

Insurance brokers and client money: Time to put things in order

Are you complying with the client money rules?

In January your CEO will have received a letter from the FSA (with a follow-up in May) seeking written confirmation that your firm is complying with client money rules, and asking for contact details of the person within your firm responsible for ensuring compliance.

Typical compliance failures include not having the correct paperwork in place (e.g. in respect of risk-transfer arrangements, trust bank accounts), not making the correct disclosures to your clients, failure to segregate client money into a trust account, improper use of client money (e.g. to fund premium financing), and poor governance and accountability in general. The FSA has taken enforcement action (fines and bans) against brokers that have not complied, and threatens more action in the future.

Are you ready for the changes ahead?

The FSA intends to consult on changes to the insurance client money rules (CASS 5) in early 2011. This is likely to include re-evaluation of non-statutory trust accounts, which enable brokers to extend 'credit' to insurers/insureds from the client money trust account. The FSA may also seek to 'read-across' some of the stricter provisions from the client money rules for investment firms (which have been called into question by the courts following Lehman Brothers' collapse, and are already being enhanced by the FSA).

Do you need to do a credit write-back (or do you want to enhance your capital)?

One of the key principles of any trust is that it can only contain trust money, and one of the FSA's key concerns is that a client money trust account should therefore be 'unpolluted' at all times. It should be cleared of (for example) money that belongs to the broker, or money that is not claims, premiums or premium return money.

Against the background of the legacy of broker regulation (and self-regulation), the complexity of multi-jurisdictional and multi-currency risks and long distribution chains, and consolidation activity within the sector involving the merging of systems between entities, the client money trust accounts of many brokers can often be in disarray, and have unexplained/unallocated items.

The basic requirement on firms that have such issues is to put their client money trust accounts in order, and we expect the FSA to be encouraging brokers to do this in preparation for the revised CASS 5 regime. This exercise must be done in a way that is sensitive to the fundamental obligations of a firm as trustee of any client money that it holds. In other words, if a firm takes steps to move money out of the client money trust account, it must have good reason for doing so.

Credit write-backs have become the recognised procedure to achieve this balance. A credit write-back is essentially a process that has several in-built governance, legal and accounting controls, and which enables an insurance broker to 'write back' certain unallocated amounts from its client money bank account to its balance sheet (and, in some cases, effect an actual cash transfer).

The FSA has considered the steps that a firm might reasonably follow as part of this procedure, and these include:

- Undertaking a thorough evidential exercise to explain any discrepancies;
- Obtaining sign-off from your auditors to confirm that the credit write-back is appropriate and in line with accounting standards;
- Obtaining a written legal opinion that the credit write-back is appropriate;
- Documenting the process thoroughly, including any board resolutions; and
- Keeping records on an ongoing basis.

How can we help?

We have helped a number of brokers with credit write-backs and we have developed an efficient methodology for satisfying FSA that a write-back is appropriate.

More generally on CASS compliance, we were closely involved in the development of the existing rules in CASS 5. We have also advised a number of firms on client money breaches and related FSA investigations. We know what can go wrong, how to avoid it and what to do if it does go wrong. We can help you ensure that your existing controls are correct and provide expert insight into damage limitation and management of relations with FSA if your controls are not up to scratch.

Next steps

Please get in touch with your usual CMS contact if you would like to discuss your firm's compliance with CASS 5, the possibility of a credit write-back or the impact of any likely future changes to the client money regime.

In addition, the following members of our insurance regulatory team would be very happy to discuss your requirements:



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