

Who's money is it anyway?

February 2010

The Financial Services Authority (FSA) recently completed a nine month investigation into compliance with its Client Asset Sourcebook (CASS). The investigation involved a number of on-site visits at investment firms and insurance brokers.

The rules in CASS build on Principle 10 of the FSA's Principles for Business, which requires firms to arrange adequate protection for clients' assets when they are responsible for them. Essentially, money belonging to a client is protected from the insolvency of a firm. Firms are, therefore, required to keep all client money separate from their own money, and are also prevented from using client money for their own purposes.

From the "Dear CEO" letter, published on 19 January 2010, it is clear that the regulated sector has a lot of work to do to convince the FSA that it takes CASS seriously. The letter, and accompanying report, lambasts firms for a series of failings including:

- poor management delegation, oversight and control;
- a lack of establishment of trust status for segregated accounts;
- a lack of adequate due diligence concerning the selection and use of banks;
- an inability to locate trust acknowledgement letters from banks or other third parties for each of their client money accounts;
- unclear and overly complex arrangements for the segregation and diversification of client money; and
- incomplete or inaccurate records, accounts and reconciliations.

The report is certainly timely, arriving in the wake of *Lehman Brothers International (Europe) (in administration) v CRC Credit Fund Limited*. During the case the court heard that when Lehman Brothers (LBIE) failed in September 2008 it did so with a \$1bn shortfall in its segregated client accounts. It soon became apparent that LBIE had also failed to identify as client money, and therefore to segregate, huge sums received for a significant number of its clients. This failure drew heavy criticism from the court and led to many clients joining the queue with other unsecured creditors.

It is little wonder that the FSA's crackdown on failing organisations will continue to be a priority in 2010. Enforcement action already taken ranges from reminder letters and private warnings to asset freezes. With the FSA anticipating increasing the enforcement resources devoted to client asset cases, the conduct and competence of significant influence function holders (SIFs) and firms will come under increased scrutiny. The report warns, "Our actions taken so far demonstrate that our tolerance level for CASS compliance failures is low." The message is clear: failure adequately to implement CASS will not be tolerated and individuals and entities need to be ready to explain to the FSA that their procedures are up to the mark.

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