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Protecting Client Money: Best Practices

Global Treasury Series

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Under the spotlight

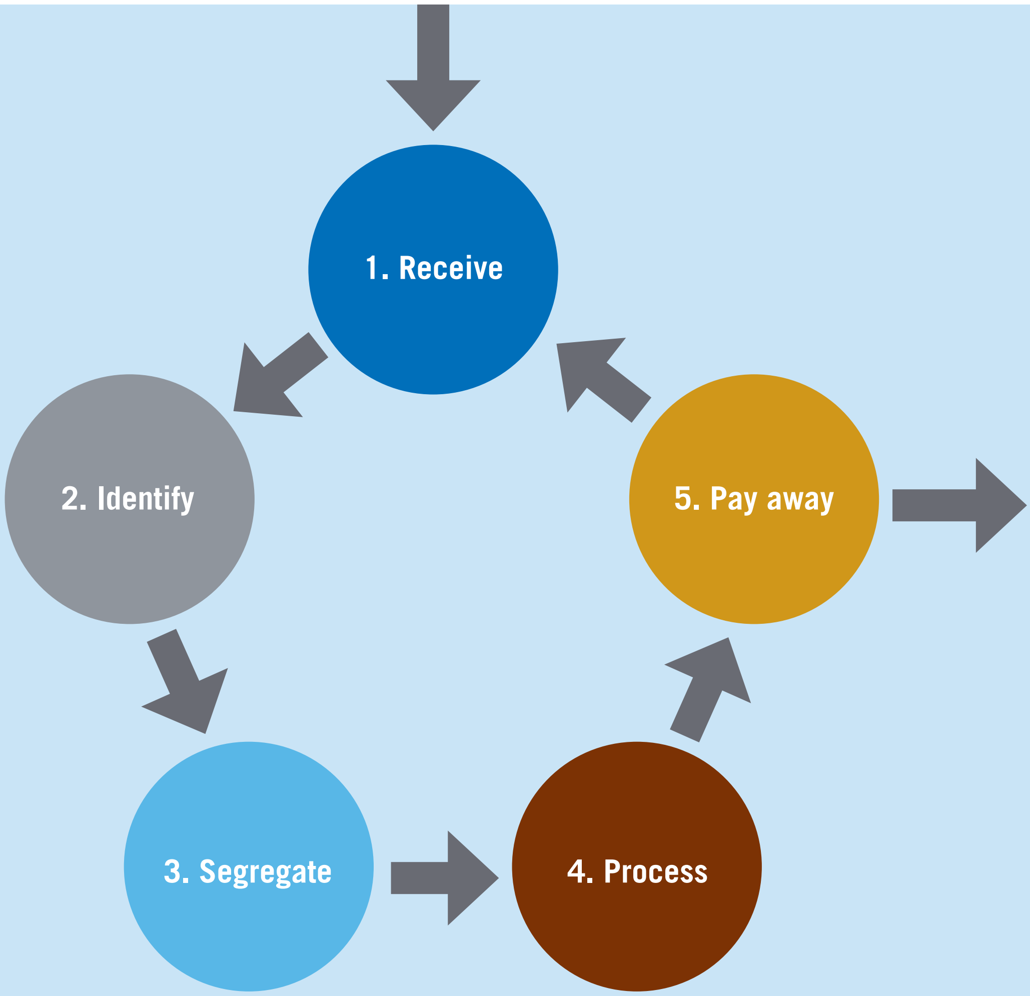
The collapse of Lehman Brothers International Europe (LBIE) in 2008 ensured a spotlight shone brightly on an area of financial management that many had taken for granted – Client Money management. For many investors there was an assumption that the duty of care an institution had to protect their money was ingrained in the institutions business processes and systems. The fact that client money could be co-mingled with an intuitions owns funds was seldom a concern. Post Lehman's all that changed. Now every geographic jurisdiction has their fair share of case studies of firms that have either been fined for failing to adequately protect Client Money or worse still entered administration.

In the UK the latest high profile case of concerns over the protection of Client Money is Alpari, the exchange broker who collapsed after the Swiss central bank's decision to abandon its attempt to peg the franc to the euro. At the point Alpari went into administration (19.01.15) it was safeguarding the Client Money of an estimated 100,000 customers. At the time of writing this letter administrators are still assessing whether any client money is missing and the FCA has issued a statement that the administrators "…will return as much client money to clients as quickly as possible".

The management or mis-management of Client Money is not restricted solely to financial institutions but extends to a list of organisations providing services requiring them to hold client funds; legal firms, care providers, property managers and real estate, insolvency managers. The regulatory bodies governing these various industries may change as may the nuances of the regulation but the basic premise of their responsibilities remains consistent; the requirement to identify, segregate and protect client money. A simple enough sounding task but in a world where long established systems and processes were designed to take care of the organisations money rather than their clients this can be challenging.

Cashfac Technologies has been providing Client Money solutions for many of the world's leading financial institutions and Corporations for more than a decade. By taking a forensic approach to managing cash across the client money lifecycle we help firms better manage client money, deliver against their client commitments and comply with relation. Reputational and operational risk are reduced and board members personally liable for compliance are protected.

We're delighted to see *gtnews* taking a focus on this subject and would encourage anyone with a concern or interest in how they can deploy technology to better manage Client Money to visit **www.cashfac.com** or get in touch directly.



1. **One of the keys to Client Money compliance is early visibility of incoming funds** – intraday updates are preferable. The later you are aware of receipts the greater the risk of non-compliance

2. **Identifying funds is more than just identifying who the funds relate to, it's important to know what they are** – which case, invoice, disinvestment etc. Good receivables systems are essential in matching as many as possible automatically so that effort can be focused on exceptions.

3. **Segregating Client Money from Firm Money** and from other Client Money is fundamental. Designated real bank accounts are fine, but opening them can be extremely time consuming and expensive – virtual bank accounts offer a speedier, more controlled alternative.

4. **Whilst storing Client Money the Ts&Cs will define any other requirements for processing** – statements, online access, interest payment are some examples. Whilst none of this is complicated it is important to get these processes slick otherwise they are using resource which would otherwise be used to maintain compliance.

5. **The cycle completes with payment back to the client or on to counterparties**. Control and compliance are important right until the funds leave the bank accounts. Is the payment process secure and risk-free?

Introduction

It's no secret that regulatory authorities have made the management of Client Money a major target. Failure to comply has resulted in large fines, the closure of financial services businesses, reputational damage and potential prison terms for any board-level member personally liable for compliance.

A number of high-profile cases have underlined the need for more stringent rules related to Client Money management. In September 2008, Lehman Brothers International Europe (LBIE), the primary U.K. trading subsidiary of U.S. giant Lehman Brothers Holding, was placed into administration.

The investment bank had failed to fully comply with the UK financial regulator's Rule Book governing Client Money (CASS 7). The purpose of the CASS 7 rules is to ensure that, upon a firm's insolvency, the clients would receive back their money in full, free from the claims of the firm's creditors. LBIE had failed to identify as Client Money - and therefore also failed to segregate - vast sums received from or on behalf of a significant number of its clients. Following its collapse, administrators were unable to determine with any certainty either the amount of client monies held by LBIE or, from an initial Client Money pool of approximately $2 billion, who was entitled to receive money from that pool.

Another high-profile case that underlined the need for more stringent Client Money rules was that of MF Global, formerly known as Man Financial. After suffering a sharp deterioration in its financial condition in October 2011, the firm was declared bankrupt at the end of that month.

Theoretically, futures and securities regulation provides safeguards to protect customer funds. Additionally, the Commodity Exchange Act (CEA) requires that customer funds received by a Futures Commission Merchant (FCM) to margin, guarantee, or secure a customer's futures contracts be held in segregated accounts. As a result, any MF Global losses related to its own proprietary trading should not have affected customers. Upon going into administration, however, approximately $1.6 billion belonging to MF Global's commodity customers was 'missing'. The missing funds were supposed to have been kept in segregated accounts for customers, but it was soon discovered that MF Global had improperly commingled client assets with its proprietary funds.

Regulators have acted to clarify the Client Money rules pertaining to financial service providers and to tighten up the requirements. Following Lehman's collapse, the FCA published a report highlighting concerns over firms' handling of client assets and the action they expected firms to take to address these concerns. The report addressed specific weaknesses including: poor management oversight and control; lack of establishment of trust status for segregated accounts; unclear arrangements for segregating and diversifying Client Money; and incomplete or inaccurate records, accounts and reconciliations. The report also outlined steps that were being taken to make auditor's reporting more effective, including the referral of auditors to the Institute of Chartered Accountants in England and Wales (ICAEW), where the FCA believed auditors had failed to meet their requirements.

In understanding what constitutes Client Money and how it should be segregated, the ICAEW offers a clear regulatory structure regarding the handling, banking and return of money held on behalf of clients. It defines 'Client Money' as any currency including cash, cheques, drafts and electronic transfers that a firm holds or receives for or from a client, including money held by a firm as stakeholder, and which is not immediately due and payable on demand to the firm for its own account.

Under the ICAEW regulations clients' money must be held in the currency in which it was received, unless the client instructs otherwise in writing. When money is received, the firm must first identify its nature before determining what to do with it. For most firms, clients' money is usually tax refunds to be paid over to a client, or payments from clients for filing fees that have yet to be paid to Companies House. Overpaid fees are clients' money and should be returned to the client, or paid into the client's account. However, if the client confirms that the sums can be kept as payment in advance of work to be performed by the firm, then this is not Client Money and can be left in the office account. *Source: ICAEW*

In both the Lehman and MF Global cases – as well as others – the issues related to the segregation of client assets ran deeper than a simple disregard for regulatory procedure. For many firms the daily task of calculating and segregating client monies, as well as operating Client Money accounts, has typically been manual, fragmented and prone to error.

Regulation is only part of the story. There are various practical benefits and opportunities to be gained beyond regulation by automating the identification, segregation, and management of Client Money.

In today's fast-moving business environment, there is no supportable reason why a financial service provider's management of Client Money should still be a manual process - a method that has proved time and again to be vulnerable to a whole host of errors. The stringent regulatory compliance requirements introduced in the U.K. in recent years, and now enforced by various jurisdictions and industry governing bodies, should be reason enough for many firms to invest in automation, which is considered a best practice in financial management.

Chris Golland, Head of CASS at Standard Life, summarises this well, saying: "The FCA requires strict compliance with the CASS rules and will take action against firms and individuals where it deems they have operated outside the rules. Fines are on the increase and the FCA is no longer focused only on non-compliance of Client Money rules but also on the impact of non-compliance of client assets. Non-compliance post 1 June 2015 is not an option. Audit firms will be auditing to the new rules from 1 June 2015, as will the FCA in their next thematic review when visiting firms."

There's simply no getting around it - a firm that is regulated will, at some point, need to be audited. The firm will have to prove reconciliation and that controls are in place for both holding and allocating Client Money. Helpful to this process is the assurance that the controls are correct and demonstrable, by way of an automated audit trail rather than a manual one.

Regulation

Regulated businesses need to both uphold industry standards and comply with financial regulation in order to remain operational and competitive. Regulation is put in place to protect consumers, financial markets and promote competition.

Following the fallout of market events such as the collapse of Lehman Brothers and MF Global, client asset

Meeting the Regulatory Challenge

From a regulatory standpoint the issue of client money segregation is fairly black and white; if you've got client money then you should have segregated it appropriately and if you've not segregated it appropriately then the regulator is justified in fining you. Clearly there have been some very big fines dished out by the regulator in relation to client money breaches however there are a number of challenges that firms still face when it comes to managing and segregating client money.

The first issue is around complexity and the fact that many firms – particularly banks and subsidiaries of banks – structure their arrangements with both clients and third parties in a fairly complicated way. The difficulty in firms creating complex arrangements is that it can lead to elements of fees, elements of interest or elements of dividends that are lurking in an account somewhere that aren't being picked up in the daily client money reconciliations and therefore aren't being segregated on a daily basis.

Another problem that exists can be found where a group entity that is subject to FCA regulation has outsourced the day-to-day operational responsibility for the oversight of client money arrangements to another part of the group. If that part of the group is not directly subject to FCA regulations for handling client money and has less familiarity with the requirements there will be greater risk of money swirling around the system and not being captured in the way that it should be.

One final headache comes from the tightening of FCA client money requirements, particularly in obtaining acknowledgement of trust status over client money from banks, including overseas banks. There have been a number of instances where financial services firms have written to overseas banks seeking the acknowledgement of trust status but are struggling to get those acknowledgements back. Come 1st June, the FCA's deadline for firms to ensure that they fully comply with all of the new rules, money will have to be moved to a bank that does acknowledge that trust status.

A starting point for firms to work around these challenges lies in getting the governance around client money policy as tight as possible and, importantly, getting the client money issue on the regular agenda of the appropriate Board committee. The right people at the right level need to be aware of, and focused on, the risks associated with not getting client money management right. They need to be asking the right questions and getting the right kind of information to allow them to manage client money more effectively and in line with any respective regulatory structure.

Ben Blackett-Ord, Chief Executive, Bovill

Ben founded Bovill in 1999 and has led the company ever since. He is Chief Executive and the majority shareholder.

Before setting up Bovill, Ben was a regulator with The Securities Association, before moving to in house compliance roles at IBJ International and Standard Bank.

Ben is a qualified barrister and is regularly invited to speak at conferences on a range of regulatory topics. He is highly respected for his thorough and client-focussed approach. He is a director of the EIS Association and sits on the Ethics and Integrity Committee of the CISI.

allocation and reconciliation have become an increasingly important aspect of the regulatory regime. Regulation, however, is a complex beast and the regulations that a firm need to comply with differs according to the type of firm. Some organisations, for example, will be subject to supervision by more than one regulator, whilst others will be subject to a single regulator.

The Financial Conduct Authority (FCA), which replaced the Financial Services Association (FSA) as the UK regulator in April 2013, regulates banks, building societies, insurers, independent financial advisers, mutual societies, investment managers and stockbrokers. The Prudential Regulation Authority (PRA), which came into being at the same time, also regulates banks, building societies and insurers as well as credit unions and large investment firms. Both the FCA and PRA have wide-ranging powers and authority over different types of firms and there is an overlap in the type of firm that they advise and supervise.

The Solicitors Regulation Authority (SRA) regulates solicitors, while the Royal Institution of Chartered Surveyors (RICS) regulate Surveyors, including Property and Land Managers. The Pensions Regulator regulates Pension Trustees and Administrators in the UK.

Below are outlined some of the regulatory authorities and regulatory frameworks that are currently impacting Client Money management. *Sources: FCA, ICAEW, ESMA*

The Markets in Financial Instrument Directive (MiFID/MiFID II)

MiFID is the European Union framework legislation for investment intermediaries providing services to clients in relation to shares, bonds, units in collective investment schemes and derivatives and the organised trading of financial instruments.

The basic tenets of MiFID were applied in the U.K. from November 2007 but have undergone revisions in light of the financial crisis and to strengthen investor protection. MiFID II is due to be implemented in January 2017.

MiFID II requires that all investment firms comply with the governance requirements set out in Capital Requirements Directive IV (CRD IV). For investment management firms, MiFID II formalises the expectations of regulators and industry best practices, which some firms have already adopted.

The regulation is expected to increase focus on the performance of members of senior management, thereby putting the onus on firms' management bodies to assess their governance structures ahead of the January 2017 implementation date.

The final version of MiFID II significantly strengthens investor protection. The new rules require that the design, marketing and distribution of products by investment firms be specifically tailored to their target market. Firms must be fully conversant with the products they sell and ensure that they are appropriate for their clients. Their staff should not set sales targets or be offered incentives, such as remuneration, which might encourage them to recommend inappropriate financial products to their clients.

Firms also must inform clients from the outset whether the investment advice they offer is independent, and whether it's based on a broad or more restricted analysis of the market. Those that provide advice on an independent basis must assess a sufficiently wide range of financial instruments available on the market without limiting it to the range that they themselves or their related entities offer.

The Financial Conduct Authority (FCA)

Along with other national regulators the FCA has incorporated MiFID into its handbook of rules and guidance. Additionally, the FCA created the Client Assets Sourcebook (CASS) in its handbook to set out the requirements with which firms must comply when holding or controlling client assets.

Since 1 October 2011, medium and large firms with CASS status have been required to complete a monthly Client Money and Asset Return (CMAR). This provides the FCA with an overview of a firm's Client Money and safe custody assets (client assets) positions and holdings, as well as a view of the trends in the industry. It enables the FCA to make regulatory interventions in relation to client assets on a timely, firm-specific or thematic basis. Additionally, the information a firm includes in the CMAR should help it to understand its own CASS position. These firms must have an individual approved for the CASS operational oversight function (CF10a) to ensure accountability throughout the firm.

Firms that only hold Client Money for the purposes of general insurance intermediation do not need to submit a CMAR, nor do small firms with CASS status.

In June 2014, the FCA set out finalised rules for improving the protection of Client Money and client assets in its Policy Statement 14/9: Review of the client assets regime for investment business (PS14/9). The changes looked to improve investment firms' systems and controls around segregation, record keeping and reconciliations and set out how such firms must address client assets risks within their business.

The new rules affect all firms that are subject to CASS and include: auditors, in relation to providing annual auditors' client assets reports; third-party providers that provide back office functions that firms use for their client assets operations; market infrastructure firms, including central counterparties, exchanges and other intermediaries with which firms may place client assets; banks with which firms deposit Client Money; custodians and other third parties that may hold client assets in a client transaction account for a firm subject to CASS; and insolvency practitioners and their advisers responsible for distributing client assets if a firm that holds client assets enters into insolvency proceedings.

> Implementation has been staggered across a number of key dates, which culminate in a deadline of 1st June 2015

Implementation has been staggered across a number of key dates, which culminate in a deadline of 1st June 2015 - by which time all remaining rules and guidance come into force and firms will need to ensure that they fully comply with all of the new rules.

Below lays out the key dates for implementation and the topics where the FCA will make changes to CASS.

From 1 July 2014 certain rules and guidance came into force providing clarifications to existing requirements, introducing optional arrangements with which firms may choose to comply and limiting the placement of Client Money in new unbreakable term deposits. These include clarifications of application provisions and the introduction of the option to operate multiple Client Money pools. A full list of changes is below:

Clarifying the general application provisions of CASS (CASS 1) and the application of the collateral rules (CASS 3), custody rules (CASS 6) and the Client Money rules (CASS 7);

- Removing the requirement for an auditor's confirmation in respect of alternative reconciliation methods for custody assets;
- Changes to right to use arrangements for custody assets;
- Changes to money ceasing to be Client Money;
- Amending rules applying to trustee firms;
- Prohibiting placement of Client Money in unbreakable term deposits with terms longer than 30 days;
- Clarifications on payment of interest on Client Money;
- Changes to Client Money held by third parties;
- A revised definition of the 'standard method of internal Client Money reconciliation';
- Clarification of CFTC Part 30 Exemption Order;
- Certain clarifications to our Client Money distribution rules; and
- Introducing multiple Client Money pools.

On 1 December 2014 certain rules and guidance came into force relating to the provision of information to or obtaining the agreement of new clients and the documenting of agreements and arrangements with any new counterparties with whom firms deposit or otherwise place custody assets or Client Money. These include requirements to notify the client of certain matters if operating the banking exemption and mandating the use of template acknowledgment letters with new client bank accounts and client transaction accounts. A full list of changes is below:

- Written custody agreements (impact on new or materially altered counterparty arrangements);
- Acknowledgment letters (impact on new client bank accounts and new client transaction accounts);
- Banking exemption (impact on new client relationships);
- Title Transfer Collateral Agreements (TTCA) – written agreements (impact on new client relationships);
- Delivery versus Payment (DvP) commercial settlement systems (impact on new client relationships);
- Information to be provided to clients before the provisions of investment services about client asset arrangements (impact on new client relationships);
- Unclaimed custody assets;
- Unclaimed Client Money; and
- Transfer of business – handling Client Money.

On 1st June 2015 all of the remaining rules and guidance come into force and firms will need to ensure they fully comply.

Audit firms will operate under the new rules as of this date and it is also expected that the FCA will review firms' implementation of the changes - with fines and other penalties imposed on those that fail to comply.

The Retail Distribution Review (RDR)

The Financial Services Authority - now replaced by the FCA - established the Retail Distribution Review (RDR) in June 2006 with the aim of improving the quality of investment and pension advice given to consumers; and improving consumers' confidence and understanding of the advice they are given. The RDR became effective at the end of 2012, primarily impacting the U.K.'s 30,000 authorised and regulated financial intermediaries who offer financial services to retail customers.

The RDR's main requirements are as follows:

- Independent advice is truly independent and responds to investors' needs;
- The firm's clients can clearly identify and understand the service they are being offered;
- Commission-bias is removed from the system and recommendations made by advisers are not influenced by product providers;
- Investors know up front how much the advice will cost and how they will pay for it;
- All investment advisers are qualified to a new, higher level, regarded as equivalent to the first year of a degree.

Institute of Chartered Accountants in England and Wales (ICAEW)

Since 1st January 2011, the ICAEW has set out its own Client Money regulations with which firms receiving or holding clients' money must comply. These regulations apply in relation to all United Kingdom and Ireland offices of sole practitioners, partnerships, or a body corporate or a limited liability partnership, the business of whom or of which includes carrying on the profession of accountancy.

An overview of the basic ICAEW guidelines and accompanying definitions can be seen below:

- **Client bank accounts.**
  Clients' money must be paid into a client bank account. This must be set up properly with the word "client" in the title, and the bank must be informed in writing that:
  - All money in the account is held by the firm as clients' money and that there can be no right of set-off;
  - Interest payable must be paid into that account;
  - The bank must describe the account in its records to make it clear that the money does not belong to the firm.

  The bank must acknowledge in writing that it accepts these terms. The ICAEW's Quality Assurance Department (QAD) will expect the firm to have a copy of this "trust letter" in its files.
- **Reconciliations and reviews.**
  At least every five weeks, the firm must reconcile the balances belonging to its clients with the balance on the bank statements. The firm must also perform an annual review of its procedures for dealing with clients' money.
  - **Alternates.** When the firm is wholly-owned and/or wholly-controlled by a single member, then the firm should appoint an alternate, and a practical way to arrange for this is to make the alternate a signatory on the client's account. ICAEW should be informed of the identity of the alternate. For the purposes of the Client Money regulations (not to be confused with the general arrangements to manage the practice) the alternate can be a spouse and doesn't need to be another accountant.
  - **Designated accounts.** If the amount held for a client exceeds (or is expected to exceed) £10,000 for more than 30 days, a separate client bank account should be opened, designated by the name of that client or by a number or letters allocated to that client.
- **Deducting fees from clients' money.**
  Fees can only be withdrawn from money held on the client's account if the client has agreed the precise amount of the fee (or it is calculated in accordance with an agreed written formula), or 30 days has elapsed from the issue of a fee statement (without complaint from the client).

Beyond the UK: The Monetary Authority of Singapore

This guide has so far focused on UK regulation and regulatory authorities, as regards the management of Client Money. Outside of the UK, both regulation and best practice guidelines will vary according to the region. For example, Asia Pacific has two major financial hubs, Hong Kong and Singapore, both of which are steadily growing in importance (and vying with one another for supremacy). This section briefly outlines the current situation in Singapore.

The Monetary Authority of Singapore (MAS) is Singapore's de facto central bank and regulator of the financial sector. It was established by the Monetary Authority of Singapore Act of 1970 and began operation on 1 January 1971. The authority's main functions are: to govern the nation's monetary policy; act as the government's banking and financial agent; manage the foreign reserves; regulate, supervise and monitor Singapore's banking and finance sectors; and foster the growth of Singapore's financial industry." *[Source: HistorySG, National Library Board]*

Money management firms located in Singapore are required to set up client accounts with Singapore banks. These accounts are designated as "trust accounts", to distinguish them from other accounts held by the firm. The firm is required to deposit money received from clients in the trust accounts no later than the business day immediately following the day on which it is received, or the day on which the firm is notified of its receipt, whichever is later.

Client Money held in trust accounts is segregated from the firm's money. This ensures that in the event of default by the firm, clients' money will be returned to the clients rather than being treated as a recoverable asset by the firm's general creditors.

In the event that the firm goes into liquidation, clients with money held in trust accounts would have their share of the funds returned, minus the administrators' costs in handling and distributing these funds and amounts owed by the clients to the firm.

Banks are selected only following a full risk assessment, to ensure that they meet the requirements of the firm's own policy on banks holding Client Money. All selected banks are monitored on an on-going basis.

In the event that a Singapore-based bank defaults, Clients' Monies held in the trust account will be treated as a liability of the Singapore bank and dealt with in accordance with applicable Singapore laws and regulations.

The management of Client Money has been a major target for regulatory authorities.

Penalties for Non-Compliance

The management of Client Money has been a major target for regulatory authorities. Failure to comply with regulation has resulted in large fines, closure of financial services businesses, reputational damage and potential jail terms for board level members who are personally liable for compliance. The largest, along with the reasons for the penalties, include:

- **JP Morgan:**
  The group was fined a record £33m by the UK Financial Services Authority (FSA) - predecessor of the FCA - in June 2010 for JP Morgan Securities' failure to segregate Client Money from that held by JP Morgan Chase. The error was found to have remained undetected for seven years.
- **BlackRock:**
  The FSA fined BlackRock Investment Management more than £9.5m in September 2012 for inadequate protection of Client Money. The penalty was incurred "for not putting trust letters in place for certain money market deposits and for failing to take reasonable care to organise and control its affairs responsibly in relation to the identification and protection of Client Money."
- **Aberdeen:**
  Aberdeen Asset Managers and Aberdeen Fund Management were fined £9.5m by the FCA in September 2013 for failing to identify that Client Money it had placed in money market deposits with third-party banks over a three-year period was subject to Client Money rules.
- **Transact:**
  The parent company to Integrated Financial Arrangements was fined £3.5m by the FSA in December 2011. The FSA said that Transact had failed to perform daily Client Money calculations to confirm that the amounts in client bank accounts matched the firm's records. This meant that it was unable to identify or fund shortfalls in its Client Money bank accounts that may have resulted from buying or selling instructions at different times. Money belonging to one client was consequently used to cross fund other clients.

Technology

With investors' demand for faster and more granular information, greater transparency, and improved risk management have come advances in technology for banks, financial institutions and intermediaries across the board. However, regulatory demand has been the principal driver for application of technology to the management of Client Money.

The evolving regulatory landscape is putting the onus on firms to respond to regulatory change, and quickly. MiFID II, for example, will place even greater demands on technology used by financial services providers as it introduces significantly increased data and reporting requirements.

The failings exposed at MF Global stemmed principally from the fact that the firm was remitting money from a pooled client account. When placing money for a client, it simply withdrew the amount from the pool - regardless of whether that client's account was sufficiently funded. While the principle has been firmly established that firms should not 'rob Peter to pay Paul,' many firms still find it difficult to accurately differentiate between Peter's money and Paul's money.

Segregation of Client Money from firm money and into individual client bank accounts is often costly and time consuming. Bank accounts typically take weeks to be opened and downstream costs are passed indirectly onto the firm.

In the collection phase, reconciliation and allocation of Client Monies is dominated by manual, error-prone processes that frequently do not reference cash correctly and don't allow for operations to scale.

Bank diversification is a key message from regulators; however this introduces operational challenges for finance and treasury departments. It is often the case that managers in these departments have multiple tokens and smart cards for authentication into multiple bank systems. Inefficiency and source of error is also introduced by having bank account data held on multiple bank systems.

> What firms require is a technology platform that becomes the source of all account information across the enterprise and provides a real time granular approach to controlling the entire Client Money lifecycle.

What firms require is a technology platform that becomes the source of all account information across the enterprise and provides a real time granular approach to controlling the entire Client Money lifecycle. Likewise, a single interface for payments and a unified workflow mean that internal policies and mandates can be accommodated alongside bank authorisation requirements.

Firms can simplify their existing account infrastructure with virtualization technology that enables client bank accounts to be instantly created, so that payments and allocations can be managed immediately. Unlimited numbers of real and virtual bank accounts can be consolidated into a single view to simplify operational processes and reduce the reliance on manually intensive and spreadsheet-based processes, which are unreliable and at risk of errors.

Automatic matching and allocation functionality means that reconciliation becomes an exception based task, which has the dual benefits of a reduced resource requirement and focusing attention on problem entries that otherwise might slip through the net. From real time account opening, through to the identification and the physical segregation and protection of Client Money in client trust accounts, designated client bank accounts and trust accounts, the correct application of technology can provide unparalleled control.

It allows firms to track, control and segregate Client Money at all times during the normal business cycle, and the firm's cash is separated with continual external and internal reconciliation, which is demonstrated in a transparent way. For example, when the system identifies that a client's account contains insufficient funds to cover a trade, the firm is then given the opportunity to fund the trade itself. This is the type of technology that MF Global and others could - and should - have been using. When operating in a fast-moving trading environment, a firm needs to have a real-time system to debit and credit individual client accounts held in a pool.

By automating the process bank accounts can be reconciled daily while client accounts can be continuously reconciled and all cash movements are automatically allocated to accounts. This enables all Client Money calculations (including FCA CASS 5 and CASS 7 and the CMAR Client Money calculation) to be made in real time and in confidence.

At some firms, software implementation is often considered a source of the problem in supporting changing regulation due to the expensive internal and external costs to upgrading on-premise software and the fear of upsetting already functioning technology due to a lack of product knowledge. However, the implementation of cloud-based software can remove many of the traditional software implementation barriers that firms face while accelerating integration with both bank and client side systems. It also removes the requirement for firms to commission their own infrastructure and eliminates the need for individual client configuration. Patches can be approved and added to a platform quickly by system experts with virtually zero risk to business continuity.

Firms that fail to take advantage of technology risk discovering too late that any inability to comply with regulation will result in large fines, closure of financial services businesses, reputational damage and potential jail terms for board level members who are personally liable for compliance.

With better insight into the physical task of segregating Client Money, including flexible matching and allocation for speedy resolution of unexpected cash and prevention of overdrawn client accounts, firms can mitigate the risk of non-compliance and future-proof themselves against further changes to the regulatory landscape.

Protecting Client Money: The Checklist

1. **Client money must be promptly segregated and held in a separate bank account from firm's money.** The designation (naming of the account) at the bank must make it clear that the account contains client money. The bank must not be put in a position where it might consider the money in the account as available to offset money owed to the bank.
2. **Designated client bank accounts, that is bank accounts holding the money of just one client, must be titled so it is clear to the bank whose money (which client) the account holds.** Failure to designate properly will most likely lead to the balance in such an account being pooled with the balances on pooled client money bank accounts. Dependent on sector and client / trust agreement the firm may be obliged to open separate designated bank account.
3. **The firm must maintain complete and accurate records for each client's money.** The timeliness of the maintenance of these records is the earlier of (1) the maximum delay set by the regulator (or self-regulatory organization) and (2) what is reasonable for the proper control of client money in the circumstances of the business. Clearly there is a difference between managing client money in a law firm and managing client money in active accounts at a stock-broking firm.
4. **The firm must reconcile client money.** This reconciliation must be external to bank, and internal to ensure that all externally reconciled money is properly allocated to the client accounts. The frequency and timing (delay) of these reconciliations is determined as a long stop by the regulator or self-regulatory organization, but the timeliness of reconciliation must be appropriate for the circumstances.
5. **A client money position may not be overdrawn** (Note that non statutory trust accounts in the Lloyds insurance market are for present treated differently). Clearly, if one client account in a pool is overdrawn then the other clients are unknowingly lending that client money. Quite likely the directors of the business would be personally liable for losses incurred by a client as a result of an overdrawn client position. The firm may be able to lend the client money in which case the firm must promptly credit the pooled client account with its own funds (which must be separately accounted) to fund the client.
6. **Dependent on sector / industry, the firm may need to provide regular client account statements to the clients.**
7. **The firm must ensure that there is an appropriate system of controls over the administration of client money.** These include segregation of function and controls (including KYC) over the opening of accounts, over payments into and withdrawals from client accounts, over low activity / dormant accounts and over internal transfers between accounts for different clients. The techniques of authorisation will depend on circumstances.
8. **Dependent on sector / industry or client agreement, interest may require to be paid in respect of the balance on the client account either to the credit of the client account or to an industry body.**
9. **Dependent on sector / industry and the value of client balances, the firm may be required to spread client money over multiple banks and / or deposit money at banks of a minimum credit rating**
10. **For financial services groups there may be limits on the percentage of client money that can be placed with an in-house bank**
11. **Fees can only be deducted from clients' money if the client has agreed the amount of the fee or it is calculated in accordance with an agreed formula or according to regulation** (for example with 30 days' notice).
12. **Adhere to client notification requirements when funds are received and before funds are withdrawn for fees**
13. **Know who is responsible for the operational oversight function to ensure accountability and communication throughout the firm.**
14. **Comply with KYC and money laundering regulations.**
15. **Perform a self-audit of client accounting.** Annual reviews of procedures for dealing with clients' money are recommended.

About AFP®

Headquartered outside Washington, D.C., the Association for Financial Professionals (AFP) is the professional society that represents finance executives globally. AFP established and administers the Certified Treasury Professional™ and Certified Corporate FP&A Professional™ credentials, which set standards of excellence in finance. The quarterly AFP Corporate Cash Indicators® serve as a bellwether of economic growth. The AFP Annual Conference is the largest networking event for corporate finance professionals in the world.

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