



Meeting the FSA's General Insurance Client Money requirements

In this article I will review the FSA's requirements for dealing with client money for general insurance intermediaries and offer some practical guidance on what you need to do to meet those requirements.



Introduction

Client money is an area that still causes confusion, and one of the few areas the FSA have commented on as an area of concern with regard to general insurance. Some of the FSAs' requirements such as the reconciliation procedure may at first seem intricate but once understood they should become a matter of routine.

Whilst it may seem obvious the basic rationale behind the FSAs' client money requirements is that client money belongs to the client and therefore must be ring fenced so that it is not used for any other purpose.

The complication for GI is the way the market operates where for example the intermediary will often pay claims themselves and reclaim the sum from the insurer. Also it is not uncommon for brokers to effectively advance credit by renewing contracts before they have received the premium from the client, particularly in the case of valuable or long standing clients.

The issue the FSA have with these practices is that it is often another customer's money that provides the funds. Whilst the vast majority of intermediaries are completely honest and efficient the risk is the clients could lose out in the event of business failure or dishonesty.

Aptus Training Services

The Trees, 63 New Road, Hethersett, Norwich, NR9 3 HJ T: 01603 814129 F: 01603 814106 E: info@aptustraining.co.uk



The choices

When it comes to dealing with client money you have three choices:

- Not to handle client money at all
- Have the insurer take responsibility (Risk Transfer)
- Hold the money on trust

Of these choices, not to handle client money at all is probably the easiest and for most brokers the least practical. This way clients pay the insurer directly and the insurer will then pay you your commission.

Risk Transfer

What is it?

Next to not handling client money at all this is the easiest option. With risk transfer the insurer takes responsibility for ensuring that the client does not suffer financially if you run off to Paris (or anywhere else for that matter) with his or her premium.

What you need to do

- Have a written agreement with the insurer confirming that you act as agent for the purposes of accepting premiums/giving refunds/settling claims and have express authority to accept premiums/give refunds/settle claims
- Keep a copy of the agreement for at least 6 years after date terminated
- Inform clients in writing that for accepting premiums/giving refunds/settling claims you hold money as agent of the insurer (can be incorporated in another document such as the terms of business)
- You will need a separate agreement with each insurer that you operate risk transfer
- If insurer agrees in writing can pass on this authority to agents

The bank account for risk transfer

Client money that you receive must be kept in a client bank account that fulfils the following criteria:

The account:

- can cover one or more clients
- must be in the name of the firm
- must include in its title an appropriate description to distinguish the money in the account from the firm's money
- Be a current or a deposit account; or a money market deposit of client money which is identified as being client money

Aptus Training Services



What can the account be used for?

Providing covered by the agreement with the insure this account can be used for

- Settling claims
- Accepting premiums
- Premium refunds

Hold the money on trust

This will be the option that many will need to take particularly if they can not secure a risk transfer agreement with their insurers. There are two types Statutory Trust and Non Statutory Trust. The difference between the two is that you cannot use a Statutory Trust to advance credit from the client account for premiums owed to you, or settle claims before you receive the money from the insurer.

With both types the principle is exactly the same, the money is held on trust for the clients i.e. it is their money not yours!

Statutory Trust

If you go into the local branch of your bank and tell them you want to set up a Statutory Trust account you will probably get a blank look. The good news is that the trust is automatically created by the FSA rules. You do not need to pay expensive lawyers fees to create one for you, all you need to do is set up an appropriate bank account (see Approved Client Accounts below)

Non-statutory Trust

If you pay the insurer premiums, or pay clients claim from the client account before you have received the money from the client (premiums) or insurer (claims) then you must operate a non statutory trust and you will need to pay (or less likely find one for free!) a lawyer to draw up an appropriate trust deed for you.

An important point to note however is that even with a Non-statutory trust you cannot take commission before you have received the premium from the client.

Aptus Training Services



Setting up a Non – Statutory Trust

Firstly before you can even consider a non-statutory trust you will need to prove you have “adequate resources, systems and controls” to run the account. These are

- Capital resources of at least £50,000
- Confirmation from an auditor that you have the systems and controls to run such an account
- Designate a manager who is responsible overseeing the trust
- Obtain client’s informed consent to operating in this way
- Have a written trust deed

The deed

We would recommend you seek legal advice when creating the trust deed so we will not go into detail of what is required in terms of the trust wording. However it is essential that your lawyer checks the FSA requirements to ensure the trust is fit for purpose.

Operation of statutory and non-statutory trusts

There are a number of rules that apply to the operation of both statutory and non-statutory trusts. These are:

- Generally speaking you must keep client money separate from your own money. More details are contained in the section on withdrawal of commission The main exceptions to this are:
 - Money needed to open or keep account open
 - Interest not yet withdrawn
 - Commission or mixed remittance not yet taken out
- You must pay any money due to the client as soon as possible (no later than one business day)
- You must pay any client money into the client account as soon as possible (normally one business day)
- Where client money is passed on to another intermediary, the second intermediary has a responsibility to segregate the money in exactly the same way as if they have received it themselves. However the original intermediary is still directly responsible to the client until the money is received by the insurer.
- There are also specific rules if you keep money in a different currency



Additional requirements for operation of a Statutory trust

There are additional requirements for a Statutory trust. These are:

- The balance relating to each client must be a credit one. In other words you cannot pay the insurer from the client account until the client has paid you.
- You have the responsibility for ensuring funds have cleared. If they have not you will be responsible for making up any shortfall

Withdrawal of commission both types of trust

The main exception to the requirement to keep money separate from your own is where you are entitled to part of the money that is being paid by the client. The most common example of this is where you are entitled to take commission from the premium paid by the client and pay the insurer net. The rules regarding this are as follows:

- You can withdraw your commission if you have received the premium from the client & your terms of business with the client and insurer allow you to do this. However provided your terms of business allow for this you can take the commission before paying it to the insurer
- If you receive a mixed remittance (i.e. part client money and part not) the whole amount must be paid into the client account and the non client money removed as soon as possible and certainly within 25 business days.
- Commission must be withdrawn from the client account as soon as it is due
- Any money you receive from third party finance in respect of client money must be paid into the client account
- If you receive premiums in instalments then each instalment is subject to these rules

Appointed representatives, field representatives, and agents (AR,FR,A)

If you have appointed reps, field reps, or agents there are some rules (would you expect anything else!) that apply. These are:

- A firm can choose if client money received by AR,FR,A is to be segregated immediately or at intervals
- The firm is treated as holder of the money not the AR,FR,A
- If AR,FR,A meets client money rules in their own right the above two points do not apply

In line with the general principles in this area, client money received by field reps etc must be kept separate from other monies. There are two ways this can be done, as soon as the money is received (immediate segregation) or on a periodic basis.

Aptus Training Services



Immediate segregation

If immediate segregation is selected then

- The money must be paid into the client money account at once or sent so it arrives within 3 business days
- The firm must ensure its agents etc must keep client money separate from other monies until it is paid into the client money account.

Periodic separation

If immediate segregation is not possible then a firm has to:

- Check on a regular basis that there is enough money in the client account to cover the amount it estimates is being held by agents. Regular is not defined but should be in line with the nature of the business done with the agent. Thus if the agent receives money weekly then the check should be done on a weekly basis, if six monthly check six monthly.
- And within 10 days of this check carry out a reconciliation of its estimate against the actual amounts held by the agent and pay into or draw out of the client account the difference.

Transfer of client money to a third party

It is not unusual with general insurance for client money to be passed along a chain of brokers to the eventual underwriter. This is perfectly permissible provided

- It is for a specific transaction
- If the customer is a retail one they have been notified in writing, although this notification can be an ongoing one there is no need to notify in each and every case. Thus it could for example be included in the terms of business

Approved client accounts

Client money must be kept in an account with an approved bank in a “designated client account.” The key requirements for this are that the word designated appears in the account title and the client consents in writing to the money being held in that particular account. Perhaps the best way of dealing with this is to incorporate details in the Terms of Business Agreement and ensure the clients sign to confirm they agree with those terms of business.

The firm has a duty of care to ensure the bank selected is suitable. The FSA does not publish lists of approved banks but for a small to medium size firm a UK clearing bank should satisfy the requirements, although it must be noted that ultimately it is the firm and not the bank who is initially responsible to the client in the event of any failure.

Aptus Training Services



For larger firms and companies that bank with another company in the same group as themselves additional checks need to be made. If business is done outside of the UK it is not always essential to hold client money with an approved bank subject to certain terms and conditions. Both of these points are outside of the scope of this guidance, for more information please contact us.

Account procedures

The firms must have notified to or received from the bank written confirmation that

- The money is held on trust and the bank has no right to combine or set off the account monies against any other account the firm holds

&

- The title of the account clearly distinguishes it from any other account held with the bank.

If the bank does not acknowledge this within 20 days all client money must be withdrawn and placed with another bank as soon as possible.

Once again there are additional rules covering the use of non UK banks and transactions outside of the UK.

Client money calculation and reconciliation

Client money reconciliation is the area where the FSA have commented that they have some concerns about firms not carrying out this reconciliation or it not being done correctly.

Please forgive me if the next few paragraphs smack of Grammas' eggs although the principles are reasonably clear the detail sometimes obscures this.

The Basics

There are some basic principles regarding the client money calculation that are important to be clear upon before we move to the detail.

Firstly the object of the exercise is to ensure there is sufficient money in the client money account to pay what is due from the said account.

Secondly you can carry out the calculation on a cash or accrual basis. You can choose which, and both are permissible whether you operate a statutory or non statutory trust. However if you operate both types of trust then you must use the same basis i.e. cash or accruals, for both trusts.

Aptus Training Services



If you decide to operate on a cash basis then the calculation is based on what is actually received and paid out and has to be performed for each client. If you operate on an accrual basis then the calculation is based on what is owed and due and does not initially have to be done on an individual basis although you do have to be able to tie amount to individual accounts.

Thirdly the FSA use the terms client money requirement and client money resource. The client money requirement is what needs to be paid out from the account and the resource is what is in it. As you may expect the resource has to equal the requirement and the reconciliation must be undertaken at least every 25 business days.

Any shortfall must be corrected by the close of business on the same day as you carry out the reconciliation, so it is probably best to start early in the morning! Any excess must also be withdrawn on the same day unless the excess is due to a safety margin for unreconciled items. (In practice this should only apply if you are operating on an accrual basis)

You then have ten days to reconcile your calculations with the actual bank account, although in practice it may be easier to do both at the same time.

A question I am often asked is which is the easier method cash or accruals. I am afraid I can't give a straight forward answer to this as much will depend on your business. The cash method is an easier calculation and is more certain as it only takes into account sums actually paid and received. Against that it has to be done for each client.

With the accruals method you do not have to perform the calculation for each individual client but the accounting is a little more complex and uncertain because you are dealing with what is owed and due.

The best answer I can give to this question is that most people would be best served by adopting the same practice, cash or accruals as they currently use in the business client money reconciliation.

Another question that frequently arises is, when can I withdraw my commission? The answer to this is in two parts. Firstly whether you account on an accruals or cash basis you cannot withdraw the commission until you have got it. Secondly the timing on when you can actually take the commission will depend on your terms of business with the client and insurer. There is no restriction on you being able to take the commission before the insurer is paid provided this is agreed by both client and insurer. Therefore your terms of business should clearly state when this will happen.

Aptus Training Services



Cash Reconciliation

Remember you have to perform this calculation for each client. The client money resource in this case is the money actually in the client account. The client money requirement is the total of the following:

- Amounts paid by the client to the firm
- Plus amounts due to the client
- Plus any investments or interest returns due to client
- Minus amounts paid to insurance undertakings for the benefit of the client
- Minus commission due to the firm
- Minus amounts paid to the client

I assume the vast majority who read this will not hold investments for clients so I have excluded any further explanation.

In the vast majority of cases only a few of these items will be needed i.e. Amounts paid by the client to the firm (premiums) less amounts paid to insurance undertakings for the benefit of the client (net premium) and commission due to the firm.

Thus imagine the situation where a client renews his motor insurance on the 1st of August at a premium of £550. The commission is 15% and the terms of agreement allows the broker to withdraw the commission immediately.

The client money resource will look like this:

Date	Transaction	Money paid into client account	Money withdrawn from client account	Client account balance
1 st Aug	Client pays premium	£550.00		£550.00
2 nd Aug	Broker withdraws commission		£82.50	£467.50
28 th Aug*	Net premium paid to insurer		£467.50	£0.00

*You may be wondering how this can take place 28 days not 25 days later. This is because the requirement is 25 business days.

This is then compared to the bank account where the balance should be nil.

Let us now look at another example.

Aptus Training Services



Client two pays her motor insurance premium of £430 on 17th August and commission is withdrawn on the 18th.

Date	Transaction	Money paid into client account	Money withdrawn from client account	Client account balance
17 th Aug	Client pays premium	£430.00		£430.00
18 th Aug	Broker withdraws commission		£64.50	£365.50
28 th Aug				£365.50

The sum of £365.50 matches the amount of the client account liability, i.e. the amount of £365.50 due to the insurer.

Assume these are the only client we have done business with in this period the bank account on 28th August look like this:

Date	Money paid into client account	Money withdrawn from client account	Client account balance
1 st Aug	£550.00		£550.00
2 nd Aug		£82.50	£467.50
17 th Aug	£430.00		£897.50
18 th Aug		£64.50	£833.00
28 th Aug		£467.50	£365.50

Once again the sum of £365.50 matches the amount of the client account liability, i.e. the amount of due to the insurer.

The situation is similar if the client is due a refund of premium or money in respect of a claim. Remember a key difference between a statutory and non statutory trust is that you cannot pay the claim out from a non statutory trust until you have received the money from the insurer, with a statutory trust you can.

The situation is as follows: The client has a claim for £670 on the 5th September. The money is paid by the insurer on 24th September and the client is paid on the 25th September.



Date	Transaction	Money paid into client account	Money withdrawn from client account	Client account balance
24 th Sep	Insurer pays claim to broker	£670.00		£670.00
25 th Sep	Broker Pays client		£670.00	£0.00

Once again the client money requirement matches the liability

Obviously the situation is a little more complicated if a premium due and claim are payable in the same period, however refunds are treated in the same way so an example might look like this.

Client 3 renews his motor insurance on 2nd September at a premium of £370 again at a commission of 15%. The broker withdraws his commission on 3rd September. On 15th September the client changes his car and is entitled to a refund of £57. Miracle of miracles this is paid by the insurer on 17th September. To spice things up a little let us assume the broker is liable to repay any commission on refunds and the way this works is by the insurer paying a net refund.

Date	Transaction	Money paid into client account	Money withdrawn from client account	Client account balance
2 nd Sep	Client pays premium to broker	£370.00		£370.00
3 rd Sep	Broker withdraws commission		£55.50	£314.50
10 th Sep	Broker pays net commission to insure		£314.50	£0.00
17 th Sep	Insurer pays net refund to broker	£48.45		
18 th Sep	Broker pays gross refund to client		£57.00	(£8.55 overdrawn)
18 th Sep	Broker balances client account	£8.55		£0.00

As can be seen the broker will need to pay £8.55 into the client bank account to balance the commission refund.

Aptus Training Services



Accrual reconciliation

With the accrual basis the same basic process applies except it does not have to be performed for each individual client although you must be able to allocate the correct proportion to each client at a later stage.

The client money requirement is the total of the following:

- Insurance creditors shown in your ledgers as amounts due to insurance companies, third party intermediaries and clients
- Plus unearned commission shown as accrued but not yet earned and payable.

Hopefully if you currently reconcile your accounts on an accrual basis this will be clear but it may still be worth a little more explanation.

The key to understanding this is what happens to the commission. This in turn will depend on your terms of business with the client and the insurer which should state when you have the right to earn commission.

Let us imagine the situation where your terms of business entitle you to take the commission straight away. For simplicity let us also assume you only have one client. If the client pays their premium of £236 on the 1st of September and the commission rate is 20% you must take £47.20 out the client account straight away. This is may sound obvious but this is because it is not client money it is yours!

This leaves £188.80 in the client account, i.e. the amount you owe the insurance company, thus the client money requirement (what you will need to pay out) matches the client money balance (what you have got)

If however if your terms of business require do not permit you to take commission until the premium is paid to the insurer you cannot take out the client money before that point. Thus the client money requirement is as follows ; due to insurance company £188.80 + unearned* unpaid commission on due to you £47.20 total £236.

* What can confuse the matter a little is the term unearned, how can it be unearned when you have got the money and the business has been transacted? The answer is that it is technically unearned until your terms of business say you can have it!

I haven't enclosed an example for accrued business as the sequence would be the same as for cash the only major difference is rather than being done for each client sums are aggregated. I also have not gone on the give an example of then reconciling the totals for individual clients has hopefully you already have a method with tying up totals with individual clients.

If you would like an example please contact us.

Aptus Training Services



A few final points

To conclude I would like to add three more points:

- If you do not perform this reconciliation or follow the other rules on this subject you are obliged to notify the FSA immediately.
- The client money rules also cover procedures to follow if the firm or the bank fails, I have not covered these here as hopefully they will never apply to you.
- Unlike other areas of the FSA rulebook where the rules are actually principles that allow for some variation in the actual application according to the nature of the firm and business, the client money rules allow no flexibility.

If you would like to discuss this article or any aspect of compliance or training and competence or just have a chat, please feel free to call or email me. Details are at the foot of the page.

Whilst I have done my utmost to ensure the accuracy of the content of this material, by reference to the actual FSA rules on the subject, regrettably I cannot take any responsibilities for any errors or omissions.

Trevor Goodbun



Aptus Training Services

The Trees, 63 New Road, Hethersett, Norwich, NR9 3 HJ T: 01603 814129 F: 01603 814106 E: info@aptustraining.co.uk