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New rules have come into effect which impact all firms authorised to hold client assets (CASS). Implementation of these rules is staggered over the course of a year, but the whole CASS sourcebook has been re-written and there are some fundamental changes which this newsletter summarises.

We have focussed on some key changes, but a full reading of the CASS Sourcebook and the Policy Statement 14/9 issued by the FCA is essential to fully understand the changes.

The three key dates are 1 July 2014, 1 December 2014 and 1 June 2015. Different rules come into effect at these various points and full details are within PS 14/9.

Issues affecting Fund Managers

DvP Window – 1 June 2015

Authorised Corporate Directors and Alternative Investment Fund Managers (for the purpose of this collectively referred to as AFMs) are currently able to take advantage of a Delivery vs Payment (DvP) window when dealing with clients buying into, and leaving Collective Investment Schemes (CIS).

Clarity has been given on when the DvP window starts and stops, and the biggest change is this has been reduced from three days to one. The staging date for this change is 1 June 2015, so AFMs need to enter into discussions with their depository/trustee to ensure everything is in place for this change.

The DvP window starts on the date the client fulfils their delivery obligation to the firm (for example, the settling of a cash transfer). It then closes at the earlier of the date the transaction settles, and the end of the following business day.

If a firm receives money that would be client money were it not for the DVP window, if it has not passed that money onto a trustee/depository by the following day then it must be treated as client money within the CASS rules. This would mean transferring it immediately to a client money bank account.

Note – this applies to business days so does not include weekends. Therefore money could be received on Friday as long as it is transferred by Monday. See section 7.43 of PSD14/9.

In the case of a redemption which has been instructed at point T, the AFM will receive funds from the trustee/depository on T+4. The firm must have transferred money over to the client by T+5 to be within the DvP window.

The AFM does not need to protect monies not yet received from the trustee/depository in the case of redemption (i.e. within the T+4 time period). Once money has been received however, it needs passing on within one business day. See section 7.46 in PS14/9 for guidance.

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How the CASS rules operate when the AFM is trading as 'principal' are clarified in section 7.47 of PS14/9. We understand this applies when an AFM is using a 'manager's box'. For the purposes of an issue of units/shares in a CIS, the client obligation is considered to have been fulfilled once they have legal entitlement to the units/shares. This may be on the date of the transfer (i.e. money received before the pricing of the fund for that day has occurred), or it could be the following day. At this point they have an asset in return for their client money. The time between receiving the money and the legal entitlement to the units/shares is the DvP window, and the same one day rule applies.

We emphasise a full reading of this section is advised should the firm be subject to this.

A new controlled function has been created called CF10A – CASS Operational Oversight Function. This is a function which a firm needs to appoint if it is a 'medium or large' firm. If at any point during the year the firm has held more than £1m in client money it is classified as medium. Fund managers may inadvertently find themselves subject to this in the event of a large transaction which is unable to be processed within the DvP window.

Client Communication and Agreement – 1 December 2014 and 1 June 2015

Firms will also have to obtain written consent from their clients that they agree that the DvP window can be used for client assets. The firm must explain to its client what a DvP window is and how it operates. This could be included within the standard Terms and Conditions (T&Cs).

New clients must agree to the above from 1 December 2014 while firms have until 1 June 2015 to obtain written consent from existing clients.

Realistically firms may struggle to get signed acknowledgement back from all their clients on the revised T&Cs firms need to think about how this will be done.

If the previous T&Cs included wording which says they can be amended with 14 days notice for example, then it may be enough to send the new ones to all clients and if anyone challenges it then it is considered that they don't agree.

A record needs to be kept of which version of T&Cs each client has seen and therefore agreed to.

Issues affecting all CASS firms

Client Bank Accounts and Acknowledgement Letters – 1 December 2014

The biggest change in this area is that all banks which client money is held at will need to sign an 'acknowledgement letter' sent by the firm. This needs to be in place by 1 December 2014.

Even if the firm had Trust Letters already in place, a new one is needed for each bank and they are now called 'acknowledgement letters'.

This also applies to third party administrators who may be holding client money on the firm's behalf. The FCA allows no deviation from the templates, and they need to be on headed paper of the firm. They can be found as an appendix to PS14/9 and also as a link through the handbook in CASS 11 Annex 1.

Although new templates are not needed annually, a firm must annually review all its letters to make sure that they are up to date.

One challenge is that it is the responsibility of the firm to ensure that the person signing the letter is authorised to do so. Even the FCA recognise that this could be tricky as you probably will not get a list of authorised signatures from the bank. The FCA suggest that a possible solution would be to get a bank stamp or seal with the letter.

Banks will be receiving a lot of requests for these, so they will hopefully be used to supplying this, but ensure that you request evidence of the authority of the signatory.

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The second most significant task in this area is to undertake and document 'due diligence' on the bank with which client money is held. Due diligence must be documented and held for five years, while being subject to a periodic review. There is no specific frequency of a 'periodic review' but as with everything the firm must justify its approach. Factors to include within due diligence should include 'credit worthiness'.

Clarifications have been made on when firms are and are not required to pay clients in the interest earned on client money. Firms will also need to communicate whether interest will be paid on client money and the frequency if applicable.

Diversification of client bank accounts needs to be considered (i.e. money is split over multiple banks). Diversification and due diligence comes into effect on 1 June 2015.

Client Money Reconciliations – 1 December 2014

The largest change in this area is the introduction of daily internal client account reconciliations (whereas previously they needed to be frequent, but could be based on the level of activity in the firm).

There is now an obligation that within two days of a request from a client or the FCA, the firm must be able to establish the position of client money/assets for that particular client. This means internal reconciliations need doing daily.

External reconciliations need doing at least monthly. An external reconciliation would be for example if client money is deposited with a third party. However, the monthly frequency is a minimum, and the FCA have said that if a firm has daily transactions then a daily external reconciliation should be done. A review of the frequency needs to be done at least annually and documented. See Section 7.259 of PS14/9.

Clarifications have been made over how firms should treat client money receipts in the form of cash and cheques, and how these should be reflected in the internal client money reconciliation. Client money reconciliations have new steps which firms are expected to follow.

Should a non-standard method of client money reconciliation be needed, auditor approval must be obtained and an audit report opining on the method prepared.

Firms are not allowed to place client money in a deposit with unbreakable term of more than 30 days. This point has been in force since 1 July 2014.

CASS Breaches – 1 July 2014

It is down to the individual firm to set a level of materiality for which it reports breaches to the FCA. It is advisable that this level is agreed with the auditors to avoid differences of opinion as to what constitutes 'material'.

Materiality could be based on a number of factors depending on the activities and size of the firm. This could include monetary size of the breach, length of breach and type, amongst other things.

Mandates – 1 July 2015

This is an agreement which allows the firm to hold and control client money.

Unwritten mandates are where a client for example calls the firm to make a transaction. The firm needs to ensure that the client has agreed to the terms and conditions and this is recorded somewhere. The firm will need to decide where the recording is made (i.e. is it the actual phone record, or is it a note on the system that the client says they agree). There needs to be a list and process to ensure all are captured and can be retrieved.

Unclaimed Client Monies

Clarification of amounts which can be given to charity after attempts made to return money to investor. This may

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contradict previous T&Cs though so be careful.

The rules have been clarified around this and now say that if there is a prior written agreement with the client to pay unclaimed monies to charity then this can be done. A firm should first make reasonable steps to contact the client and document this.

If the contact details are believed to be correct, three attempts must be made to contact the client to gain permission to pay away unclaimed funds (or return them). Any media can be used, but the final attempt should be in writing (either post or email). There must be 28 days between each attempt. Multiple attempts are not required if the firm establishes that the contact details are incorrect and has no other way of contacting the client.

Should unclaimed money be paid, the firm is still liable should the client have a valid claim on those monies.

Immediate Segregation – 1 June 2015

For firms, where the intention is for client money to end up in a client account but go through the office account first, new 'immediate segregation' rules apply. So where money is client money it should not go through the office account first but be paid straight into the client money account.

While this will undoubtedly result in lots of breaches initially, the FCA think that over time as payment instructions are circulated, clients will become accustomed to paying money straight into the CBA. For monies which are paid into the office account first, firms must have transferred relevant client amounts into a client money account by the end of the following business day.

Cash or cheques received should be paid into a client bank account no later than one business day after receipt. If this is not possible, due to Money Laundering Regulations and Know Your Client checks, then it must be done 'as soon as possible'.

Client communication – 1 June 2015

A client should be provided with a statement of their client money within one week of requesting it. Costs associated with preparing this can be passed on however they must reflect the actual cost to the firm. This must be done in a 'durable medium' which can include email and certain types of website. Firms have until 1 June 2015 to have this in place.

The policy statement also makes reference to the existing obligations within COBS 16.4 and 16.3 to provide reports to clients on their holdings of client assets. These are required at least annually, or between monthly and six-monthly depending on the type of client. Note that these rules are already in place, and may be something the FCA take a closer interest in from now on.

Specific advice should be obtained before taking action, or refraining from taking action, in relation to the above.

London

10 Orange Street
Haymarket
London
WC2H 7DQ

T +44 (0)20 7312 0000

F +44 (0)20 7312 0022

E advice@shipleys.com

Godalming

3 Godalming Business Centre
Woolsack Way
Godalming
Surrey
GU7 1XW

T +44 (0)1483 423607

F +44 (0)1483 426079

E godalming@shipleys.com

www.shipleys.com



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