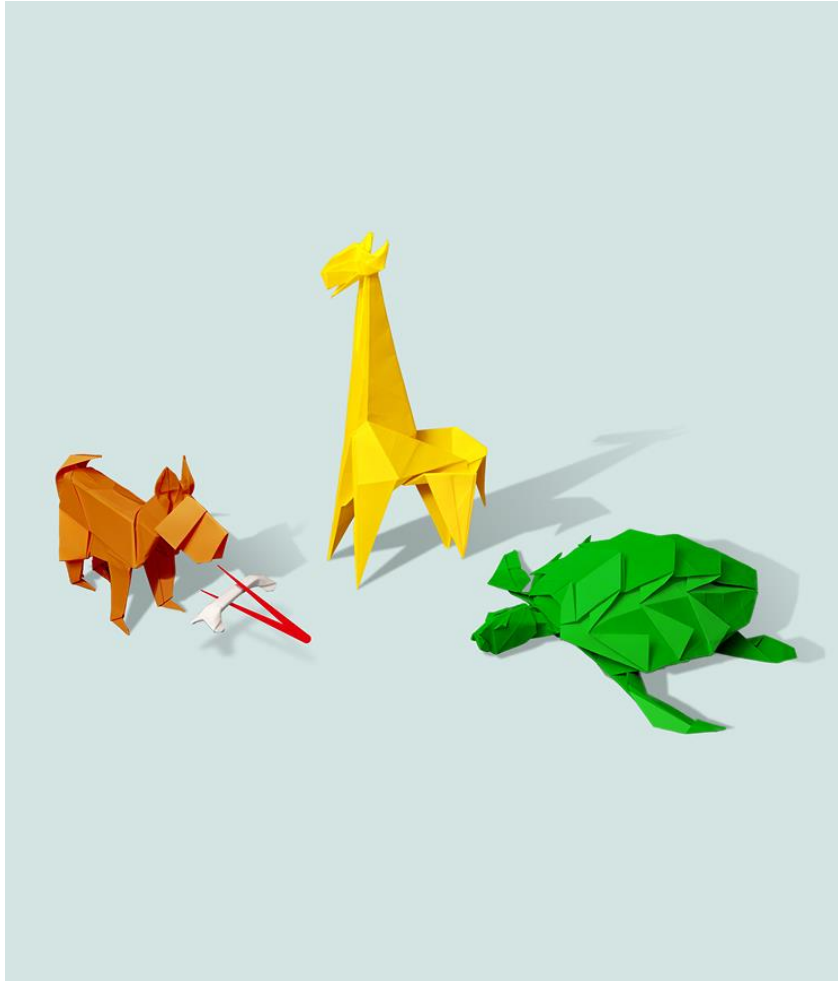




# *CASS Audits 2021*

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# ***Presenters***



**Rob Anderson**  
Stakeholder Assurance  
Team  
**PwC**



**Shermeen Kazmi**  
Director, Financial Services  
Audit  
**Grant Thornton**



**John Mongelard**  
Risk & Regulation  
**ICAEW Financial  
Services**



**Mduduzi Mswabuki**  
Partner, Financial  
Services  
**EY**



**Sam Worsley**  
Client Assets and Client  
Money SME  
**KPMG**



# ***CASS and Regulatory Landscape***

1 MARCH 2021

MDUDUZI MSWABUKI

EY

# ***The importance of CASS – overview***

- In simple terms, '**client assets**' include both financial instruments held for clients, such as shares, bonds, or fund units (**custody assets**) and money held for clients in connection with investment business (**client money**)
- The Financial Conduct Authority (FCA) maintains the Handbook, including the **Client Assets Sourcebook (CASS)**, which sets out rules for **protecting client assets**

**The protection of client assets is central to confidence in markets and to consumers' rights and the trust they place with firms.**

**The FCA aim to do this by:**

- Intensive supervision of firms holding client money and custody assets. When appropriate enforced with directed regulatory intervention and disciplinary action
- Continued review of the client assets regulations for investment business
- Publishing of new rules to strengthen existing protection to clients

## **FCA Principle 10**

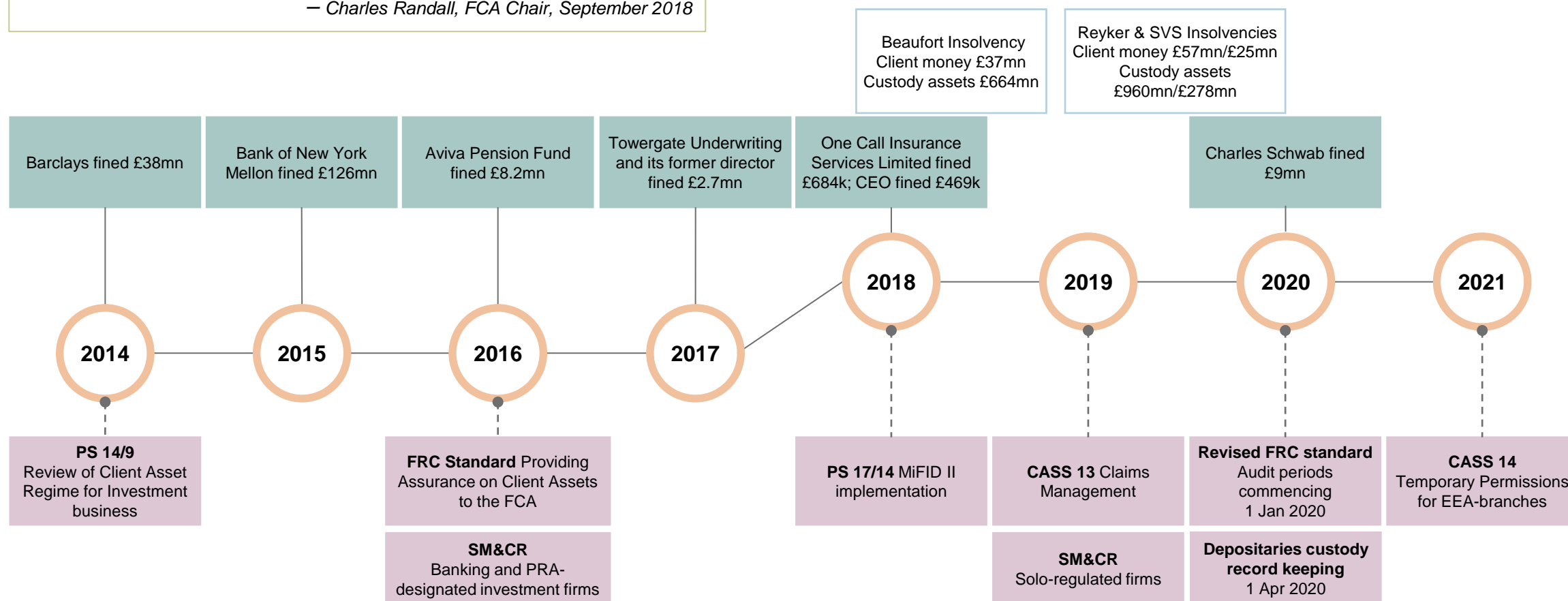
- A firm must arrange adequate protection for clients' assets when it is responsible for them
- This requires firms to hold client assets separately from the firm's own assets. This minimises the risk of loss to clients if the firm becomes insolvent
- An essential part of protection is the proper accounting and treatment of client assets



# The importance of CASS – timeline

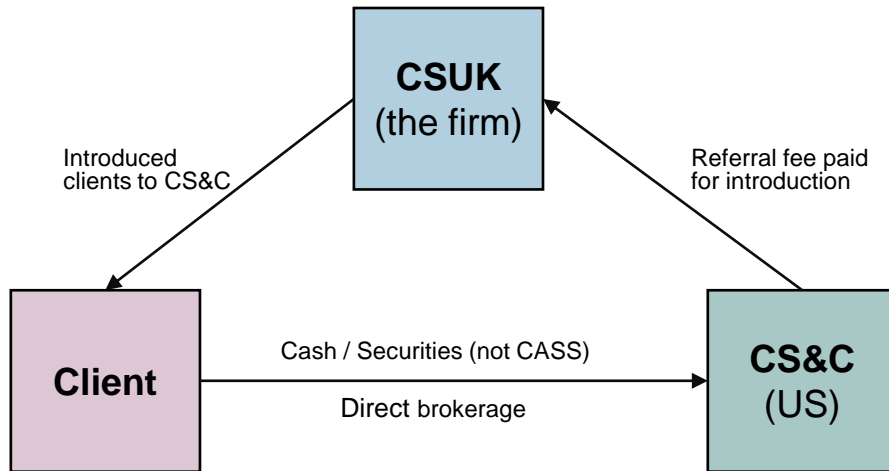
***“We have a very low tolerance for CASS failings, because of the significant customer detriment these can cause, and we expect auditors to identify CASS failings when they report to us.”***

*— Charles Randall, FCA Chair, September 2018*

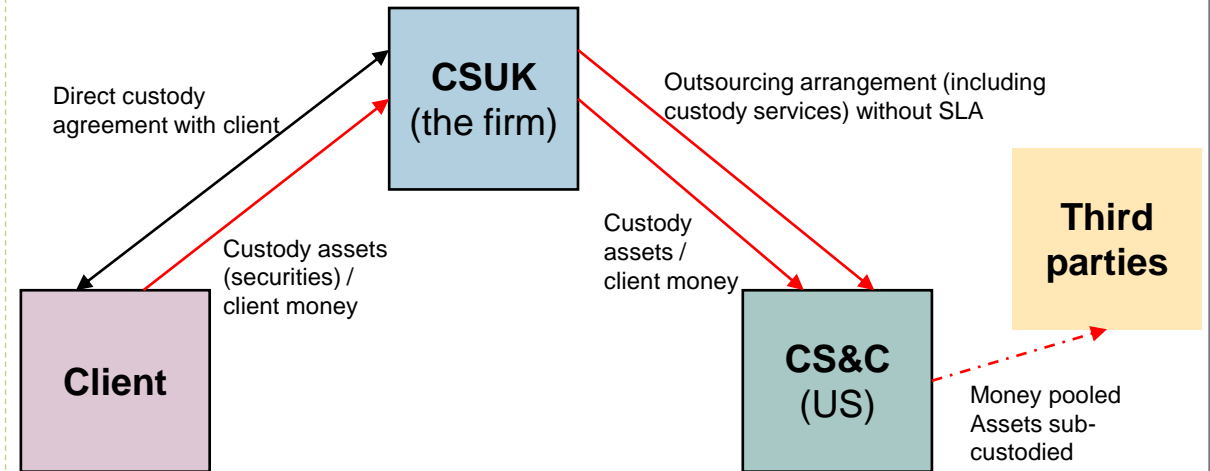


# Charles Schwab FCA fine and breaches

Model pre-2017



Model post-2017



## Breaches and findings

### Breach 1a: Organisational arrangements (CASS 6.2.2.R, 7.12.2R)

The firm failed to:

- Ensure that client money was segregated at all times
- Have a committee that dealt specifically with CASS issues
- Have suitable monitoring and oversight of its outsourced activities
- Prepare a CASS risk assessment
- Have a CASS resolution pack (CASS 10.1.3R)

### Breach 1b: Records and reconciliations (CASS 6.6.2R, 6.6.34R, 7.15.12R, 7.15.20R)

CSUK's books and records were one and the same as CS&C's and so the firm failed to:

- Maintain its own custody assets books and records
- Distinguish between firm and client holdings and between individual client holdings
- Conduct reconciliations for client money and custody assets held by CS&C

**Breach 2:** CSUK undertook safeguarding and administration of assets without permission (FSMA s.20)

**Breach 3:** CSUK made a false statement to the FCA that auditors had confirmed adequate systems and controls for CASS (Principle 11)

# FCA communications: Dear CEO Letters

Issue and date	Addressed to	Regulator Concerns	Actions for firms
<p>Inappropriate use of title transfer collateral agreements (TTCAs)</p> <p>24 July 2020</p>	<p>Brokers in wholesale financial markets holding clients' cash or securities as collateral (or which may do so in future)</p>	<p>Inappropriate use of TTCAs ('excess collateral'), in particular:</p> <ul style="list-style-type: none"> <li>▶ Holding collateral without considering client obligations,</li> <li>▶ Holding inappropriate amounts of collateral when compared with client obligations</li> <li>▶ Increased movement of collateral from segregation to TTCA without considering connection with client obligation.</li> <li>▶ No arrangements to promptly return or segregate collateral</li> </ul>	<ul style="list-style-type: none"> <li>▶ Review use of TTCAs</li> <li>▶ Confirm to FCA they have considered all issues and notify of any breaches</li> </ul>
<p>Increased client money balances</p> <p>12 August 2020</p>	<p>Non-discretionary investment managers (excludes tax wrappers and margined collateral)</p>	<p>Increase in client money balances in the first half of 2020. FCA will continue to review CMARs and follow up with firms that report significantly increased balances.</p>	<ul style="list-style-type: none"> <li>▶ Consider need to hold client money which is unlikely to be reinvested, and client's best interests (better with a bank?)</li> <li>▶ Communicate with clients with high balances (further investment planned?)</li> <li>▶ Return money unlikely to be reinvested in the short term</li> </ul>
<p>Adequacy of client assets arrangements</p> <p>30 September 2020</p>	<p>All firms holding client assets through investment business, debt management or claims management</p>	<p><i>"The impact of Covid-19 is being felt widely and is affecting all the entities we regulate in ways that may not have been predicted"</i></p> <p>Maintaining adequate arrangements that safeguard client assets is "imperative". FCA will continue to assess these arrangements and review audit reports.</p> <p>Areas for attention:</p> <ul style="list-style-type: none"> <li>▶ Governance and oversight</li> <li>▶ Oversight of third parties, including due diligence</li> <li>▶ Adequate records and reconciliations</li> <li>▶ Acknowledgement letters for all client money accounts (when holding client money)</li> <li>▶ Accurate and up to date CASS Resolution Pack</li> </ul>	<ul style="list-style-type: none"> <li>▶ Review attention areas; be prepared to explain response to regulator;</li> <li>▶ Senior management to have appropriate oversight (discuss letter with Board)</li> </ul> <p>Additional considerations:</p> <ul style="list-style-type: none"> <li>▶ Ensure client assets will not be subject to increased risk from end of Brexit transition</li> <li>▶ Ensure no excess client money held in third party transaction accounts.</li> </ul>



# ***FCA communications: CASS compliance issues resulting from COVID-19***

Handling cheques	Physical asset reconciliations	Depositing client money	Notification to FCA	Delays to process improvements	CASS audit reports
<ul style="list-style-type: none"><li>• Cheques delivered to unmanned offices and remaining unbanked,</li><li>• Consider potential harm caused by not being able to cash the cheque on a case-by-case basis</li><li>• To meet 1-day banking requirement, firms advised to:<ul style="list-style-type: none"><li>• Pay own money into client bank account</li><li>• Look to receive money by electronic transfer</li><li>• Return or destroy duplicate cheque payments</li></ul></li></ul>	<ul style="list-style-type: none"><li>• Take any mitigating steps possible</li><li>• Notify the FCA if unable to conduct a reconciliation</li></ul>	<ul style="list-style-type: none"><li>• Increase in client money holdings leading to challenges in meeting segregation and diversification requirement</li><li>• Assess all options available before contacting the FCA</li></ul>	<ul style="list-style-type: none"><li>• Continue to notify FCA of CASS breaches under Principle 11 and SUP 15 (CASS 6.6.57R and CASS 7.15.33R)</li><li>• No need to notify FCA of categorisation outside the usual January reporting window</li></ul>	<ul style="list-style-type: none"><li>• Consider informing FCA of delays to CASS compliance improvement programmes</li></ul>	<ul style="list-style-type: none"><li>• The FCA does not expect significant additional audit costs</li><li>• Multiple occurrences of the same breach can be grouped in the audit report</li></ul>



# ***Governance and IT***

1 MARCH 2021

SAM WORSLEY

KPMG

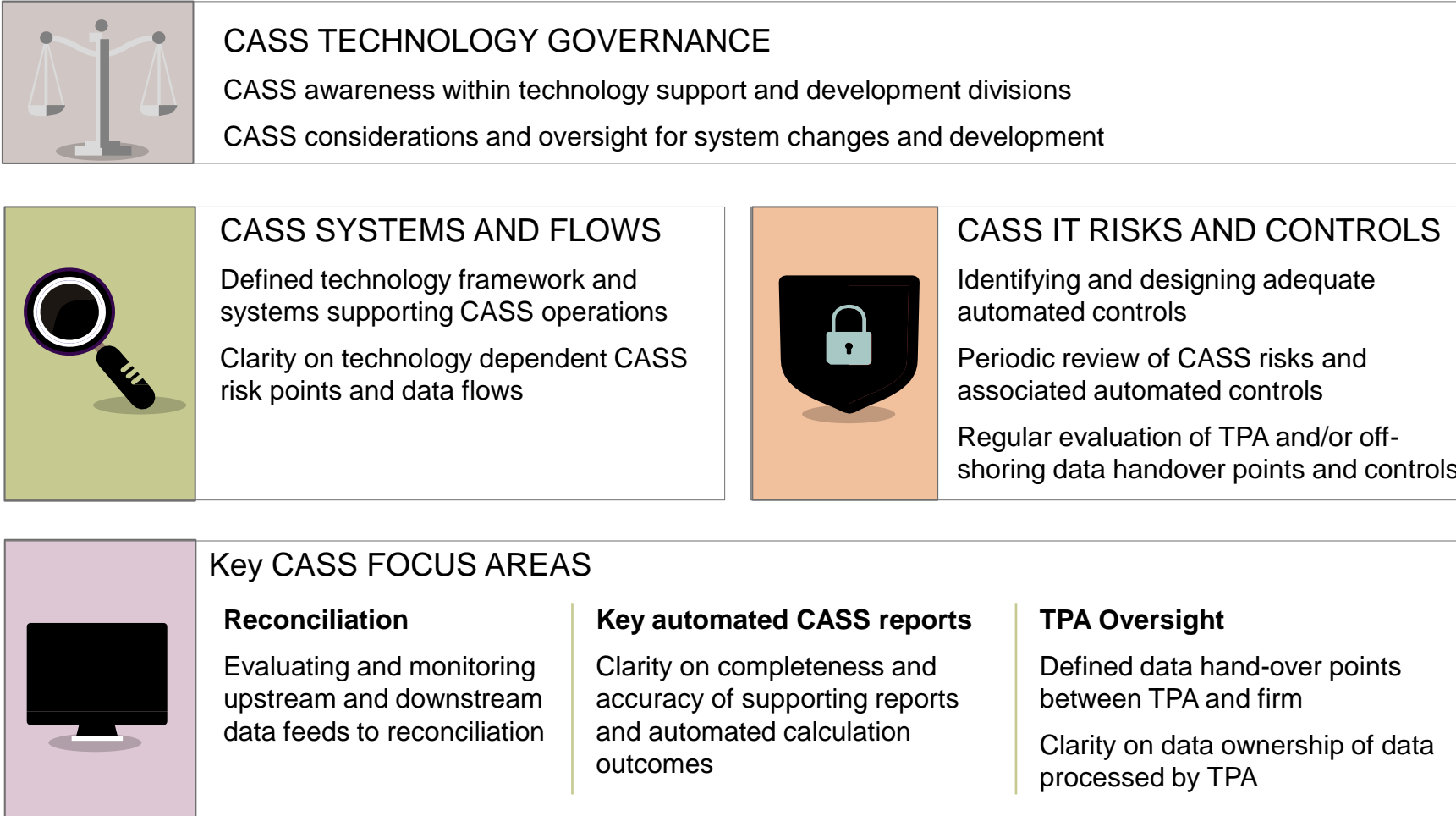
# Common CASS Governance Issues



## *Governance*

EMBEDDED RISK FRAMEWORK	CASS TRAINING	TPA's OUTSOURCE PROVIDERS
<p>CASS controls document only updated in time for audits</p> <p>Frameworks are continuing to evolve</p> <p>Firms are looking to develop more robust repositories of the information, improved attestations and monitoring programmes</p>	<p>Staff not adequately trained on CASS risks and compliance issues</p> <p>Issues around completeness of coverage</p>	<p>Lack of visibility and oversight over the processes and controls to facilitate CASS compliance</p> <p>Governance forums need strengthening</p> <p>Insufficient awareness of CASS processes</p>

# *CASS IT focus areas*



# *Common CASS IT issues*



Utilising external reconciliation outputs to perform internal reconciliation



Inconsistent and insufficient change control prior to system releases/updates



Misinterpretation of ISEM requirements



Key CASS reconciliation and MI reports not complete and accurate



Data feeds between key systems and data transfer batch jobs not complete and accurate



IT controls not tailored to identify and flag CASS failures



Key CASS instructions are not retained in line with data retention requirements



Information provided by TPA is not complete and accurate



Inadequate design of control environment over the overall IT



# ***Client Asset Reconciliations***

1 MARCH 2021

ROB ANDERSON, PWC & SHERMEEN KAZMI, GRANT THORNTON



# **CASS 6**

## **RECONCILIATION**

***Rob Anderson***

***PwC***

# CASS 6 reconciliations

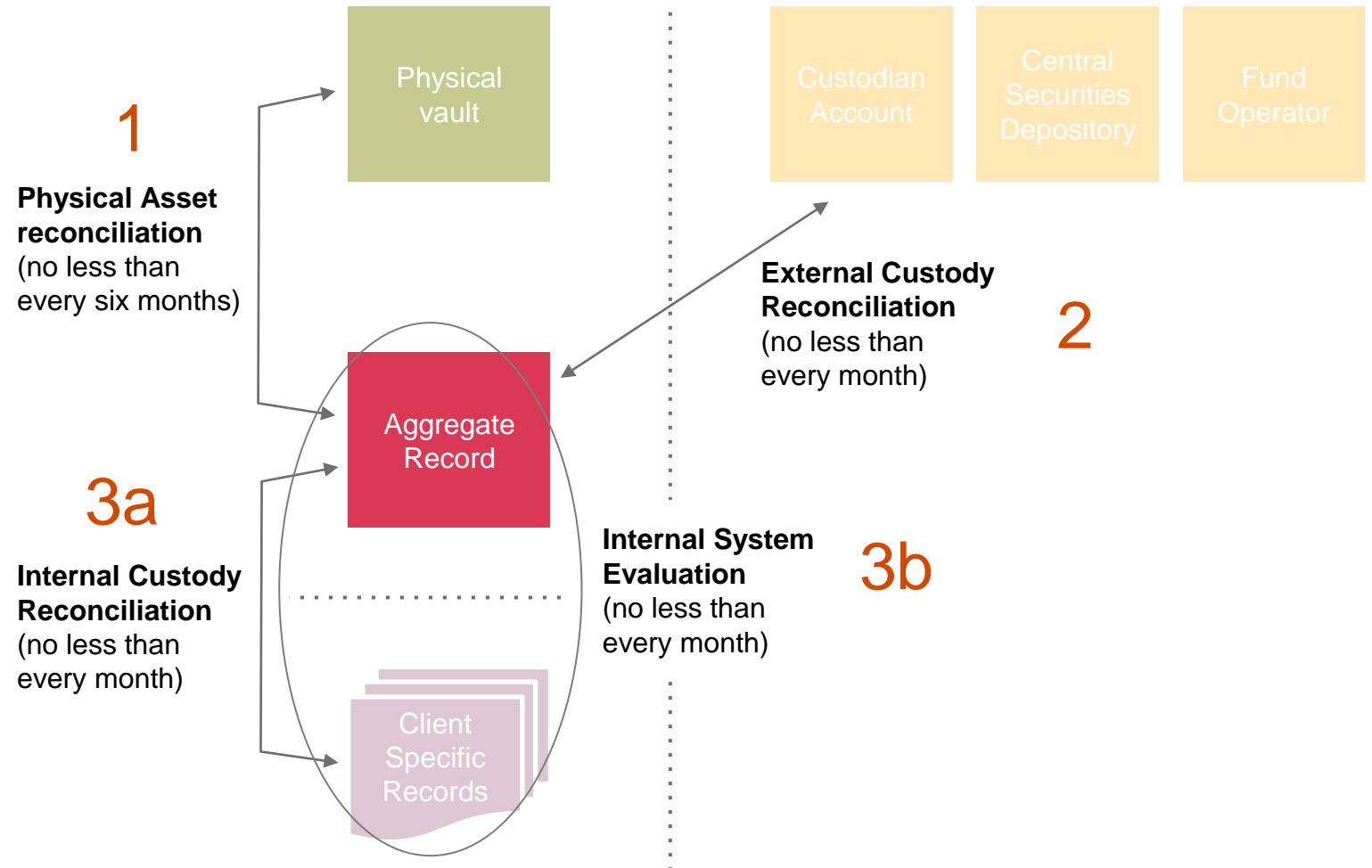
## Types of custody reconciliations

**Objective:** To ensure that the firm's books and records correspond to the assets actually held.

1. Physical asset reconciliation
2. External custody reconciliations

**Objective:** To ensure that custody asset records are complete and accurate at a client level

3. Internal custody record checks





# CASS 6 – *Internal custody reconciliation*

- In order use this method (as opposed to the ISEM) a firm needs to have two '**separately maintained**' and '**comparable**' records
- Must be the comparison of positions not transactions
- It must be theoretically possible to have discrepancies so what types of discrepancies can arise and what should we do with them?

IT/processing/  
journal errors

1

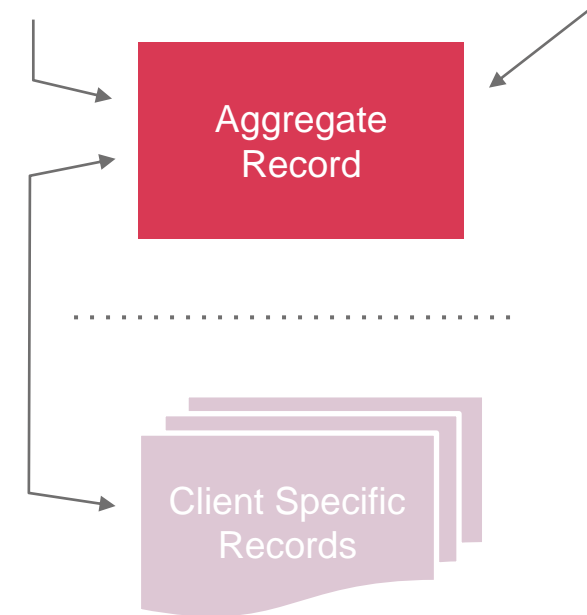
Timing  
differences

2

Erroneous  
entries

3

**Internal Custody  
Reconciliation**  
(no less than  
every month)



# CASS 6 reconciliations – ISEM

- Not actually a reconciliation – although can include looking at an internal reconciliation that does not have two distinct sources.
- As the name suggests, it involved an ‘evaluation’ and includes three key steps:
  1. **Establish a process** that evaluates the completeness and accuracy of the firm's custody asset internal records
  2. **Run the evaluation process** established under (1) on the date of each internal custody record check; and
  3. **Promptly investigate and resolve** any causes of discrepancies that the evaluation process reveals.
- Some risks that firms (at a minimum) should consider are included in the wheel to the right.



# ***Other reconciliation reminders***

And don't forget some other important points relating to custody asset reconciliations

## **Frequency**

- Firms should determine the frequency at which reconciliations are performed (considering specific factors) and review this annually – **CASS 6.6.44R & CASS 6.6.46R**
- Internal custody record checks and external asset reconciliations should be performed at least monthly – **CASS 6.6.11R & CASS 6.6.37R**
- Physical asset reconciliations should be performed at least every 6 months – **CASS 6.6.22R.**

## **Discrepancy investigation and resolution**

- Any discrepancy identified by custody asset reconciliations (or outside of the reconciliation process) should be investigated and resolved 'without undue delay'.

## **Shortfalls**

- If a reconciliation discrepancy gives rise to a shortfall, the firm should (in most cases) fund this with its own money or assets while it is being investigated.



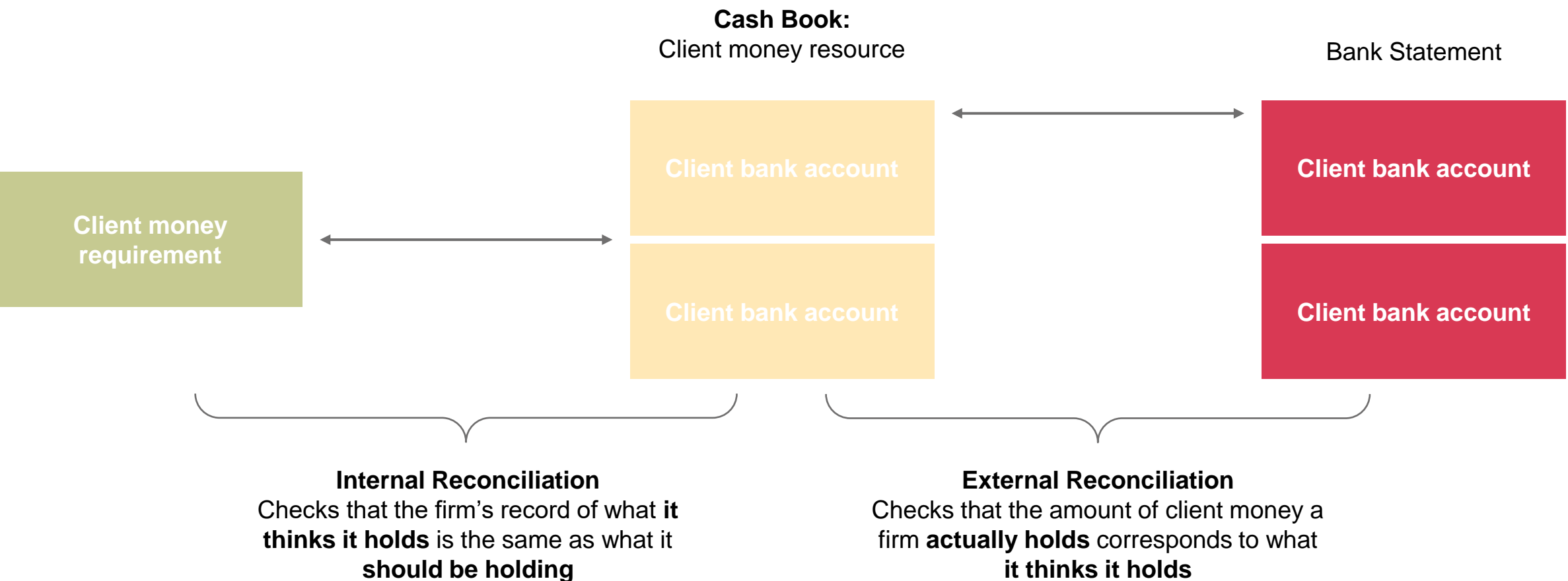
# **CASS 7**

## RECONCILIATIONS

***Rob Anderson***

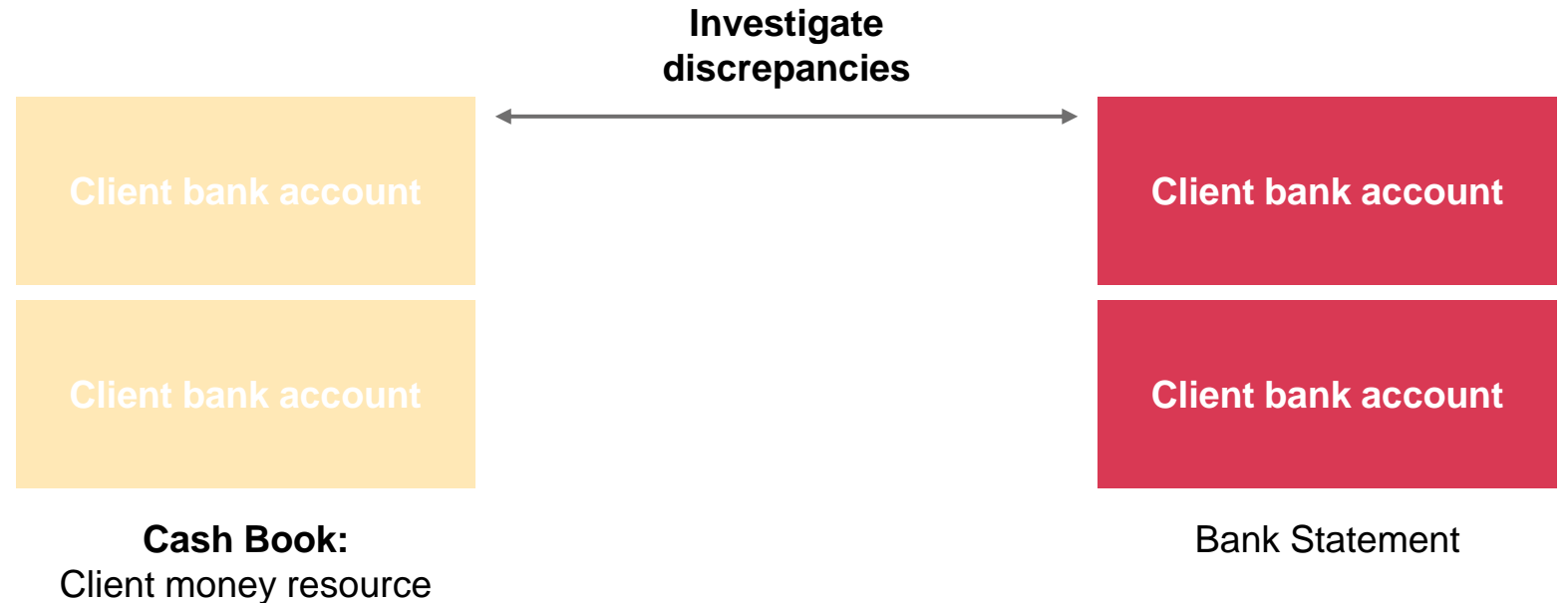
***PwC***

# ***Client money reconciliation overview***



# ***Client money reconciliations – External***

- Compares the firm's cash book to the bank statement ... the same as any other bank reconciliation.
- Should be carried out on a bank account by bank account basis.
- Reconciliation discrepancies should be followed up and resolved promptly.



Timing differences

1

Unexpected receipts

2

Unknown payments

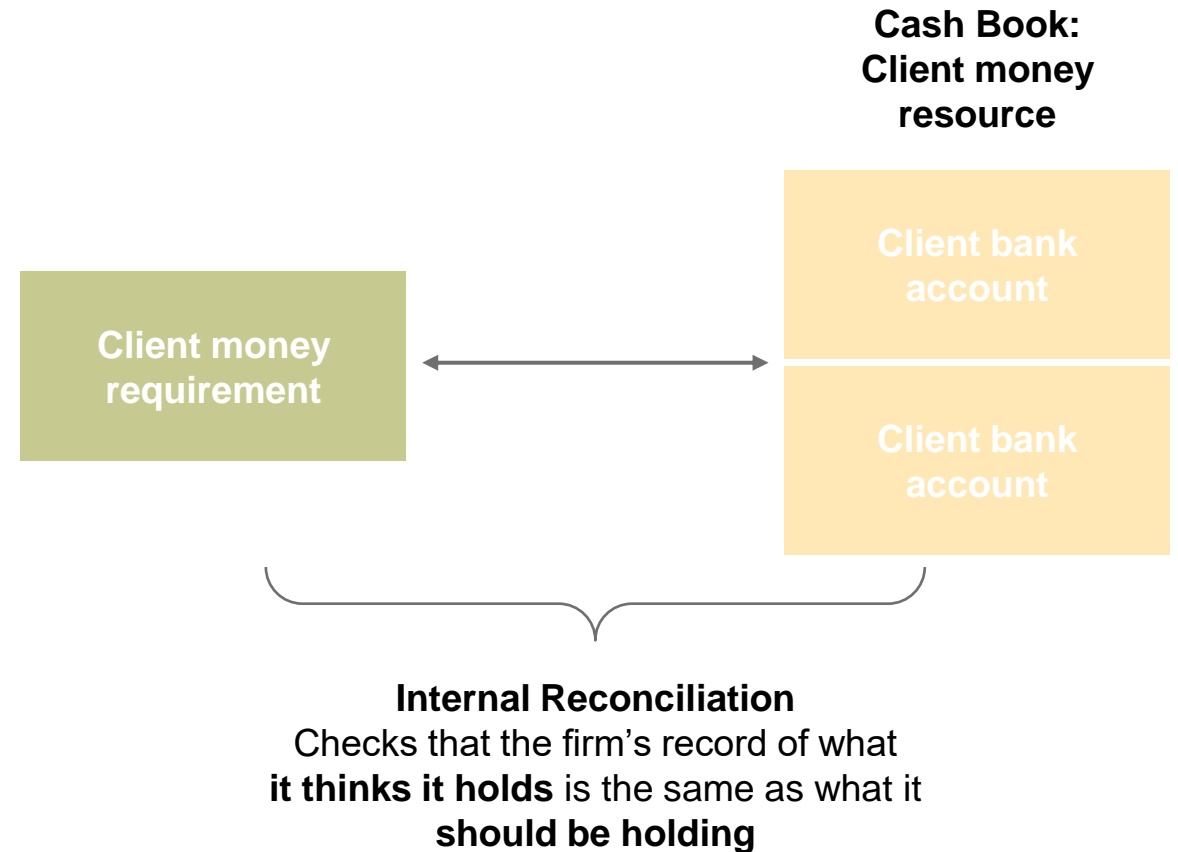
3

Record keeping errors

4

# ***Client money reconciliations – Internal***

- Reconciliation is a bit of a misnomer ... it is really a calculation.
- The internal client money reconciliation is designed to ensure that a firm doesn't have too much or too little money segregated in its client money accounts.
- When comparing the client money requirement (what should be held) to the client money resource (what is held), any differences should either be funded as a shortfall or removed as an excess.
- Both sides should be based on the records as at the close of business the previous day.
- There are two different methods to calculating the client money requirement: the net negative add-back method and the individual client balance method.



# Client money reconciliations – NNAB

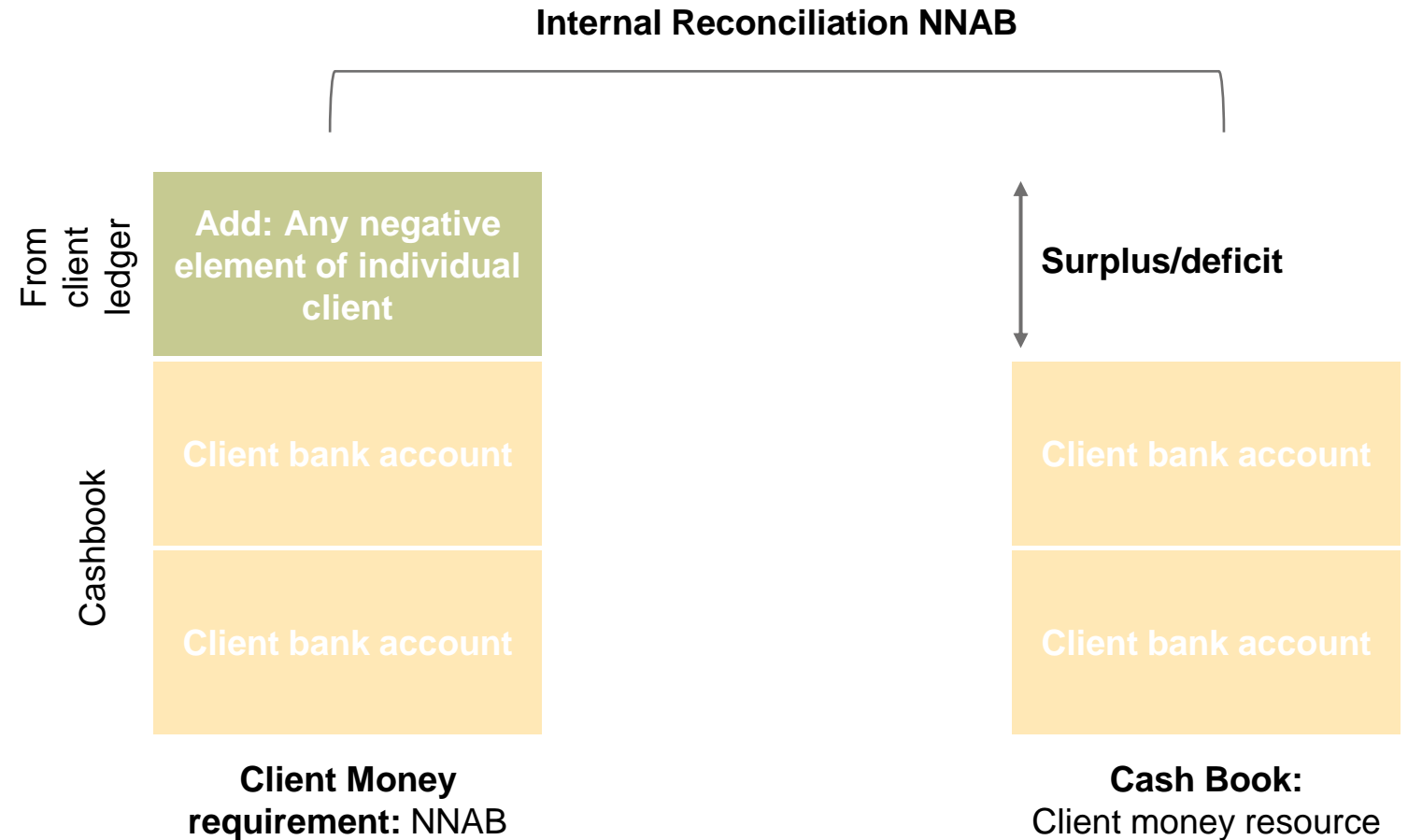
- **Client money requirement (for each bank account) =**

The amount that the firm's records show as held on the account (e.g. cashbook)

+

Any client balances where the client is in a net negative position.

- Can only be used by a certain firms
- Firms should be able to readily use the figures previously recorded in its internal records and ledgers at COB prior day.





# *Client money reconciliations – ICB*

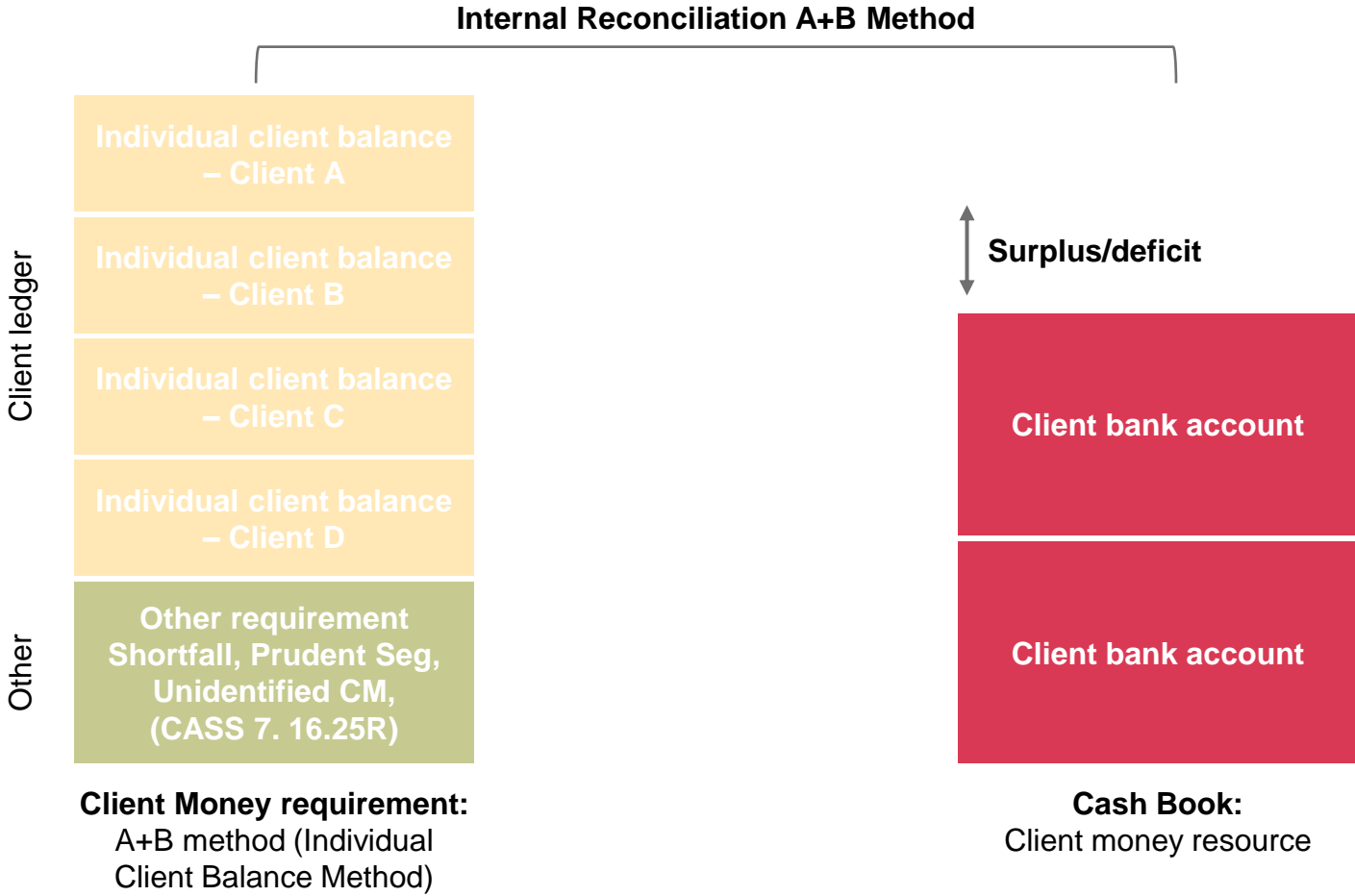
- Client money requirement =**

The sum of each individual client's entitlement **(excluding those which are negative)**

**+**

Any other balances which cannot be attributed to a client, e.g. unallocated monies.

- The result of this is that any clients which have a negative client entitlement should lead to a funding requirement.



# ***Other reconciliation reminders***

And don't forget some other important points relating to client money reconciliations

## **Frequency**

- Firms should determine the frequency at which reconciliations are performed (considering specific factors) and review this annually – **CASS 7.15.23R & CASS 7.15.26R**
- External client money reconciliations should be performed at least monthly – **CASS 7.15.22R**
- Internal client money reconciliations should be performed daily – **7.16.1G.**

## **Discrepancy investigation and resolution**

- Any discrepancy identified by external client money reconciliations (or outside of the reconciliation process) should be investigated and resolved 'without undue delay'.

## **Shortfalls**

- Any shortfall/excess identified by the internal client money reconciliation must be actioned on the day that the reconciliation is completed.
- If an external client money reconciliation discrepancy gives rise to a shortfall, the firm should fund this with its own money.



# **CASS 5**

**CLIENT MONEY CALCULATION AND  
RECONCILIATION**

***Shermeen Kazmi***

***Grant Thornton UK LLP***

# ***The client money calculation (CMC) and reconciliation***

## Step 1 Perform CMC



Compare:  
Client money **Resource**  
to  
Client money **Requirement**

## Step 3 Perform bank reconciliations



Within **10 days of** carrying out **a CMC**,  
reconcile the client money bank  
accounts to bank statements.  
Repeat Step 2 if differences arise.

## Step 2 Make any deficit good or transfer surplus out



If **Resource > Requirement** pay the **surplus** out of the client money account  
If **Resource < Requirement** make **deficit** good from corporate account  
on the **same business day** of performing **the CMC**

**A key process to monitor that the trust status is not compromised ('no pollution' by non-client monies)**

# ***The client money calculation - two allowed methods***

(A) accruals method

(B) client balance method



must be able to match by reference to individual clients

- within a reasonable period
- for the majority of clients

**Note:** A firm must choose one method, **keep a record of the choice**, and **apply consistently** throughout the financial year.

# Accruals method

(A) accruals method: Client money resource =

Aggregate of  
the balances on  
the firm's client  
money bank  
accounts



**ST:** insurance debtors (**no prefunded items**)

**NST:** insurance debtors  
(including pre-funded items)  
due from: insurance companies, clients and third  
parties, valued on a prudent and consistent basis

**Note:** Ledger balances to be used for the calculation on day 'n' are as at the previous business day (i.e., as at day 'n-1')

# Accruals method (continued)

(A) accruals method: Client money requirement =

All insurance creditors shown in the firm's ledgers  
(due to insurance companies, clients and third parties)



Unearned commission (accrued, but not due and payable) as at the date of the calculation\*

*\* if the firm can not provide an exact figure for this they can use a prudent estimate instead*

**Note:** Ledger balances to be used for the calculation on day 'n' are as at the previous business day (i.e., as at day 'n-1')

# ***Client balance method***

(B) client balance method: Client money resource =

The aggregate of the balances on the firm's client money bank accounts

(B) client balance method: Client money requirement =

The amount  
paid by a  
client to the  
firm



The amount due to  
the client (claims &  
return premiums)



Any interest  
or investment  
return owed  
to the client



Amount paid to the  
insurer for the benefit  
of the client

— money paid by the firm to its clients



# ***Common breaches to watch out for***

	<b>Client money calculations and reconciliation</b>
	<ul style="list-style-type: none"><li>➤ CMCs not performed min every 25 business days;</li><li>➤ Bank recs not completed within 10 days of CMCs</li><li>➤ Any deficit / surplus not made good / withdrawn by the close of the day the calculation was made</li><li>➤ No written record of the firm's election of method for performing the CMC</li><li>➤ No evidence that the firm, if using accruals method, can match its client money resource to its requirement by reference to individual clients</li><li>➤ Use of incorrect ledger balances (i.e. not from close of prior business day)</li></ul>

	<b>Client money calculations</b>
	<ul style="list-style-type: none"><li>➤ General ledger balances not reconciled to the broking ledger</li><li>➤ Aged unallocated cash, no monitoring of unallocated cash – consider when should be treated as client money</li><li>➤ Premium finance or consultancy fee debtors included in the CMC ( i.e. other than unearned brokerage)</li><li>➤ Bad debt, or unreconciled items not included in the CMC</li><li>➤ Adjustments made to bad debt provisions in the CMC (i.e not per TB)</li></ul>

# ***Upcoming Events and 2021 schedule***

- Upcoming Events
  - Stress Tests 2021, 24<sup>th</sup> March 12:00 – 13:00 (included in your membership)
- Webinar Library
  - Review our recordings and access topics such as LIBOR transition, Stewardship Code, IFRS 17, CASS, Ethical use of big data, COVID-19 and much more
  - Go to **[icaew.com/fsfwebinars](https://icaew.com/fsfwebinars)**
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