



Jersey Financial  
Services Commission

# **Themed Examination Programme 2018: Client Assets**

Issued: 27 November 2018

## Glossary of terms

All defined terms used in this feedback paper:

CASS Rules	Client Asset Sourcebook Rules
Client Bank Account	As defined in Article 1 of the IB Order
Client Money	As defined in Article 3 of the IB Order
Client Property	Has the meaning defined in Part 3 of the IB Order
Client Assets	For ease of reference, and unless separately identified, Client Money and Customer Money, as defined in the IB and TCB Orders, will be collectively referred to Client Assets.
CMP	Compliance Monitoring Programme
Customer Money	As defined in Article 1 of the TCB Order
Customer Pooled Bank Account	As defined in Article 1 of the TCB Order
FCA	Financial Conduct Authority
FSJL	Financial Services (Jersey) Law 1998, as amended
the Handbook	the Handbook for the Prevention and Detection of Money Laundering and the Financing of Terrorism for Regulated Financial Services Businesses
IB	Investment Business
IB Code	Code of Practice for Investment Business (effective 01/07/08 – last revised 21/03/18)
IB Order	Financial Services (Investment Business (Client Assets)) (Jersey) Order 2001.
JFSC	Jersey Financial Services Commission
MLO	Money Laundering (Jersey) Order 2008
Protected Property	As defined in Article 1 of the IB Order
Registered Person	A person registered by the JFSC under Article 9 of the FSJL, to carry on IB or TCB, as defined under Article 2 of the FSJL
TCB	Trust Company Business
TCB Code	Code of Practice for Trust Company Business (effective 01/01/08 – last revised 21/03/18)
TCB Order	Financial Services (Trust Company Business (Assets – Customer Money)) (Jersey) Order 2000

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## 1 Introduction

As communicated in November 2017, the JFSC set out in high level terms its planned thematic examination programme for the first half of 2018, to be undertaken by the JFSC's Supervision Examination Unit (**SEU**).

The programme identified the theme of Client Assets, whereby the SEU would examine whether Registered Persons, who can hold Client Assets, have in place appropriate systems and controls to segregate, account for, use, manage or otherwise safeguard those assets in accordance with applicable Laws, Orders and Codes. The themed examinations commenced in Quarter 2 and concluded in Quarter 3 of 2018. This paper provides the key findings from that themed examination.

## 2 Scope and regulatory requirements

### **Investment Business (IB)**

In terms of the requirements of the IB Order, the scope of the themed examination was to review and assess:

- › the Registered Person's treatment of client money, in particular the segregation of, accounting for and use of client money;
- › the client bank accounts in which money was held;
- › payments into and out of a client bank account and the reconciliation of the accounts; and
- › the effectiveness of the Registered Person's internal control systems in respect of all of the above.

In some instances, where protected property was held, the themed examination reviewed and assessed:

- › the treatment of protected property, in particular the safekeeping of documents of title and accounting for and reconciliation of title to investments; and
- › the effectiveness of the Registered Person's internal control systems in relation to the above.

### **Trust Company Business (TCB)**

In terms of the requirements of the TCB Order, the thematic examination was to review and assess:

- › the Registered Person's treatment of Customer Money;
- › the Registered Person's treatment of Customer Money kept in Customer Pooled Bank Accounts; and
- › the effectiveness of the Registered Person's internal control systems in respect of the above.

The examinations also considered the Registered Person's compliance with Principles 3 and 4 of the IB Code and TCB Code and any relevant guidance issued by the JFSC, in order to reach an overall view as to whether the Registered Person could demonstrate that they had acted with due skill, care and diligence in fulfilling their Client Assets responsibilities.

### 3 Limitations

The JFSC regularly undertakes on-site examinations on specific themes to: (1) assess the extent to which regulated entities are operating in accordance with their regulatory obligations under the respective Laws, Orders, Code and Guidance Notes; (2) provide direct feedback to the entities examined; and (3) issue related guidance for the wider industry.

The JFSC's on-site examination programme is designed to:

- › assess the risks faced by individual entities and review the controls, procedures, policies
- › assess the processes in place to mitigate those risks.

The purpose of this paper is to summarise the key findings from this themed examination, and also to provide, where noted, areas of good practice observed by way of example<sup>1</sup>. It is not intended to comprehensively describe all risks that may be associated with non-adherence to regulatory obligations and not all entities face the issues described below. However, the observations made reflect areas of potential risk and are provided for general guidance.

### 4 Methodology

This themed examination was conducted in two phases:

#### **Phase One**

This was an initial data collection exercise, whereby 161 Registered Persons, who held a licence allowing them to hold Client Assets, were canvassed by way of a focused questionnaire<sup>2</sup> which asked questions in relation to:

- › Client Assets - volume of accounts held / approximate value / are they distinguishable from those of the Registered Person
- › Policies and Procedures - operation / handling / protection / management
- › Oversight - accounts overdrawn / breaches of internal procedures / does CMP assess compliance with Registered Person's procedures regarding Client Assets
- › Third Party Arrangements – handling / protection / management of arrangements or agreements
- › Client Property - Protected Property / documents of title / safekeeping arrangements.

#### **Phase Two**

Having reviewed and analysed the data submitted as part of the Phase One exercise, together with supervisory knowledge of entities held by the JFSC, a selection of eleven IBs<sup>3</sup> and six TCBs was made for on-site examination. This selection accounts for some 10% of the Phase One total sample size.

Prior to each on-site examination, the JFSC requested a range of policy and procedural documents from the entities subject to examination. Information regarding monitoring and reporting was also requested, along with terms of business provided to clients. The JFSC also sought clarification in respect of specific responses to the data collection exercise where

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<sup>1</sup> The areas of good practice observed and referenced herein should not be taken as formal guidance issued by the JFSC as they may not be relevant or appropriate to every IB or TCB.

<sup>2</sup> In instances where Registered Persons conducted both IB and TCB activities, a questionnaire was sent to both requiring completion under the separate licences.

<sup>3</sup> This total included several banks which hold IB licenses.

necessary. This information was assessed before the on-site examination commenced. On-site discussions were held with management and staff, and client files were reviewed (where relevant) to determine whether procedures were being adequately followed and to establish the extent of any control deficiencies.

In the event that any findings were identified, these were based upon information provided by the IB and TCB and evidence available at the time of the on-site examination. Those findings are being separately addressed by the individual entities and are subject to a formal remediation plan having been submitted by the relevant entity to the JFSC, and agreed, setting out actions to be taken and timescales to complete.

## 5 Executive Summary

The JFSC takes this opportunity to thank the 161 entities who provided a response to the Phase One data collection exercise and also the courtesy and assistance shown by the 17 entities during the Phase Two on-site examinations.

In respect of Phase Two, of those entities examined it was pleasing to note that breaches of both the IB and TCB Order were limited. In each of the Registered Persons visited, policies and procedures were in place to protect Client Assets and Protected Property, albeit in some instances these required further enhancements or specific tailoring to the local regulatory framework rather than CASS rules.

Oversight of Client Assets was generally good with the majority of Boards or Management Committees being provided with relevant management information in a timely manner. That being said, JFSC officers did identify limited instances whereby information was not being provided, or it was not always correct, or was lacking in sufficient detail.

JFSC officers noted several examples of good practice in relation to compliance monitoring when it came to testing of controls in relation to Client Assets; however, compliance monitoring once again was an area which required improvement across the majority of Registered Persons examined. Compliance monitoring continues to be a repeat finding not only in this thematic examination, but in other recent thematic and entity risk examinations, and therefore will be a dedicated theme in the SEU led themed examination programme for 2019.

The JFSC would like to make some general observations as a result of this themed examination process, which is to remind all Registered Persons:

- › to ensure that the requirements of the local regulatory framework are at the forefront of internal systems and controls
- › that discussions and decision-making by the Board or Management Committee is clearly documented with any subsequent actions allocated and tracked.

## 6 Key findings

### 6.1 Phase One Data Review

6.1.1 The following key data was observed and is broken down by licence-type:

**Number of entities which were sent focused questionnaire**



**Number of entities which held in excess of £5,000,000 in customer pooled accounts as at 31st December 2017**



**Number of entities where customer pooled bank account or client bank accounts had become overdrawn in the 12 months prior to the date of the questionnaire**



**Number of entities which identified breaches of internal Client Assets procedures in the 12 months prior to the date of the questionnaire**



**Number of entities where the CMP did not assess compliance with internal procedures for handling Client Assets**



**Number of entities which advised that they outsourced activities related to Client Assets**



## 6.2 Investment Business

### Internal Systems and Controls

#### Areas for further improvement

- 6.2.1 Paragraph 3.2.1.1 of the IB Code requires Registered Persons to operate within the requirements of the regulatory framework. JFSC officers noted in several instances that the IBs were over reliant on the FCA's CASS rules. Policies and procedures made little or no reference to the Jersey regulatory framework and the controls in place to evidence compliance with CASS had not been mapped to the requirements of the IB Order. In some instances, although a compare and contrast exercise had been completed, this had not been sufficient in identifying the differences between both regulatory frameworks, and in one instance the exercise had not been refreshed, despite extensive changes to the CASS rules.
- 6.2.2 Paragraph 3.2.1.2 of the IB Code requires periodic reviews of internal control systems to be undertaken to ensure they work effectively. JFSC officers identified instances in which the control framework in respect of Client Assets had not been reviewed for a number of years.
- 6.2.3 A Registered Person is required to ensure they are compliant with the regulatory framework in line with paragraph 3.5.1 of the IB Code. JFSC officers noted examples of compliance monitoring tests which required strengthening to fully comply with the requirements of the IB Order. For example, compliance testing checked adherence with Article 6(3) of the IB Order, however it did not go on fully to check compliance with Article 6(3)(a) to (d). In another instance, testing of first line of defence controls was not conducted by the Registered Person.

#### Good practice identified

- 6.2.4 Conducting a mapping exercise which compared the requirements of the IB Order to the CASS rules, with potential gaps documented and resulting actions noted, tracked and effected.
- 6.2.5 Monitoring tests were mapped to the requirements of the IB Order and conducted periodically using a risk-based approach.
- 6.2.6 Comprehensive policies and procedures which were able to be clearly demonstrated to JFSC officers during the on-site examination.
- 6.2.7 Registered Persons had implemented procedures which identified, up to five days in advance in some instances, scenarios in which Client Bank Accounts may go overdrawn; the bank account was funded accordingly to prevent the overdraft position from occurring.

### Corporate Governance

#### Areas for further improvement

- 6.2.8 JFSC officers noted examples of material issues relating to Client Assets not reaching the Board or Management Committee. In one instance KPIs were rated as green, when this was clearly not the case in relation to aged reconciliations.
- 6.2.9 Decision-making at Board or Management Committee level in relation to identified Client Asset issues was not always documented in sufficient detail and, although those Registered Persons were able to articulate how situations were being actively managed during Phase Two of the examination process, this was not readily evident from the minutes reviewed at Phase One.



- 6.2.10 Despite the Terms of Reference for oversight committees referring to the review of reports from second or third line of defence functions, it was not always the case that these reports were provided to the relevant forums.

#### **Good practice identified**

- 6.2.11 One entity had developed a Materiality Policy which provided guidance on matters which should be escalated internally, including the reporting line, and to the regulator.
- 6.2.12 The creation of a specific committee which reviewed all matters in relation to Client Assets.
- 6.2.13 Standing agenda items which encouraged discussion in relation to Client Asset management.

#### **Sanctions Screening**

- 6.2.14 Although not a requirement of the IB Order, JFSC officers noted certain instances where sanction screening did not necessarily identify the underlying client when there was a free receipt/delivery of a security. This findings is a breach of Article 11(3)(e)(iii) of the MLO, section 6.2.2 of the Handbook and paragraph 3.2.1.6 of the IB Code. Ensuring gaps of this nature are identified and addressed is of extreme importance. Registered Persons who provide such a service are encouraged to conduct an immediate review of any relevant procedures and controls in this regard.

#### **Undertaking**

- 6.2.15 Article 6(3)(a) to (d) of the IB Order requires an undertaking from the bank at which client money is held. This undertaking outlines how the bank must treat client money, for example in relation to the title of the account and in respect of interest earned. In a number of instances, the undertakings did not meet the requirements of the IB Order. The JFSC recommends that all Registered Persons review undertakings for compliance with the IB Order.

#### **Custodian Agreements**

- 6.2.16 Article 18 of the IB Order details the requirements to be contained within written agreements entered into between Registered Persons and approved custodians. These include the need to hold documents of title in a way that makes it apparent they do not belong to the Registered Person and to issue statements to the Registered Person at least every six months. Although custodian agreements were in place, they did not always wholly satisfy the requirements of the Order. The JFSC recommends that all Registered Persons engaging the services of an approved custodian conduct a review of their current agreements.

#### **Insurance**

- 6.2.17 Article 21 of the IB Order requires the Registered Person, and their own nominee, to maintain adequate insurance covering non-registered securities of clients. JFSC officers noted one instance in which the consideration for the requirement for such insurance could not be evidenced.

## 6.3 Trust Company Business

### Mixing and Use of Customer Money

- 6.3.1 Articles 5 and 6 of the TCB Order detail the requirements to ensure that Customer Money is not mixed with other money; and further that it is not distributed unless it is properly payable. JFSC officers observed an instance in which Customer Money was used for fees without an invoice being raised to support the transaction and, as a result, Customer Money was mixed with other money thus breaching both Articles of the TCB Order.

### Undertaking

- 6.3.2 Article 7(1)(c) of the TCB Order requires an undertaking from the bank at which Customer Money is held in a Customer Pooled Bank Account. In one instance an undertaking was not held in relation to Customer Pooled Bank Accounts.
- 6.3.3 Article 7(2) of the TCB Order outlines how the bank will treat Customer Pooled Bank Accounts. In a second instance, an undertaking in letter form did not comply with the requirements of the TCB Order.
- 6.3.4 The JFSC recommends that all Registered Persons review undertakings for full compliance with the TCB Order.

### Internal Systems and Controls

#### Areas for further improvement

- 6.3.5 A Registered Person is required to ensure they are compliant with the regulatory framework in line with paragraph 3.5.1 of the TCB Code. JFSC officers observed examples of compliance monitoring which did not fully test compliance with the requirements of the TCB Order.

#### Good practice identified

- 6.3.6 Comprehensive policies and procedures in relation to customer pooled accounts.