5.43 R.

In periods of market turbulence, we would anticipate that firms would conduct due diligence more frequently. We are reminding firms to document their due diligence,

paying due regard to those factors considered in CASS 5.5.45 G and CASS 7.4.9 G, and considering the context of how UK clients would be treated under the insolvency and regulatory regime in a non-UK jurisdiction. In particular, we highlight the need for senior management to consider the need for diversification of risks, the credit rating and capital of the relevant credit institution or bank, and the level of risk in the investment and loan activities undertaken by the relevant credit institution, bank or affiliated company.

### **Further work in 2009**

We will be continuing our work in this area to ensure that firms are arranging the adequate protection of their clients' assets and money. A number of FSA firm visits will be scheduled for the second and third quarters of 2009, focusing specifically on CASS compliance, including those areas highlighted in this letter and an assessment of the 2009 regulatory client money audit report. We will publish a report setting out our findings in the fourth quarter of this year.

### **What you need to do**

Please communicate the contents of this letter to the compliance team that is responsible for client assets and money at your firm.

Yours faithfully,

Richard Sutcliffe  
Head of Prudential Standards, Conduct and Organisational Policy