



Guernsey Financial
Services Commission

Client Money

Thematic Review 2016



Foreword

We are pleased to present the findings of our 2016 Thematic Review of “**Client Money**”. This topic was chosen as it represents a key area of responsibility for trustees and logically follows on from last year’s thematic review regarding “Fiduciary decision making in respect of assets under trust”. This year’s thematic also enabled us to focus on crystallised risks recently experienced in the sector whilst enabling the Fiduciary Supervision Policy and Innovations Division (“the Division”) to assess the need for Client Asset Rules to ensure that the jurisdiction complies with International Standards.

The introduction of Client Asset Rules would provide clients of Fiduciary Licensees with a degree of protection should a firm fail, equivalent to that afforded to the customers of other financial institutions. To this end, regulators are expected to put in place rules for the administering of and holding of Client Assets.

Our objective in selecting this theme for review was:

To understand how local fiduciary firms approach the operation of client money accounts.

The review again highlighted both the diversity of the fiduciary sector in Guernsey and the efforts made by the vast majority of local fiduciary firms to design effective and proportionate procedures in order to comply with the current Regulations, Codes and Guidance in this area.

The Codes of Practice¹ state that licensees are required to keep the funds of each client company, trust or foundation separate from each other and from the licensee’s own funds and the Guernsey Trust Law states:

“A trustee shall keep trust property separate from his own property and separately identifiable from any other property of which he is trustee.”²

The Group of International Finance Centre Supervisors (“GIFCS”), which introduced the Standard on the Regulation of Trust and Corporate Service Providers (“TCSPs”) (“the GIFCS Standard”) in October 2014, is more prescriptive regarding Client Money Rules and extends the requirement to include, inter alia, Client Money Accounts to be reconciled promptly and for licensees to disclose to clients the terms on which Client Money is held.

In order to ensure that the Bailiwick retains its leading reputation for the provision of TCSP expertise to the appropriate standard, the Commission intends to introduce Client Asset Rules as trailed at the 2016 Industry Presentation and a Consultation Paper is currently being developed in this regard.

Broadly the thematic review uncovered a number of areas of good practice, for example (1) a significant number of firms were able to evidence a robust approach to determining the suitability of the banking institutions used to hold Client Money, (2) the majority of firms have policies, procedures and controls to prevent the inappropriate use of Client Money to settle fees and (3) the majority of firms undertake Individual Client Money Account and Global Client Money Account reconciliations on at least a monthly basis.

The Client Money thematic review also allowed the Commission to engage with those firms which have the lowest potential adverse impact which would, under risk based supervision, not form part of our structured engagement plans.

¹ Principle 4 of Code of Practice – Trust Service Providers, Principle 6 of Code of Practice – Corporate Service Providers and Principle 6 of Code of Practice – Foundation Service Providers

² The Trusts (Guernsey) Law, 2007

We would like to thank the licensees who have taken the time to contribute to this review, especially those who hosted site visits. We would encourage all licensees to read the findings of the review and satisfy themselves that their own arrangements reflect good practice for the trusts and structures which they administer.

Gillian Browning

Director, Fiduciary Supervision Policy and Innovations Division

Eamonn Finnerty

Deputy Director, Fiduciary Supervision Policy and Innovations Division



Contents

I.	Scope.....	5
II.	Current Responsibilities of Licensees	7
III.	The Group of International Finance Centre Supervisors – Standard on the Regulation of Trust and Corporate Service Providers.....	7
IV.	Use of Client Money Accounts	8
V.	Banking Arrangements	11
VI.	Policies, Procedures and Controls	14
VII.	Breaches and Overdrafts	16
VIII.	Anti-Money Laundering measures	18
IX.	Key Findings	19



I. Scope

Client Money was selected as the topic for the 2016 Thematic Review as it forms a key part of a fiduciary’s duties and responsibilities, and follows on naturally from last year’s thematic review. Further it enabled the Division to reflect on crystallised risks recently experienced in the sector and provided an opportunity for the Division to assess the need for Client Asset Rules to ensure that the Bailiwick complies with International Standards as there is currently limited prescribed guidance in this area.

Each of the Codes of Practice³ sets out the current requirements to maintain funds held in companies, foundations and trusts to be kept separately from each other, and from the firm’s own funds.

Principle 6 of the Principles of Conduct of Finance Business further details the requirement for firms to protect client assets as follows:

“Where a financial institution has control of or is otherwise responsible for assets belonging to a customer which it is required to safeguard, it should arrange proper protection for them, by way of segregation and identification of those assets or otherwise, in accordance with the responsibility it has accepted.”

Approach

The thematic review consisted of two stages:

- A questionnaire was sent to all full fiduciary licensees, asking for an overview of the firm’s Client Money provisions;
- On-site visits to eight firms were conducted in order to gain a practical understanding of their arrangements.

The questionnaire was divided into the following sections, which collectively reflect the requirements of the Code and the Principles of Conduct of Finance Business.

Section	Component parts
Client Money Accounts	<ul style="list-style-type: none">• Description of the circumstances in which the Trustee would utilise a Global Client Money Account and where Global Client Money Accounts are not utilised the alternative arrangements that have been put in place.• The length of time that funds typically sit on the Global Client Money Account.• The number of individual Client Money Accounts operated and an estimation of the number of transactions going over the account per month.• Outsourcing of cash management of Individual Client Money Accounts to a third party, oversight of those outsourced arrangements

³ Principle 6 of the Code of Practice – Corporate Service Providers
Principle 6 of the Code of Practice – Foundation Service Providers
Principle 4 of the Code of Practice – Trust Service Providers

Banking Arrangements	<ul style="list-style-type: none"> • Details of banking institutions holding the Fiduciary's Client Money, the jurisdictions they are held in and the frequency that bank statements are received. • Procedures applied for determining whether a particular banking institution is appropriate to hold the Fiduciary's clients' funds. • Details of any difficulties experienced when opening/operating Client Money Accounts. • A description of how any commission, retrocession or other incentives from the banking institutions holding Client Money is disclosed to clients.
Procedures and Controls	<ul style="list-style-type: none"> • Identification of policies, procedures and controls in place to operate Client Money Accounts generally and to prevent inappropriate use of client funds for settlement of fees and disbursements. • The oversight and controls implemented by the Board in respect of Client Money, including signing controls and contingency arrangements in the event of staff absence. • The arrangements for providing staff with Client Money training. • The frequency of Client Account reconciliations and how they are documented i.e. reconciliations or procedures.
Breaches and Overdrafts	<ul style="list-style-type: none"> • The identification of whether the firm has breached its own Client Money procedures during the last 12 months. • Where a firm's Client Money bank account has gone overdrawn, the financial impact on the Client, the notification made to the Client and whether there was a need for the firm to fund any shortfall to the Client.
AML/CFT	<ul style="list-style-type: none"> • The policies, procedures and controls applied to obtaining CDD prior to the firm accepting Client Money. • The procedures applied for the receipt of Client Funds in cash e.g. £10 as initial settled funds. • Procedures for paying cash away or arranging for cash to be made available for collection by Clients.

The questionnaire responses provided a useful benchmark on how fiduciaries are currently operating their Client Money arrangements and, in aggregate, the questionnaire responses are useful for benchmarking the sector as a whole.

Eight firms were selected for a one day on-site visit. Firms were selected in order to represent the diversity of the sector and included a cross section of PRISM impact ratings, ownership structures (specifically including bank owned institutions), size of firm and types of Client Accounts operated. Visits consisted of a discussion with management to gain an overview of the systems and processes relating to the operation of Client Accounts, and a review of a small sample of client files to understand how these arrangements operate in practice.

Our objective in carrying out a questionnaire and on-site visits was to allow us to identify a spread of good practice relevant to the sector as a whole and to review and consider specific areas of poor practice. We are grateful to the firms that participated for their time and cooperation.

We should also like to thank Mr Peter Mills and Miss Tina Torode of Optimus Group Limited for their assistance with the Thematic Review.

The following pages will consider each of the sections shown above to highlight how local firms are discharging their responsibilities.

Please note that all graphs contained within this report are based on the questionnaire responses received unless otherwise stated.

II. Current Responsibilities of Licensees

As has been acknowledged, there is currently limited prescribed guidance in the area of Client Money. The existing guidance can be found in the Principles of Conduct of Finance Business and within the Codes of Practice for Trust Service Providers, Corporate Service Providers and Foundation Service Providers and is summarised below.

Principle 6 of the Principles of Conduct of Finance Business “Customer Assets”

Where a financial institution has control of or is otherwise responsible for assets belonging to a customer which it is required to safeguard, it should arrange proper protection for them, by way of segregation and identification of those assets or otherwise, in accordance with the responsibility it has accepted.

Principle 4 of the Code of Practice – Trust Service Providers (“TSP”)

TSPs should treat the interests of beneficiaries as paramount subject to their legal obligations to other persons or bodies. In particular, TSPs should:

Ensure that the funds of different trusts are kept separately from each other and from the TSP’s own funds

Principle 6 of the Code of Practice – Corporate Service Providers (“CSP”)

A CSP should, through its staff:

Keep the funds of each client company separate from each other and from the CSP’s own funds,

Principle 6 of the Code of Practice – Foundation Service Providers (“FSP”)

A FSP should, through its staff:

Keep the funds of each foundation separate from each other and from the FSP’s own funds,

III. The Group of International Finance Centre Supervisors – Standard on the Regulation of Trust and Corporate Service Providers

Given the lack of existing prescribed guidance in the area of Client Money there is currently a gap between the Principles of Conduct of Finance Business and Codes of Practice for TSP, CSP and FSP and the GIFCS Standard.

The GIFCS Standard was issued in October 2014 and is intended to promote and reinforce high standards in the sector. Part 3 of the Standard governs the oversight of licensed fiduciaries by the Commission and constitute the minimum elements that should be present in a regulatory framework for TCSPs. Standard E is entitled “Control over Vehicles”.

Section 2 states:

2.2 The Regulator should require TCSPs to establish and document clear policies and procedures that ensure:

2.2.2 there is a segregation of Vehicle assets from those of the TCSP

Section 3 states:

3.1 The Regulator should put in place rules for the administering of and holding of Client monies which at a minimum address:

- 3.1.1 segregation of the Client monies from the monies of the TCSP*
- 3.1.2 the requirement to hold Client monies in clearly separate and distinct accounts from any accounts of the TCSP’s own monies;*
- 3.1.3 the disclosure to Clients of the terms upon which Client money is held;*
- 3.1.4 the requirement for Client money accounts to be reconciled promptly by the TCSP;*
- 3.1.5 the requirement for the payment away of Client monies to be subject to a dual signature regime; and*
- 3.1.6 the establishment of policies, procedures and controls to prevent the inappropriate use of Client monies for the settlement of TCSP fees and disbursements*

IV. Use of Client Money Accounts

Client money can be held in an **Individual Client Money Account** (a bank or building society account holding client money for a particular trust, company, foundation or structure) or in certain circumstances may be held in a **Global Client Money Account**⁴ (a bank or building society account holding client money for more than one client). As licensees are required to keep the funds of each client company, trust or foundation separate from each other we sought to ascertain the circumstances in which a licensee would operate a Global Client Money Account.

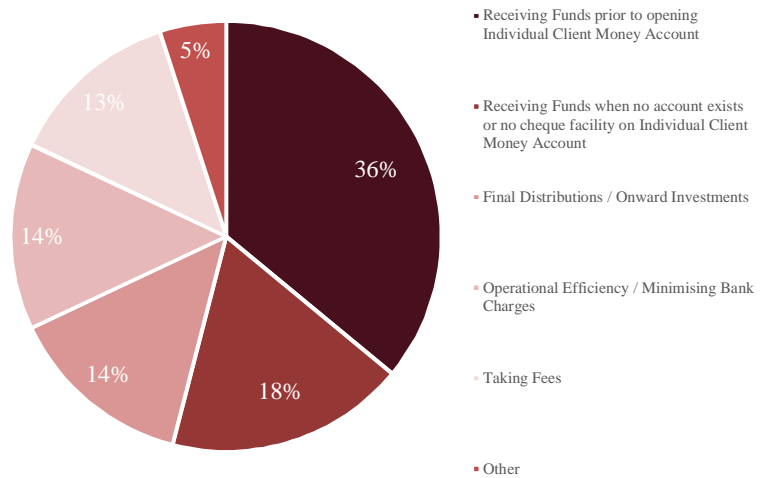
Operation of Global Client Money Accounts

The questionnaire identified that 59% of respondents used Global Client Money Accounts and the table below sets out the various reasons why licensees open and operate Global Client Money Accounts. By far the most common reason was to receive client funds prior to opening an Individual Client Money Account, but licensees also use them for operational efficiency such as paying registry fees on behalf of a number of client companies, taking fees or making a payment by cheque where the Individual Client Money Account does not have a cheque book. The third main use of Global Client Money Accounts is at the end of a client relationship to make final distributions or onward investments.

⁴ Simplified due diligence measures in s6.5 of the Handbook for Financial Services Businesses on Countering Financial Crime and Terrorist Financing can only be applied by a bank on a client account in the name of a person licensed under the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2000 when holding funds on a short term basis.

“ Describe the circumstances in which you would use a Global Client Money account. ”

Rationale for Utilising Global Client Money Account

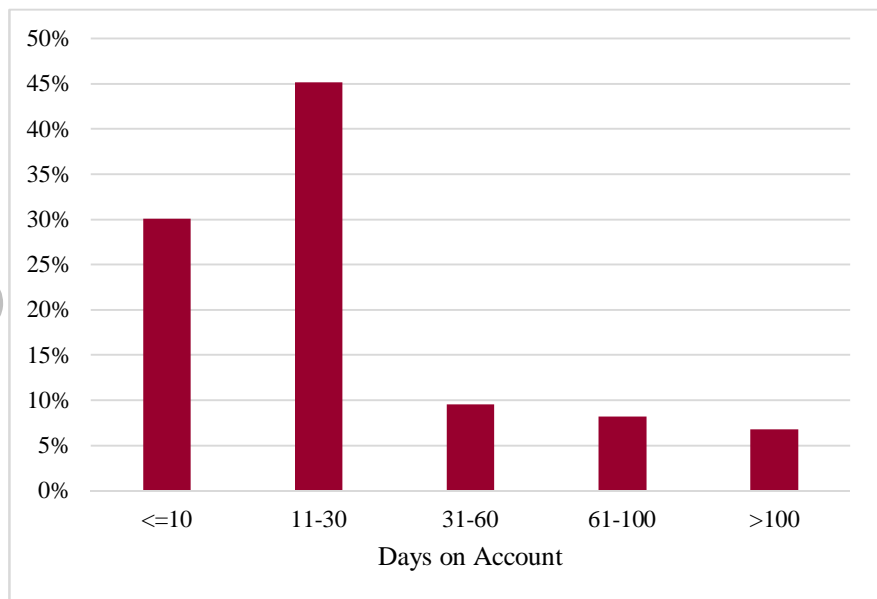


There were no unexpected reasons for using a Global Client Money Account in the responses.

Global Client Money Account Transactions

We asked those firms that maintain Global Client Money Accounts to detail how long funds typically sit within a Global Client Money Account. The range of responses is detailed in the chart below. For all types of firms the median number of days for items remaining on a Global Client Money Account was 30 days, with 75% of firms responding that items remain on Global Client Money Accounts for 30 days or fewer. Firms maintaining items on a Global Client Money Account over 30 days are in the minority and out of line with their peers.

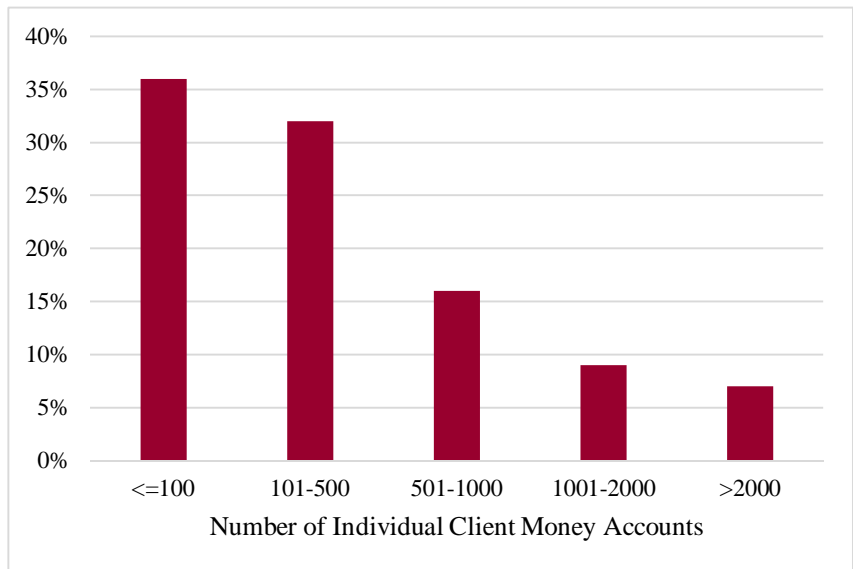
“ For how many days do funds typically sit on your firm’s Global Client Money Account? ”



Individual Client Money Accounts

We asked firms how many Individual Client Money accounts they operated. The number varied significantly, with some firms running several thousand and others running only a handful. The median number of accounts was 220.

“ Please state how many Individual Client Money accounts your firm operates? ”



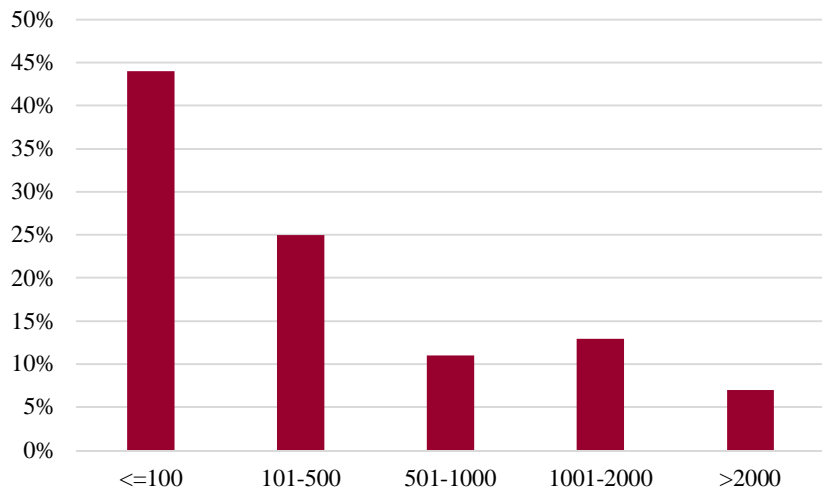
There was no particular type of firm ownership structure that stood out as having more accounts than others and in many cases it simply depended on the types of clients that they held. Over two thirds of the firms had 500 or fewer Individual Client accounts as shown.

This information further highlights the significant diversity of the Guernsey Fiduciary sector and reinforces the need for firms to ensure that their risk appetite, procedures and training are tailored to their individual requirements.

Individual Client Money Account Transactions

We asked firms to estimate the number of transactions that typically pass through their Individual Client Money accounts on a monthly basis.

“ Please provide an estimate of how many transactions pass through Individual Client money accounts each month? ”

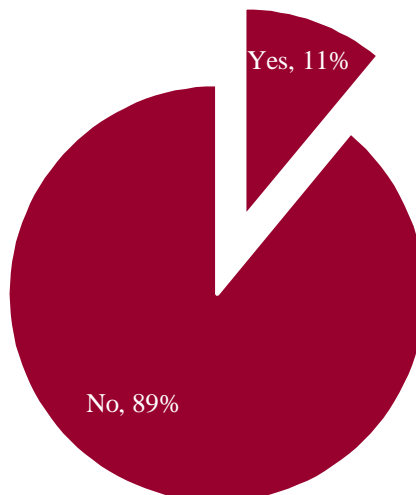


Some firms indicated that they were running several thousand transactions per month and others running only a handful. The bar chart above reflects the responses for firms reporting between 1 and 90,000 transactions. Almost half of the firms have fewer than 500 transactions across all their Individual Client Money accounts each month and only 7% of firms have more than 2,000 transactions per month. The median number of monthly transactions was 100, and there was no correlation between the number of transactions and the ownership category of firms.

Outsourcing of cash management to a third party

We asked firms whether they outsource their cash management to a third party and if yes for details of their outsourcing arrangements. 11% of firms confirmed that they outsource cash management to third parties.

“ Does your firm outsource cash management of Individual Client Money accounts to a third party? ”



Most of those firms that outsourced cash management are privately owned firms or trust companies linked to legal and accounting practices. There are a very small number of firms linked to international financial groups that outsource their cash management to another part of the group and, in such circumstances, formal agreements should be in place to ensure that the interests of the beneficiaries remain paramount. Whilst these statistics were interesting, it highlighted that there are very few firms that currently outsource this function.

As with retrocessions the Commission would expect those firms engaging in outsourced cash management services to have appropriate outsourcing agreements in place which are monitored and to fully disclose to clients, in a transparent manner, the terms upon which the funds are held to avoid conflicts of interest or the appearance thereof.

V. Banking Arrangements

Responsibilities of Licensees

Principle 4 of the Code of Practice – Trust Service Providers

TSPs should treat the interests of beneficiaries as paramount subject to their legal obligations to other persons or bodies. In particular, TSPs should:

manage the investment and custody of trust assets professionally and responsibly

Banking Institutions

As expected there were a wide range of banking institutions used by firms reflecting the diverse nature of the business undertaken by the fiduciary sector. The majority of respondents appear to utilise the services of a combination of Guernsey based banks as part of their provision of Client Money Accounts.

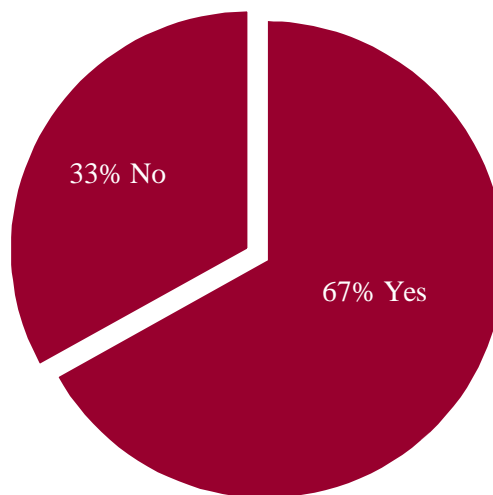
As expected the preference among firms appears to be for the bulk of relationships to be held in Guernsey,

however the jurisdictions used by the Fiduciary Sector for banking services again reflect the wide diversity of the industry. Firms indicated that banking relationships are held in most of the world’s major banking centres and a very small number are held in more remote jurisdictions.

Procedures for Banking Arrangements

We asked firms to confirm whether they have procedures for determining whether a particular banking institution is appropriate to hold client funds. 67% of those responding to the Questionnaire indicated that they do have procedures in place for determining the suitability of a banking institution.

“ Does your firm have procedures for determining whether a particular banking institution is appropriate to hold your clients’ funds? ”



The majority of respondents who have procedures for determining whether a particular banking institution is appropriate to hold client funds also indicated that they maintained an approved list of banking institutions. It appeared that in most cases any new banking institution added to the approved list would be the subject of a review and agreement by the Board of Directors of the firm prior to being added.

During the on-site visits we were able to discuss the assessment of banking institutions directly with representatives of the firms visited. The nature of the ongoing assessment of the suitability of a banking institution differed, however, the criteria used to make the assessment were generally the same. There were examples of enhanced metrics being used to monitor the suitability of a banking institution where firms did not feel comfortable placing reliance solely on the more traditional ratings issued by ratings agencies.

In one instance the Board of Directors of a firm had become sufficiently concerned regarding the suitability of a banking institution to consider exiting all relationships held which is a good example of a proactive approach to their fiduciary responsibilities.

Banking Arrangements

Through the results of the questionnaire the Commission has been able to collate information relating to any challenges experienced in opening banking relationships by the Fiduciary Sector. The examples provided, and discussions held during the on-site visits, indicate that the main challenges experienced are as a result of stricter criteria being applied on a global basis as banking institutions seek to de-risk their client base.

Retrocessions, Commissions or Incentives

Principle 6 of the Principles of Conduct of Finance Business “Conflicts of Interest” states:

A financial institution should either avoid any conflict of interest arising or, where a conflict arises, should ensure fair treatment to all its customers by disclosure, internal rules of confidentiality, declining to act, or otherwise. A financial institution should not unfairly place its interests above those of its customers and, where a properly informed customer would reasonably expect that the financial institution would place his interests above its own, the financial institution should live up to that expectation.

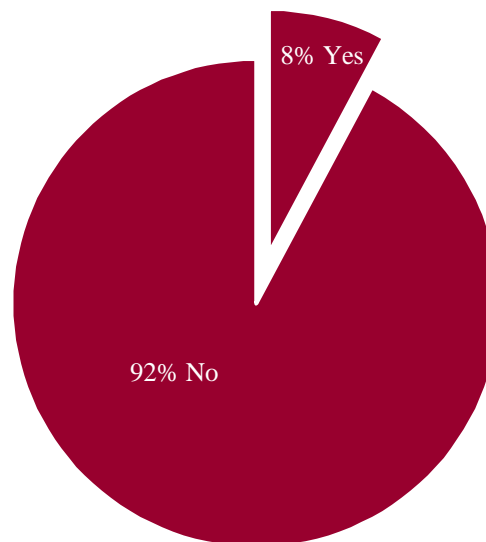
Principle 5 of the Code of Practice – Trust Service Providers states:

TSPs should, through their staff:

once a trust has been established, identify and act in the best interests of the beneficiaries and avoid or deal properly with any conflict of interest between trusts or between the TSP and the beneficiaries of a trust

We asked firms to indicate whether they receive commissions, retrocessions or other incentives from the banking institutions holding Client Money.

“ Does your firm receive any commission, retrocession or other incentive from the banking institutions which hold your Client Money? ”



It was encouraging to see that the percentage of firms in receipt of commissions, retrocessions or other incentives is lower than the response received during the 2015 Thematic Review of Fiduciary Decision Making in Respect of Assets Under Trust.

We also asked firms to indicate how any commission, retrocession or other incentive from a banking institution is disclosed to clients.

Despite the recommendations made in the Thematic Review of Fiduciary Decision Making in Respect of Assets Under Trust it was disappointing to see continued examples of firms advising in their terms and conditions that the trustee may receive retrocessions but failing to disclose actual amounts received in subsequent communications to their clients. The Commission would like to remind Trustees that firms should advise clients of the actual amount of any retrocessions received in relation to their account in a fully transparent manner in order to avoid conflicts of interest or the appearance thereof. It is also important to note that the terms of a trust must permit trustees to receive retrocessions otherwise they may be acting in breach of trust.⁵

⁵ Section 24 (c)(iii) The Trusts (Guernsey) Law, 2007

VI. Policies, Procedures and Controls

Responsibilities of Licensees

Under the Codes of Practice licensees are required to keep the funds of each client company, trust or foundation separate from each other and from the licensee's own funds.

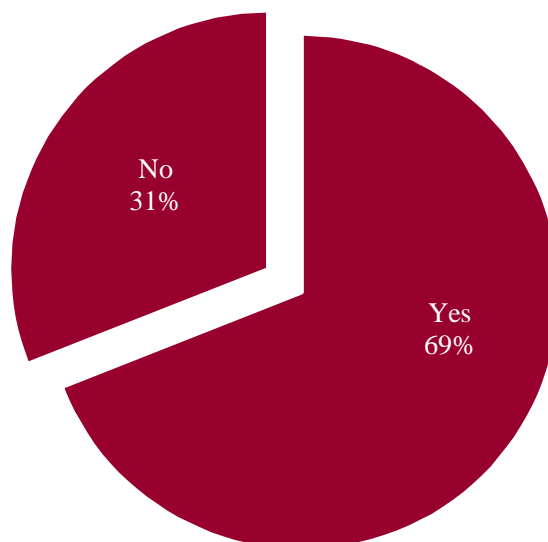
Principle 4.4 Code of Corporate Governance

The company should maintain a sound system of internal controls to safeguard the company's assets and to manage risk, and the Board should regularly review such controls.

Documented policies, procedures and controls

Question 3.1 of the Questionnaire asked if the firm has documented policies, procedures and controls to prevent the inappropriate use of Client Money. The majority of fiduciaries reported that they had documented policies, procedures and controls for the operation of Client Money Accounts.

“ Does your firm have documented policies, procedures and controls to prevent the inappropriate use of Client Money for the settlement of fees and disbursements? ”

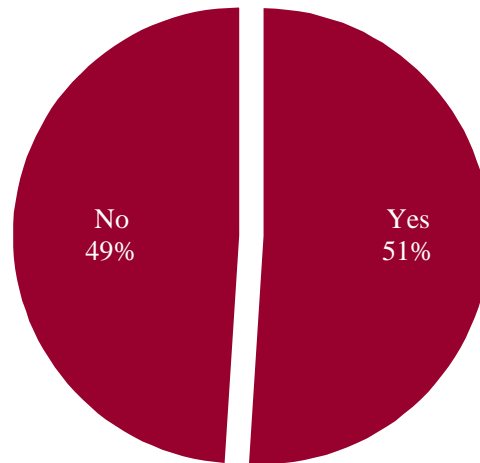


Where firms did not have documented policies and procedures for the operation of Client Money Accounts they were able to demonstrate that controls existed around the use of Client Money Accounts. For example, payments were subject to four eyes authorised signatory arrangements and Client Money Accounts were reconciled on a regular basis. Clearly documented procedures should be in place and we would encourage those 31% of firms above to address this issue expeditiously.

Client Money Training

Question 3.3 of the Questionnaire asked firms if their staff received client money training, the frequency of training and when it was last provided. About half of the firms reported that they provided Client Money training to their staff.

“ “ Do staff receive Client Money training? ” ”



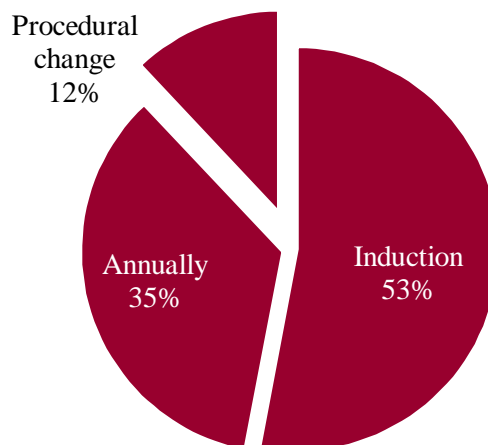
Frequency of Client Money Training

Of those firms that do provide Client Money training to their staff more than half provide formal training, while 20% provide on the job training.

When looking at the frequency of training we noted that over half of the firms that provide training do so during the induction of new employees, although 63% of those firms then do not provide any further on-going training. Good practice would include on-going refresher training or a requirement for staff to re-read procedures and confirm their understanding on a regular basis.

Over one third of firms provide annual training and another 12% provide training when procedures change.

“ “ How frequently is training provided and when was it last provided? ” ”



When analysing these figures further we identified that 46% of firms have Client Money procedures and provided training to their staff. However, of concern was that almost 19% of firms that operate client money accounts do not have client money procedures and do not provide client money training. Again we would suggest these firms remedy this situation in early course.

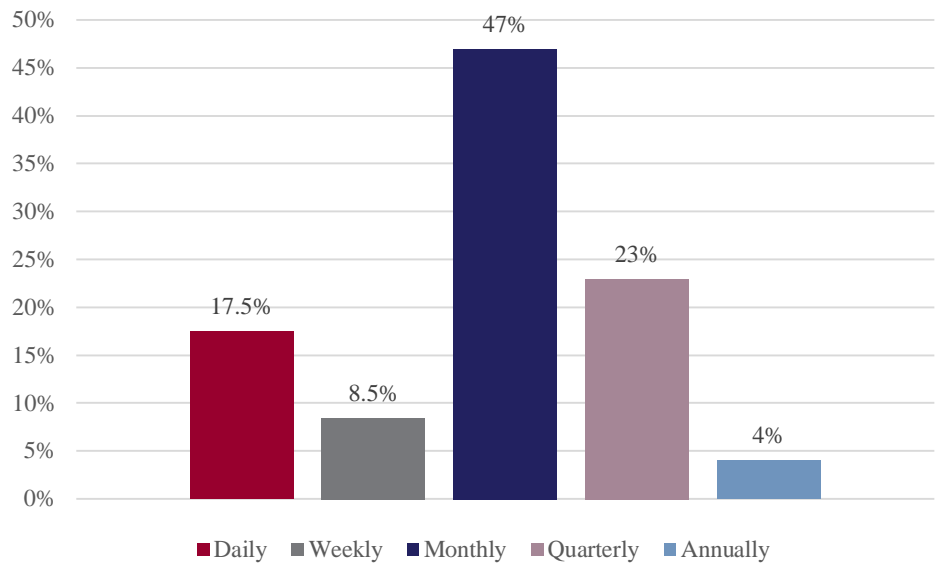
Good practice suggests that initial and ongoing training ensures staff knowledge of policies and procedures remain current which should reduce the likelihood of errors.

Reconciliation of Client Money Accounts – both Global and Individual

Carrying out bank reconciliations is recognised as an essential control for safeguarding a client’s assets and identifying bookkeeping errors. We asked licensees how frequently they carry out Client Account reconciliations. The reconciliation frequency varied from daily through to annually. The most popular reconciliation frequency was monthly at 47%, and 73% of firms reconcile their Client Money accounts at

least monthly. It was interesting to note that 17.5% of respondents reconcile their accounts daily by accessing their online banking facility or taking daily feeds.

“ How often does your firm reconcile the accounts which hold your clients' funds? ”



Although firms were asked how often they reconcile their Client Money Accounts the majority provided separate data in respect of Global Client Money Accounts and Individual Client Money Accounts. It is interesting to note that 23% of firms reconcile their Global Client Money Accounts on a daily basis compared to 12% of monthly reconciliations for Individual Client Money Accounts. Overall, 80% of firms reconcile their Global Client Money Accounts at least monthly compared with a monthly reconciliation frequency of 68% for Individual Client Money Accounts.

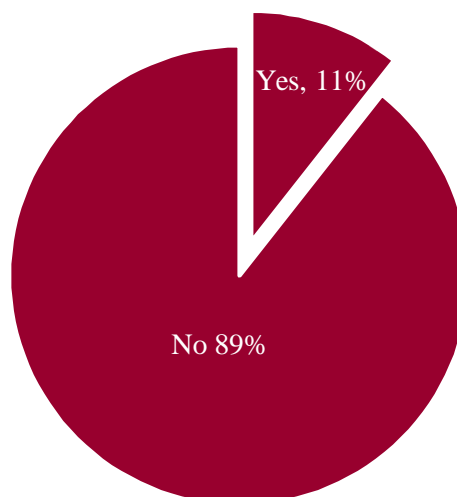
Although there are often good reasons that determine how often Client Money Accounts are reconciled, such as the frequency of bank statements and the term of a fixed deposit, good practice suggests reconciliations should be carried out more frequently where there is a high volume of transactions. This is an area where we saw examples of both good practice and poor practice. An example of good practice is where the bank reconciliations are carried out automatically or independently of the bookkeeper posting the transactions. We saw examples where bookkeeping of transactions was not completed until receiving bank statements, better practice suggests that firms should post transactions as they occur and subsequently reconcile upon receipt of the bank statement.

VII. Breaches and Overdrafts

Breaches of Client Money procedures

We asked firms to identify whether there had been any breaches of their Client Money procedures in the last 12 months. Largely firms had complied with their internal procedures during the past 12 months with 89% of firms not experiencing any breaches.

“ Has your firm suffered any breaches of its own Client Money Procedures during the last 12 months? ”



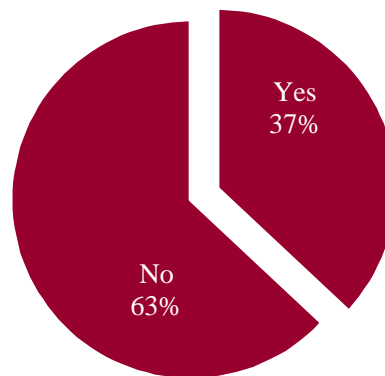
Of the 11% of firms that had had breaches half of the breaches occurred due to an operational error by the firm. In the remaining handful of cases breaches occurred due to an operational error by the bank or as a result of a very small number of email frauds.

The number of breaches disclosed in response to the Thematic Questionnaire was very low across the industry. While this may indicate that most firms have strong controls around the operation of Client Money accounts the majority of the errors disclosed related to operational errors either by the firm or the Bank.

Client Money bank account overdrafts

We asked firms whether any Client Money Accounts had gone overdrawn in the last 12 months. 37% of firms confirmed that they had incurred overdrafts on their Client Money bank account(s).

“ Have any of the firm’s Client Money bank accounts been overdrawn? ”



The vast majority of overdrafts (two thirds) related to errors caused by the firm and a further 15% were due to errors by the bank, which in total is 81%. Of that 81% over half were as a result of errors relating to the taking of fees/charges. The remaining 19% related to late incoming funds.

There would appear to be a couple of steps that licensees should take to avoid the instances of Client Money Accounts going overdrawn. The first is that firms should ensure that they fully understand the charges that would be levied by the Bank (e.g. monthly charges or fees for PEP relationships or payment charges). It is important, especially on Client Money Accounts, for firms to understand fully and agree the banking terms applicable to those accounts and to ensure that the banks operate those accounts appropriately.

Secondly, where payments are made on the basis of the receipt of incoming funds firms should ensure, by contacting the bank, if necessary, whether those funds have actually been received.

Question 4.4 of the Questionnaire asked the firms whether there had been any financial impact on the client. Of the 37% of firms confirming they had incurred overdrafts 71% of them confirmed that there had been no financial impact and only 29% had incurred some financial impact. None of the losses were large and most of the losses related to interest and/or bank charges.

Of those firms where there had been a financial impact on the Client, 58% of firms made good the error and 67% of firms advised their client. Interestingly in the case of 4 firms where there had been no financial impact as a result of the overdraft those firms openly communicated the circumstances to their client.

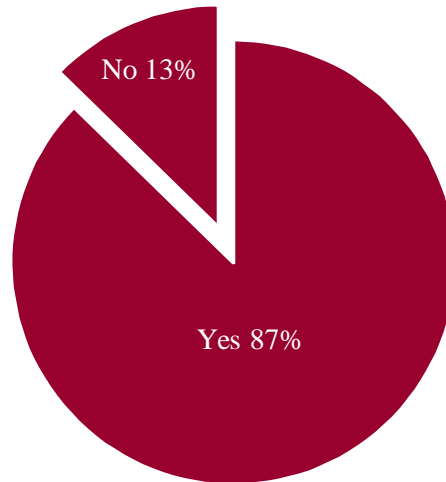
It was pleasing to note that firms understood the importance of treating clients fairly and ensuring that in most cases clients did not suffer financial losses.

VIII. Anti-Money Laundering measures

Obtaining CDD

We asked firms to confirm whether full CDD was obtained prior to the firm accepting Client Money and if yes how was the procedure applied? 87% of firms confirmed that they do obtain full CDD prior to accepting Client Money.

“ Is full CDD obtained prior to your firm accepting client money? ”



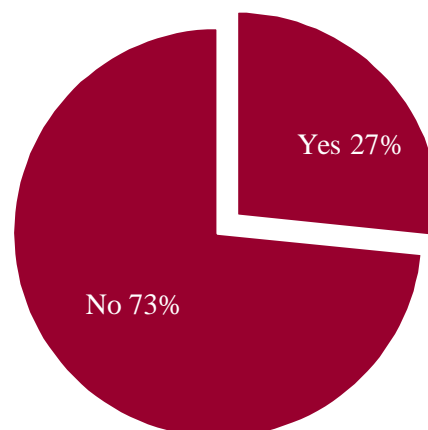
The majority of those 13% of firms that admitted to accepting client money before obtaining full CDD made the point that such funds were only accepted on an exceptional basis, in specific circumstances and the receipt of those funds would have to be signed off accordingly. Those funds would be blocked so that they could not be paid away to a third party and would be returned to the originating bank account in the event that satisfactory CDD was not obtained⁶.

Firms demonstrated strong controls in ensuring the CDD is obtained before fully accepting Client Money and utilising Client Money accounts.

Client funds received in cash

We asked firms to confirm whether they received any Client Funds in cash. Only 27% of firms confirmed they receive Client Funds in cash and 79% of those firms indicated that this was to receive the initial settlement into trust structures (typically £10 or thereabouts). Fewer than 5% of all firms indicated that they received funds in cash directly from clients for anything other than the initial settlement into the trust structure.

“ Does your firm receive client funds in cash at any point? ”

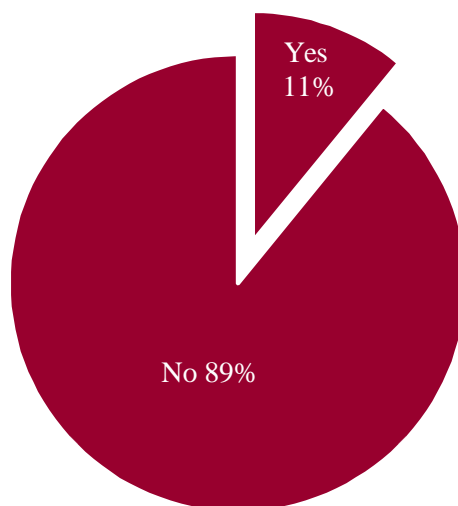


⁶In all cases the shareholders/settlers/beneficiaries had been identified and the outstanding CDD related to completion of background checks or receipt of original copies of identification data.

Cash payments/collections

Finally, we asked firms to confirm whether they paid cash away or arranged for cash to be collected by clients and only 11% of firms confirmed they do provide these services. Those firms indicated that this is rare and only done in exceptional circumstances. Further 67% of those firms indicated that they maintain a cash register and 83% of those firms indicated that they include extra authorisation controls before allowing cash payments. Good practice would suggest that a register of cash transactions be maintained to record such transactions.

“ Does your firm pay cash away or arrange for cash to be made available for collection by Clients? ”



IX. Key Findings

Our overall findings from the thematic review highlight that the sector largely demonstrates good practice and a strong control environment regarding the operation of Client Money Accounts. However, there are some areas for improvement as highlighted in our results.

Use of Client Money Accounts

The majority of firms used either Global Client Money Accounts, Individual Client Money Accounts or a combination of both. Global Client Money Accounts were typically used when an Individual Client Money Account did not exist, or for operational efficiency. Firms recognised the importance of keeping Client Monies separate from the firm’s own money and utilising appropriate account designations.

Three quarters of firms only kept items on Global Client Money Accounts for 30 days or fewer and this is clearly the industry standard. Firms recognised that client monies should not be left on Global Client Money accounts for extended periods.

Banking Arrangements

In general, firms have policies and procedures in place for the selection of banking institutions and we were able to see that in a number of cases firms had a robust review process for the ongoing monitoring of those relationships, including considering the future of a banking relationship.

The vast majority of fiduciaries declared that they do not accept retrocessions, however there are still instances where they are accepted by a minority of fiduciaries. Where this is the case, the Commission expects that fiduciaries fully disclose this to clients in order to avoid actual and perceived conflicts of interest.

Policies, Procedures and Controls

The majority of firms indicated that they have documented procedures in place to operate Client Money Accounts and about half of firms stated that they train staff in the use of Client Money accounts. Of those firms approximately half provide training during a staff member's induction, a further 35% provide annual training and 12% provide training when procedures change. We would expect firms to have in place procedures in relation to the operation of Client Money accounts and staff should be appropriately trained in the use of those accounts on a regular basis.

Firms recognise the importance of reconciliations and approximately three quarters of firms reconcile their Client Money accounts at least monthly. Almost one quarter of firms reconcile their Global Client Money account on a daily basis taking feeds directly from the Banks. Regular reconciliations are an important control and can minimise losses through early detection of problems.

We saw evidence of some firms using technology to increase the amount of information received directly from banking institutions which appeared to enable firms to keep up to date with bookkeeping and recording transactions rather than relying upon manual entry. In some cases we saw practice which indicated that bookkeeping of transactions may not occur until the receipt of bank statements which could be received on a quarterly basis.

Breaches and Overdrafts

Firms recognised the importance of minimising breaches and overdrafts and only 11% of firms had a breach of their Client Money procedures between June 2015 and May 2016, although 37% of firms had suffered an overdraft on a Client Money account. Most of the breaches related to some form of operational error, while most overdrafts were as a result of bank charges. Firms are encouraged to understand the charges levied by the banks to minimise the impact of these types of error.

Anti-Money Laundering measures

Almost 90% of firms obtained CDD prior to receiving funds into a Client Money account. In the vast majority of cases where Client Money may have been received prior to full completion of CDD there were strong controls in place to ensure Client Money was not utilised until the CDD process was complete. In some cases, firms would return funds to the originating bank account if CDD was not forthcoming.

About a quarter of all firms received some funds in cash and typically these related to the settlement of the initial trust corpus. Only 11% of firms confirmed that they paid cash away or arranged for cash to be collected. In all cases where cash is received or paid away firms should have strong controls, including a register, appropriate authorisation and a robust rationale for allowing a cash transaction.

The Future

The Commission is looking to comply with the GIFCS Standard by April 2019 and submitted its action plan for compliance in advance of the Plenary meeting held in Chile on 29 November 2016. In order to comply with Standard E of Part 3 of the GIFCS Standard (as set out under section III above) the Commission considers that it will need to issue Client Asset Rules during 2017. During the Client Money Thematic it became clear that differences between the existing requirements for Fiduciary Licensees and those holding an Investment Licence had resulted in alternative interpretations of the Client Money Thematic Questionnaire. The proposed Client Asset Rules will take consideration of both the Fiduciary and Investment sectors so that there is a common approach and, as such, we have been liaising with our colleagues in the Investment Supervision and Policy Division. We have also been liaising with the Guernsey Association of Trustees and the rules are currently being drafted. We intend to issue a Consultation Paper during the first half of 2017.