



Insurance intermediary client money rules

22 October 2012

In late August the FSA released a consultation paper (CP 12/20) (**CP**) proposing amendments to its handbook rules on client money handling by insurance intermediaries (**CASS 5**). CASS 5 currently allows brokers to handle such monies (ie premium, premium refunds and claims payments) in three ways, as follows:

- “risk transfer” where the broker acts as agent of the insurer (meaning that claims/premium refund monies received by the broker from the insurer are not treated as received by the insured until actually paid, and premium monies received by the broker from the insured are treated as received by the insurer).
- “statutory trust” (**ST**) where the broker acts as trustee (for the benefit of the insured) in relation to the monies. In this case, CASS 5 restricts the broker’s ability to lend or advance credit from those monies.
- “non-statutory trust” (**NST**) where again the broker acts as trustee but where CASS 5 allows the broker and insured to agree that the broker may lend/advance monies. This arises in a number of situations, both voluntarily (eg by payment of a premium to an insurer without yet having received it from the insured) or involuntarily (eg where a third party broker deducts claims monies from payments to a broker before

the broker has itself received the relevant monies from the insurer). A broker will typically adopt a bordereau accounting method under this approach.

The CP preserves these three approaches, but introduces a range of amendments, impacting mostly on ST and NSTs. The main proposals may be summarised as follows:

Statutory and non-statutory trusts

Broker failure

In the case of failure of a broker – referred to as a “primary pooling event” – the FSA wishes to allow the liquidator/administrator/receiver increased flexibility in how it deals with client monies held in an ST or NST. Rather than merely pooling monies and returning it rateably to clients (as currently provided for), the liquidator/administrator/receiver would have an option to use reasonable endeavours to complete open transactions. A further alternative would be to allow him/her within a set period of three months to sell the entire undertaking together with all associated client money.

The FSA also wants to introduce requirements for a “resolution pack” that would allow a quick understanding of a broker’s ST and NST arrangements. This would include a master

Any comments or queries

Richard Burger Partner

richard.burger@rpc.co.uk
D +44 (0)20 3060 6429

George Belcher Senior Associate

george.belcher@rpc.co.uk
D +44 (0)20 3060 6552

document, details of all institutions where money is held, a list of all representatives or agents used in the collection of client money, details of the manager or director who is responsible for client money (see below), and all the latest client money calculations, reconciliations and trust deeds. This follows a requirement for client money resolution packs that was introduced earlier this year for investment firms.

Transfer of business

The FSA proposes to facilitate the sale or transfer of broking businesses by allowing brokers to obtain pre-consent from insureds to include client monies in such a transfer. This pre-consent can be obtained in the relevant terms of business agreement.

How client monies are held

The FSA wants to diversify the locations in which client money is held, and to encourage brokers to use an appropriate range of different banks to avoid or mitigate the risk of the impact of bank failure. What is appropriate is not specified, but in the particular case of a bank that is in the same group as the broker, deposits should be limited to 20% of total client money.

The FSA also proposes (in the case of NSTs) to remove the ability of a broker to invest client monies in “designated investments” (eg stocks/shares). Instead, brokers would be required to hold monies either in cash or money market funds.

Orphan funds

The FSA would like brokers to tidy up their client accounts by dealing with unattributable “orphan” funds that have accrued since January 2005 (when CASS came into force). This would allow the firm a period of 13 months in which to undertake proper investigation and to deal with such monies as follows. If the correct payee can be identified then the monies should be paid to it (or if the

payee refuses, to a charity). If not, the monies may be claimed by the broker itself. After this 13 month period, the FSA proposes that unattributable funds must be paid to a charity. In all cases of payment to charity or the broker itself, the broker must give an irrevocable undertaking to repay the funds if the correct payee subsequently emerges.

New responsibility for CASS Approved Person

The FSA also propose that all CASS brokers nominate an existing Approved Person as the person responsible for issues. This would not be a new controlled function – rather it would be additional to the responsibilities of an existing Approved Person (and in addition to the manager required in the case of an NST).

This is likely to be an unpopular role. Why for instance would an existing Approved Person agree to accept a role the scope and consequences of which are as yet undefined? What, for instance, would failure of this role mean for his/her status as Approved Person, or indeed personal liability? Further detail is required here, and it would seem to merit consideration at least of a new approved client money function with its precise parameters and responsibilities (as with certain investment firms).

Other key proposals

In the case of chains of brokers, the FSA has proposed requiring firms that accept money as third party brokers to send monthly statements to the originating broker detailing the monies held, when it is to be paid, and to whom.

Where the broker uses the “accruals” accounting method, the FSA has proposed that record-keeping requirements should be enhanced by requiring the broker every year to reconcile the account to the level of individual client balances so that at least 95% of client money is reconciled.

Non-statutory trusts

The FSA has concerns about the potential for monies to be advanced from NSTs in an uncontrolled or undocumented manner. Whilst recognising the need for flexibility, it wants to tighten this up. It proposes that brokers calculate the balance of an NST at least once every seven business days (or 14 business days where the balance is under £250,000), and conduct a reconciliation of balances to bank records within at least two business days after that. It is also proposing maximum periods for the extension of credit (45 days for credit to insureds and 90 days for credit to insurers) and an obligation to “top-up” for advances or credits that have not been repaid within these periods. Similar calculations and reconciliations would be required in advance of the withdrawal of commission.

These proposals will require extra administration costs by brokers. Furthermore, brokers will need to establish that the banks with which they deal are able to produce the necessary information within the timetables required

Risk transfer

The FSA wishes to prohibit risk transfer agreements between insurers and brokers that are conditional. These are agreements that make the appointment of the broker conditional on certain events – eg minimum payment periods. Brokers will no doubt wish to review the terms of their existing TOBAs to check for any provisions of this sort.

Timetable for comments

The FSA has extended the period for comments until 30 November 2012, and hopes to be in a position to publish the new rules by the second quarter of 2013. It is considering delaying commencement of the rules for 12 months from publication save for the provisions for orphan funds described above which would come into force immediately. This would allow historic pre-2005 balances to be cleared in advance of the rest of the rules coming into force.

Conclusion

The FSA has for some time focussed on client money in the investment world, and has clearly been spooked by the client money issues experienced on the collapse of Lehmans. It is now turning its attention to the insurance broking world – with perhaps the sheer number of brokers (as well as in many cases their small size) adding weight to this – and we can expect FSA enforcement activity to follow. Brokers should look to the enforcement activity in the investment world – most recently in relation to Blackrock (which recently incurred a fine of £9.5m for CASS breaches) – to get a feel for the kind of crackdown they can expect.

It is also interesting that the CP dwells on the possibility of broker failure, which may indicate that the FSA is actively planning for more of this in the industry. Consistent with its moves away from a “no-risk” environment, it is planning to mitigate the impact of failure on client money rather than avoid failure altogether.

The FSA is simultaneously consulting on amendments to CASS 6 and 7 (applicable to investment firms) – see CP 12/22. Separately, the FSA is undertaking a more fundamental review of its entire client money regime and has reserved its position in several areas, on which it plans to consult in 2013. This exercise is likely to reflect aspects of the Supreme Court’s judgment in relation to Lehmans earlier this year and may also have an impact on CASS 5.

In the meantime, brokers are encouraged to undertake a thorough review of their existing arrangements in anticipation of these rules. As an added incentive, they may be pleasantly surprised to identify monies that cannot be found a home, which they may (after proper investigation and within a limited period) be able to claim for themselves.