



Society of
Insurance
Broking
Standards. Professionalism. Trust.

Good Practice Guide

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Client Money for Brokers

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This paper is in response to members' requests to provide a summary of good practice within one source document and is based upon the Society of Insurance Broking's understanding of the regulator's rules and current stance. Whilst a summary, it is not intended to be exhaustive and should not be relied upon at the exclusion of other sources of information.

In association with
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Foreword



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In our experience from carrying out numerous audits, investigations and due diligence projects, the subject of client money and risk transfer is sometimes misunderstood by insurance brokers, insurers and auditors alike. The rules around client money are a blend of legal, financial and regulatory concepts, and while no single rule is overly complex in its own right, the application of the rules in practice is not always straight forward.

We see a range of approaches by firms; some firms dedicate a lot of resource to client money whilst others lack the required skills. The key to protecting client money is ensuring the senior team take things seriously, promoting client money governance and supporting those responsible for client money to ensure they have sufficient training and resources.

There are not many references in the public domain that can help you with the practical aspects of handling client money which is why we helped the Society of Insurance Broking produce this Good Practice Guide to help brokers improve their client money handling. We hope you find this a useful introduction to, what can be, a challenging topic.

Introduction

Why do insurance brokers hold client money?

When taking out an insurance policy, a client will pay a broker who then pays an insurer, or an agent of the insurer. Money may be held by the broker in a bank account, controlled by them, during the course of that transaction.

When this money is held it needs to be held correctly and securely. There are two ways that brokers can hold this money:

- under risk transfer; or
- in a client money trust

Risk transfer

An insurer may agree to let a firm hold money as an agent on its behalf. By transferring the risk from the broker to the insurer, the insurer becomes accountable for the credit risk. This comes in the form of a formal written agreement from the insurer who confirms that the intermediary acts as agent of the insurer in respect of the collection of premiums. If funds paid by the client to the broker are not available to meet the cost of the premium, the insurer is now held responsible for protecting the client, regardless of payment.

If all money is held as risk transfer then client money is not held; the broker holds risk transfer money. All terms of business agreement (TOBA) must be duly signed and provide for risk transfer without exception and ambiguity. The best practice for holding risk transfer money is to follow the BIBA guidelines and use an 'Insurer Non-Statutory Trust'.

Holding client money

If a broker does not have a risk transfer arrangement they must handle the money as client money.

The FCA state that, "Client money is money of any currency that, in the course of carrying on insurance mediation, a firm receives and holds on behalf of a client. It can include premiums, claims money and premium refunds - as well as professional fees due from clients, for example, for onward payment to a loss adjuster"¹.

What are the rules for holding client money?

As money is either held or being processed, there are certain rules that should be observed when holding client money. These rules are found in Chapter 5 of CASS (Client Asset Sourcebook) of the FCA handbook².

To hold client money a broker will hold client money in one of the following;

- **statutory trust client bank account:** when the firm has a duty of care for the client money to be managed in accordance with trust law, without making advances of credit from the account; or
- **non-statutory trust client bank account:** when the firm executes a non-statutory trust deed that permits the broker to extend credit from the client money account to clients or insurers.

The money held in either of these accounts has to be held in accordance with CASS 5. This section sets out some of underlying concepts within CASS 5:

- These trusts in which the client money is held are subject to UK Trust law resulting in the trustees (being the firm) having a fiduciary duty to their clients. Fiduciary duty means they have to put their clients' interests above their own.
- The establishment and ongoing protection of the trust is critical. Many rules exist to ensure the trust is constituted in the right way and that the trust is not broken through pollution of the trust through leaving unidentified money in the trust or through non-client money being co-mingled. For example, where an insurer doesn't give the broker co-mingling permissions, this money is not client money and has the potential to pollute the trust.
- The format of the client money reconciliation, segregation and timing requirements are driven by the need for the firm to ensure that it can calculate on a timely and accurate basis the cash held for each client, on a client by client basis, at any point in time.
- A non-statutory trust gives brokers the ability to extend credit to a client or insurer (not to themselves) from the client money pot, but this brings additional controls and potentially increases capital requirements due to the higher risk posed to the trust.
- For a non-statutory trust there needs to be a client money manager who is formally appointed.
- Compliance with the rules must be absolute. There is no concept of materiality or judgement.

These are high level themes, however anyone with responsibility for client money must ensure that the detail of the client money rules are understood by the business.

Issues regarding holding client money

The FCA's rules are in place to ensure that client money is protected. There are times where brokers may not be fully aware of the rules when using client money accounts. Sometimes there is an assumption that the finance team is familiar with the CASS 5 rules without checking first if they have up to date training or enough resources to cope with the work required. This could mean that firms are not using FCA materials, such as client money health-checks or templates, they are relying on their broking software without critiquing the process, or their attention to detail is lacking when cross-referencing the CASS 5 rules. The FCA expects all intermediaries to be fully compliant and knowledgeable of the CASS 5 rules, without exception.

Some common mistakes or misunderstandings include:

- A firm must use the client money calculation format prescribed by the FCA and ensure they consider every element of this reconciliation.
- The reconciliation must be done based on balances from the previous business day and the commission surplus transferred on the day of the reconciliation.
- Firms miscalculate or don't understand the 'unearned' commission figure used in the client money calculation (CMC) as it is frequently a system generated number.
- Firms often rely on standard reports from broking software and don't test or validate the reports.
- Firms don't have signed copies of all their TOBAs with insurers or don't have TOBAs with the relevant, required terms.
- Firms using the accruals method don't carry out a client by client reconciliation. This additional reconciliation is not optional.
- Firms don't use the client money calculation as the basis for the commission transfer. The CMC is the only basis that can be used and a mid-month transfer, without a CMC, is not permitted.
- Money is either client money or is held under risk transfer. Risk transfer money becomes client money the moment it is paid into the client money trust and is subject to the CASS 5 rules.
- The firm must ensure it has correctly named its bank accounts and has received bank letter acknowledgments.

Many of these errors occur because the individuals responsible are not familiar with the detail of the rules or the implications on the client money trust of not complying with those rules

Auditing client money

The FCA requires all general insurance intermediaries who hold client money (statutory trusts over £30k) to arrange their own client money audit. The auditor provides an opinion on whether the firm has adequate systems and controls to comply with CASS 5.

Firms are responsible for appointing an auditor with appropriate skills to carry out the audit. Consider asking questions like:

- Do you audit more than one broker/client? If the answer is only one or two this might indicate the firm doesn't have the necessary experience.
- Do you have the appropriate knowledge/training to perform the audit? The firm should provide regular training for its staff and have partners with specific CASS 5 knowledge.
- What guidelines is the audit firm observing when performing the audit? The audit firm is required to follow specific audit guidelines. These guidelines were developed in collaboration with the FCA. They are called "Providing Assurance on Client Assets to the Financial Conduct Authority"³.
- What is the audit procedure? The audit firm should be expected to have specific working papers and testing procedures for carrying out a client money audit. It is a separate exercise to the year end accounts preparation process or year end statutory audit.

Sometimes a firm may rely on auditors to be wholly knowledgeable of the CASS 5 rules and believe they can pass the responsibility of compliance to them. If the audit firm is not up to date with the CASS 5 rules they may form an inaccurate opinion of the firm's systems and controls, resulting in a false comfort being drawn from the audit performed. In any case a firm cannot devolve its regulatory responsibility.

Virtually all audits will uncover some breaches. Even a small breach should be reported. A clean audit opinion is one where there are no breaches.

Client money is a key priority to the FCA. The FCA review the reporting via the RMAR C forms⁴ and carry out phone interviews to assess brokers' compliance with the rules.

³ <https://www.frc.org.uk/getattachment/3bf164e1-5158-4b2a-ade2-3070cf123e32/Standard-Providing-Assurance-on-Client-Assets-to-the-FCA-Nov-2015.pdf>

⁴ https://www.handbook.fca.org.uk/form/sup/SUP_16_ann_18A_20181001.pdf#page=3

Good Practice

1. Compliance starts with you.

When it comes to client money, don't pass the buck! Even if you are not personally accountable for the managing or processing of funds, make sure that you are involved in conversations about client money compliance. A positive client money culture starting at the top is a good way to ensure good client money practices are instilled in the business.

2. Training and resources.

Client money compliance is a technical subject. Your staff should be given adequate training on an ongoing basis to ensure they are up to date. They also need to be given sufficient time and resources as the client money calculation process can be onerous depending on the systems in place.

3. Challenge yourself.

A firm should seek to test and challenge the results of the client money calculation and the data used in it. By asking questions like, "how do we know this is right?", the firm can improve its client money accuracy. There should always be a cross validation test to ensure that the client money surplus calculated using the CMC is correct.

4. Automation of process.

Subject to the comments above, firms that can automate or streamline their CMC process can then spend more time on validation. They can also increase the frequency of the reconciliations, improving cashflow.

Conclusion

When brokers hold client money they need to make sure that, as well as complying with FCA rules, they are also putting their clients' interest before their own. Client money rules exist to protect consumers, but this can only work if those responsible for client money are knowledgeable of the rules in the first place.

Brokers should be leading conversations by improving communication and encouraging a better understanding of the CASS 5 rules. With the FCA taking a greater interest in the protection of a client's assets in the event of a firm's failure, brokers need to be more proactive in ensuring that proper procedures are in place once the money is held and action taken when knowledge of the rules is not at a sufficient level.

Appendix – Primary Source Material

Financial Conduct Authority

Date	Name	Summary	Link
	CASS 5	Client money: insurance distribution activity.	https://www.handbook.fca.org.uk/handbook/CASS/5/?view=chapter
	RMAR C Form	Client money and assets.	https://www.handbook.fca.org.uk/form/sup/SUP_16_ann_18A_20181001.pdf#page=3
9 March 2007	Guide to Client Money for General Insurance Intermediaries	Guide for authorised firms on how to hold client money in accordance with CASS 5.	https://www.fca.org.uk/publication/archive/fsa-client-money-guide.pdf
20 August 2008	Client Money Health Check	Guide to help firms assess their understanding of client money and how it should be protected.	https://www.fca.org.uk/publication/archive/fsa-client-money-healthcheck.pdf
16 May 2016	RMA-C Client money and assets	FAQs.	https://www.fca.org.uk/firms/gabriel/rma-c-client-money-and-assets-faqs

Financial Reporting Council

Date	Name	Summary	Link
November 2015	Providing Assurance on Client Assets to the Financial Conduct Authority	Client asset assurance standard.	https://www.frc.org.uk/getattachment/3bf164e1-5158-4b2a-ade2-3070cf123e32/Standard-Providing-Assurance-on-Client-Assets-to-the-FCA-Nov-2015.pdf

PKF Littlejohn

Date	Name	Summary	Link
	Client money templates and reosurces	Varous templates and resources to help comply with the CASS 5 rules.	https://www.pkf-littlejohn.com/sectors-insurance-sectors-intermediaries

