



Guernsey Financial  
Services Commission

## Client Money – Investment

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*Thematic Review 2024*



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## Executive Summary

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During 2024, the Commission undertook a thematic review to assess the effectiveness of controls over Client Money at investment and fiduciary licensees. This report sets out the findings for investment licensees – specifically, all designated administrators, brokers and investment intermediaries. The Commission was pleased to note that there was a 100% response rate to the Thematic Review.

The Commission was generally satisfied with Client Money safeguarding arrangements, with a range of good practice observed.

### **What did the Commission find?**

#### **A) Licensees appropriately segregate and reconcile Client Money**

Licensees operate Client Money Bank Accounts for specific funds or brokerage accounts, ensuring clear designation and proper labeling to prevent co-mingling.

The COB Rules require reconciliations of Client Money Bank Accounts to take place at least monthly, a practice confirmed by all respondents to the investment questionnaire.

#### **B) Overall, licensees demonstrated a robust control environment to ensure the safety of Client Money**

The Commission reviewed policies and procedures related to Client Money, noting that detailed checklists and clear signposting helped mitigate risks and reduce errors. Training on these policies varied in frequency and method. Some firms rely heavily on experienced staff which presents a key person risk if detailed and accessible policies and procedures are not embedded within the business.

Additionally, policies ensured that payments from Client Money Bank Accounts had thorough checks to enhance accuracy and security. The Commission found that CMP testing for Client Money is conducted as expected across investment licensees, with adequate internal and external audits, and any identified issues are assigned actions for remediation.

#### **C) Licensees should ensure that local regulatory requirements are embedded within policies and procedures**

The Commission saw some policies and procedures, for licensees who are part of a larger multi-jurisdictional groups, where local regulatory requirements are not taken into account. Licensees should ensure that, prior to adopting any groupwide policy and/or procedure, consideration is made in respect of local regulatory requirements to reduce the regulatory risk of non-compliance.

#### **D) Licensees should take care to prevent overdrawn Client Money Bank Accounts**

Some licensees reported overdrawn Client Money Bank Accounts in the past 12 months, with breaches being of low value and mainly due to transaction timing issues. In the past 12 months, all overdrawn accounts were cleared within 24 hours without any detriment to clients.

There is no evidence of widespread poor practice; however, licensees should ensure an adequate level of oversight to reduce the risk of overdrawn Client Money Bank Accounts, such as making sure that there is an appropriate level of communication with their banking providers.

### **E) Client Money is mostly held at Approved Banks, but with some exceptions**

Licensees adequately scrutinise and monitor the banks at which they hold Client Money. Most accounts for Client Money are held at banks in the Bailiwick. Licensees maintain an internal Approved Bank list, evaluating factors such as credit rating and financial stability, and monitoring those providers for adverse media.

The Commission found that the vast majority of licensees hold Client Money with Approved Banks, as required by the COB Rules. However, some licensees reported holding Client Money at banks or other institutions that do not meet the Approved Bank criteria without having received the necessary modification to, or derogation from, the COB Rules to do so. If a licensee wishes to hold Client Money outside an Approved Bank for a particular reason, it should submit a request for modification of the COB Rules, which should be appropriately detailed and contain sufficient rationale.

## Background

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Thematic reviews are used by the Commission as a tool to gather information on specific aspects of the Bailiwick's financial services sector. A review also provide a means by which the Commission can share observations with industry on good practice and areas for improvement and engage with a wide selection of regulated entities.

Client Money was selected as the topic for the 2024 Thematic Review in order to ascertain whether or not Client Money held by Guernsey-licensed entities is safe. Licensees can take steps to protect Client Money by “ring-fencing” so as to:

- Prohibit firms from using Client Money to finance their business;
- Prohibit the use of one Client's funds to finance another Client; and
- Assist with the return of Client Money to the Client in the event of bank failure

Licensees must ensure Client Money, both at receipt stage and pending distribution or onwards transfer, is safeguarded and appropriately accounted for. Failing to do so, especially at the receipt stage, can cause an unwanted knock-on effect by, for example, affecting the accuracy of accounting records and potentially affecting investors' percentage allocation with respect to collective investment schemes.

It is important to ensure that even when a licensee ceases to operate, Client Money is safeguarded and kept separately from the licensee's own.

Protecting consumers and the reputation of the Bailiwick are key for the Commission, and fundamental to this is the protection of Client Money.

### Current legislation and international standards

The International Organization of Securities Commissions (“IOSCO”) published a report entitled “Recommendations Regarding the Protection of Client Assets” in 2014. The relevant principles pertaining to this Thematic Review can be summarised as follows:

- **Principle 1:** A licensee should maintain accurate and up-to-date records and accounts of client assets that readily establish the precise nature, amount, location and ownership status of client assets and the clients for whom the client assets are held. The records should also be maintained in such a way that they may be used as an audit trail.
- **Principle 3:** A licensee should maintain appropriate arrangements to safeguard the clients' rights in client assets and minimise the risk of loss and misuse.
- **Principle 4:** Where a licensee places or deposits client assets in a foreign jurisdiction, it should understand and take into account the foreign regime to the extent necessary to achieve compliance with applicable domestic requirements.

The above principles are incorporated into the Commission's regulatory framework through The Licensees (Conduct of Business) Rules, 2021 (the “COB Rules”).

## Scope

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The Commission sent questionnaires to all designated administrators, asset managers/brokers and investment intermediaries, including a data request for number and location of all Client Money Bank Accounts held. Licensees responded based on the 12-month period immediately preceding the issuance of the questionnaire (“the reporting period”).

## Approach

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The Thematic Review consisted of five stages:

1. The Commission considered international standards relevant to the safeguarding of Client Money; specifically the IOSCO report referenced in the Background section, as well as the Commission’s rules in respect of Client Money.
2. An initial information gathering stage. Questionnaires were sent to the relevant licensees (as listed above in the Scope).
3. A desk-based review of the information provided in response to the initial requests was undertaken, which was used to inform discussions during the interview stage.
4. A representative sample of investment licensees were invited to attend a short interview at the Commission’s offices.
5. The licensees interviewed provided their policies and procedures relating to Client Money, as well as any relevant Compliance Monitoring Programme (“CMP”) tests, which were analysed by the Commission.

## Analysis

The below table shows the breakdown of licensees by type and whether or not they operate Client Money Bank Accounts:

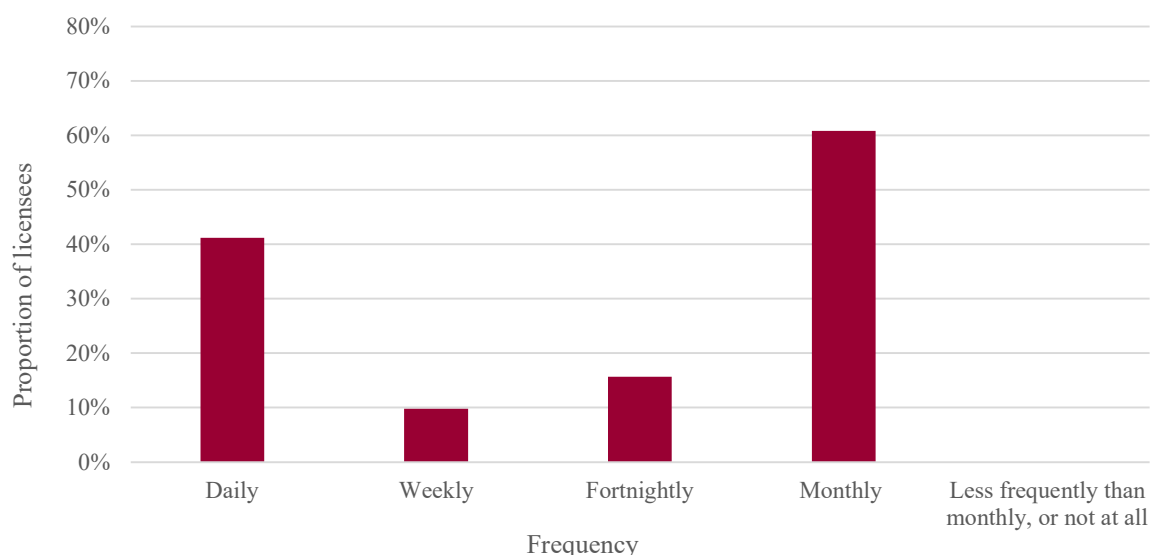
|   | Designated Administrators | Investment Intermediaries | Asset Managers/ Brokers | Total |
|---|---------------------------|---------------------------|-------------------------|-------|
| Number of licensees that operate Client Money Bank Accounts | 74%                       | 13%                       | 38%                     | 52%   |

Some licensees reported not operating Client Money Bank Accounts: this was due to operating fund structures where investor money was received directly into a bank account in the name of the fund or fund manager.

Of the respondents who reported operating Client Money Bank Accounts, they use 52 different bank providers in 17 different jurisdictions for these accounts; albeit the vast majority of accounts are held in Guernsey. The average number of Client Money Bank Accounts operated by licensees was 20.

### 1) Segregation and reconciliation of Client Money

Licensees operate Client Money Bank Accounts for specific fund or Client groups, or brokerage accounts, where investor monies are collected, either for onward investment or for distribution. When sending and receiving Client Money, licensees need to clearly identify such funds as Client Money and designate it appropriately to the correct account. Licensees' policies need to ensure correct labeling, and in the vast majority of cases, sub-accounts are used to clearly segregate specific Client Money. This practice helps maintain consistency and protects Client Money by preventing them from being co-mingled with other monies.



*Figure 1 – Frequency of Client Money Bank Account reconciliations. Licensees were able to select multiple options on the questionnaire.*

The COB Rules require Client Money Bank Accounts to be reconciled at least once monthly. Every licensee that had Client Money Bank Accounts reported that reconciliations took place at least monthly.

One of the interview firms described how its reconciliation process is outsourced to an overseas provider, reconciling between 10-30 transactions per day with reports being sent to the firm daily for monitoring purposes. Monthly service review meetings take place between the outsourced service provider and the firm. The Commission reminds licensees that if a decision is made to outsource a particular function, this must be carried out in accordance with the Guidance Note on Outsourcing of Functions by Entities Licensed under the Protection of Investors (Bailiwick of Guernsey) Law, 2020, with licensees retaining responsibility and ensuring adequate oversight, as in this example.

As demonstrated in Figure 1, the Commission found that reconciliations of Client Money Bank Accounts were performed at least in accordance with the COB Rules, and in many cases, more frequently than the minimum requirement and reflective of the scale and nature of transactions.

## **2) Sufficient Controls – policies and procedures**

The interviewed firms' policies and procedures were detailed and directly relevant to those firms' operations in respect of Client Money. The policies and procedures reviewed were not merely replicated from the COB Rules and included sufficient detail to allow staff to follow them effectively.

During the Commission's review, examples were found where the policies set out how errors, if identified, could be corrected and by whom; for example, users were directed to the departments or individuals responsible for the restitution of accounts if they were to go overdrawn. This ensures that errors can be quickly remediated, thus aiding the licensee with its compliance with, in this particular example, the requirement to ensure an overdrawn account is immediately restored<sup>1</sup>.

The Commission also found clear signposting from policies to the relevant procedures. This includes step-by-step approaches for outgoing payments, for example, often accompanied by a checklist to be completed. This clarity mitigates the risk of errors taking place.

There were also instances where clear and concise references to particular operational processes were contained within policies and procedures; for example, ensuring that payments made from Client Money Bank Accounts had four-eyes checks by the appropriate business function, thus reducing errors and enhancing accuracy and security as a result.

The Commission reviewed some licensees' Client Money policies where those licensees were part of a larger, multi-jurisdictional group; these ensured that an appropriate framework was in place to cover both group policy and making specific reference to local regulations and differences in procedures.



### **AREA TO CONSIDER:**

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The Commission has seen examples of licensees in some larger, multi-jurisdictional groups where group policies and procedures are adopted locally and do not specifically reference either local regulations or a supplementary policy setting out local requirements. This exposes licensees to the regulatory risk of non-compliance.

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<sup>1</sup> 9.5(4) of the COB Rules.



The Commission observed that some policies and procedures referred to manual checklists and more manual operational functions, which are naturally more open to human error. Ensuring appropriate controls are in place, with additional care required for manual checklists and procedures, is important to mitigate the risks of error.

The Commission identified that those firms who were interviewed that had automated processes reported fewer breaches than those with manual processes.

### **3) Sufficient controls – embedding**

There was a range of responses from the interviewed firms regarding the embedding of policies and procedures, mostly focussed around training. The frequency of this training varied from annual to ad-hoc, and in terms of method of delivery from formal sessions to more team-based discussion. The nature and extent of the training was informed either by breaches being identified through the normal course of business, or via CMP tests identifying areas for focus.

There was also reference made to changes in policies and procedures being communicated to staff via circular email, or a central policies hub on the firm's intranet, and staff being required to confirm that they had read and understood those updated documents.

Specific references were made to training all relevant new employees on the licensee's Client Money policy and procedure.

### **4) Overdrawn accounts**

Questionnaire responses indicated that some of the licensees who operate Client Money Bank Accounts had reported overdrawn accounts during the reporting period. The licensees that reported overdrawn accounts were a mix of designated administrators and investment intermediaries, suggesting this is not a business model-specific issue, and the number of breaches reported in each instance was low.

The rationale for overdrawn accounts predominantly centred around bank service and transaction charges, and transaction timing issues where incoming funds had not arrived in order to fund time sensitive outgoing transactions.



#### **AREA TO CONSIDER:**

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Wherever possible, licensees should take precautionary measures to ensure that Client Money Bank Accounts do not go overdrawn. These measures could include more proactive communication with banking providers, and keeping a minimum amount on account for purposes of maintaining that account.

Responses from licensees indicated that there were no instances in the reporting period where overdrawn accounts were not rectified within 24 hours and no instances where the overdrawn status of the account was to the detriment of Clients. This indicates that licensees are taking into account the best interests of their Clients and appropriately meeting their conduct obligations in this respect.

## 5) Audit and CMP

The Commission found that CMP testing in respect of Client Money takes place as expected across investment licensees, with both the internal audit function engaged where appropriate/on a cyclical basis, as well as control audits carried out as part of the external audit both for licensees and the funds they administer.

The CMP tests observed by the Commission appeared to be adequate in nature in respect of the requirements of the COB Rules. Of those firms that were interviewed which submitted examples of completed tests, the Commission observed that any issues identified had been assigned actions to remediate those deficiencies.



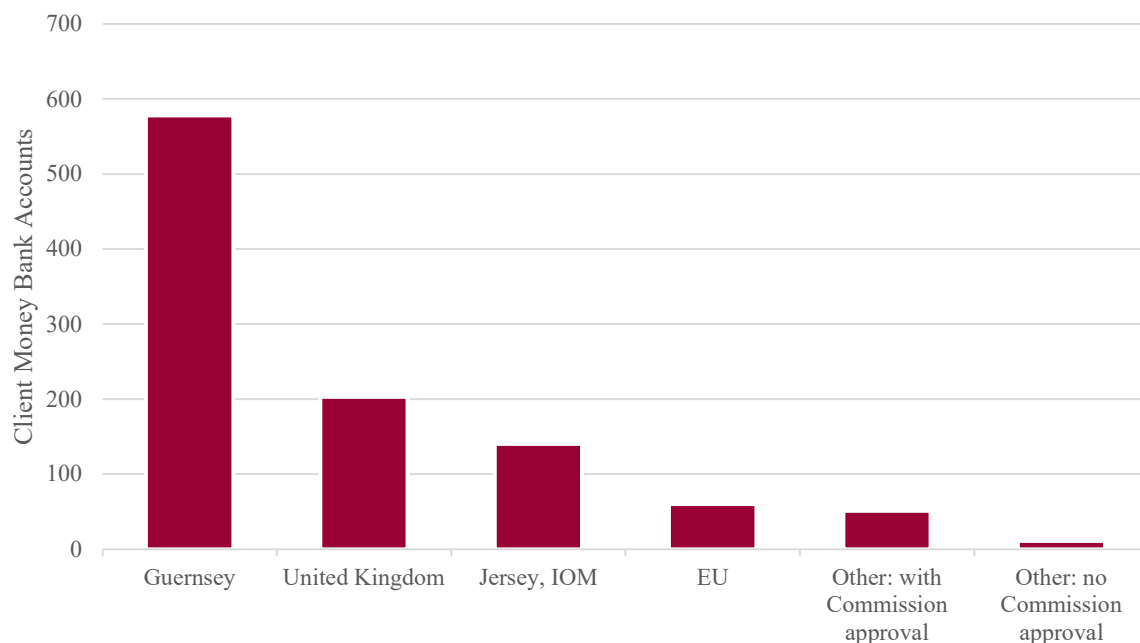
### GOOD PRACTICE:

Firms demonstrated a clear understanding of the importance of maintaining independence for this business function, recognising that the CMP function must operate independently from the areas it is reviewing to ensure objectivity and impartiality. This independence is crucial for identifying weaknesses, ensuring compliance with regulations, and enhancing the overall effectiveness of internal controls.

## 6) Approved Banks and due diligence on banking relationships

Client Money must be held with an Approved Bank, as defined at 13.1(2) of the COB Rules.

The requirements surrounding the choice of Approved Bank is to ensure that banks where Client Money is held are regulated under a similar regulatory framework to that of the Bailiwick.



*Figure 2 – Breakdown of jurisdictions used by licensees for Client Money Bank Accounts. Licensees were able to select multiple options on the questionnaire.*

From the data provided, it is clear that the vast majority of licensees are holding Client Money Bank Accounts with Approved Banks, and the vast majority of licensees are using banks in Guernsey. The Commission will be following up with those licensees operating Client Money Bank Accounts which do not meet the requirements of 13.1(2) of the COB Rules. From the data gathered as part of the questionnaire, the Commission identified that 95% of all Client Money Bank Accounts were being held with Approved Banks.

The Commission is conscious of concerns raised by industry representatives regarding ease of access (both speed and cost) to Approved Banks in some cases.

Licensees should be cognisant that if it is not possible to open Client Money Bank Accounts with an Approved Bank, all options having been exhausted, a modification request in respect of alternative arrangements, accompanied by a detailed rationale, may be submitted to the Commission for review on a case-by-case basis. Any such request should clearly explain why compliance with the COB Rules is not possible and why the alternative arrangement does not present undue risk to clients. Whilst access to banking arrangements was not raised as an overarching concern by licensees during the Thematic Review, the Commission will continue to monitor this issue and is open to further policy work in this area should modification requests increase.

The Commission also found that some misreporting had taken place, with some licensees confirming that the data submitted was incorrect and that not all accounts initially reported as Client Money Bank Accounts were in fact holding Client Money.

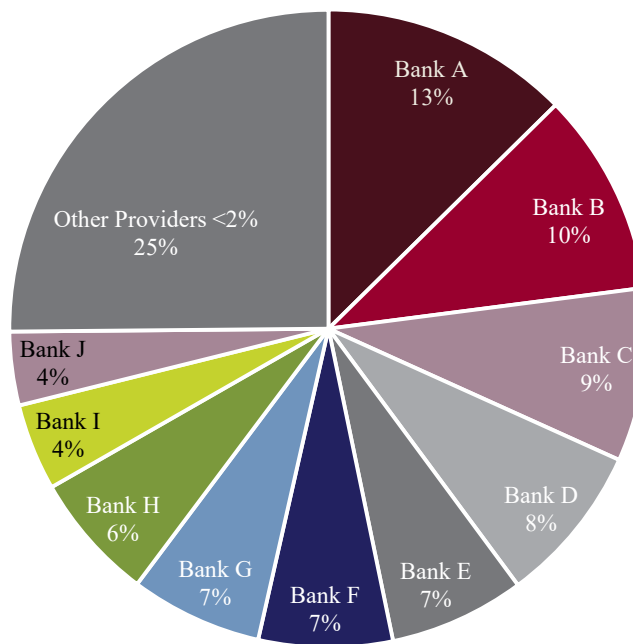


#### **AREA TO CONSIDER:**

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Licensees must ensure that data submitted to the Commission is as accurate as possible.

In spite of the above stated misreporting, it is important to point out that safeguarding arrangements remain appropriate, and as such this does not change the overall message that licensees have implemented adequate controls in relation to Client Money.



*Figure 3 – Breakdown of providers of Client Money Bank Accounts for licensees.*

Accounts are distributed among various banks. The graph above illustrates that there is no significant concentration risk regarding Investment Client Money Bank Account arrangements for sampled licensees.

The Commission observed licensees maintaining an internal Approved Bank list, which considered various factors, including the credit rating of the bank, and a review of the bank's audited financial statements. Licensees described overnight screening being undertaken on the banks for adverse media.

The maintenance of such lists and conducting due diligence was either the responsibility of the local risk committee or similar (having been delegated authority by the board of directors), the board of directors itself, or a group risk function.



#### **GOOD PRACTICE:**

The Commission observed licensees reviewing their internal Approved Bank lists on a periodic basis and conducting due diligence – at minimum annually, but in some instances quarterly. Regularly reviewing these arrangements ensures they are fit for purpose for the licensee and its clients.

## Conclusions

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Our findings from the Thematic Review highlight that the investment sector largely demonstrates good practice around the operation of Client Money Bank Accounts, with an effective control environment to keep Client Money safe.

Licensees regularly use Client Money Bank Accounts. The Commission found that licensees were cognisant of the additional risks associated with Client Money Bank Accounts and had thus implemented enhanced controls, such as restricted access, clear identification and designation of Client Money and frequent reconciliations. Investment licensees often exceed the COB Rules' monthly reconciliation requirement, with often daily or weekly reconciliations carried out according to the nature and complexity of the activity on account.

The Commission found that licensees generally have policies and procedures that are appropriate to the nature, scale, and complexity of the licensee, and are aligned with the requirements of the COB Rules. It was encouraging to see that licensees who were part of larger groups have considered local regulatory requirements; conversely, there were examples where local requirements have not been considered. Good practices for firms include regularly reviewing policies and procedures to ensure they remain fit for purpose, and embedding these policies and procedures within the staff contingent through requisite training and processes to ensure adherence. However, it was evident that licensees relying on manual procedures reported more breaches, which needs to be mitigated against in the future by ensuring that sufficiently robust controls are in place.

CMP testing is an important factor in ensuring an adequate risk and control framework. The CMP tests observed by the Commission appeared appropriately detailed and robust, identifying areas for improvement and actioning these accordingly. The independence of this function is crucial to help ensure that licensees maintain high standards and do not compromise on the integrity of its risk framework.

Irrespective of the fact that the Commission found that licensees appropriately restituted overdrawn Client Money Bank Accounts within 24 hours, an area for improvement for licensees is to apply appropriate measures to prevent Client Money Bank Accounts from going overdrawn in the first place where possible, such as more proactive communication with banking providers.

The Commission found that some Client Money Bank Accounts are being held with non-Approved Banks. Licensees should ensure that any non-approved arrangements are regularised, or that the Commission is approached with sufficient rationale in order to consider a potential modification to the COB Rules. It was, however, pleasing to note that the due diligence procedures that licensees apply in respect of banks is an area of strength for the investment sector.

The Commission also found that there was some initial misreporting by licensees in terms of appropriately identifying Client Money Bank Accounts. The Commission expects licensees to ensure that all data submitted to the Commission is done so accurately.

## Self-Assurance Questions

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The following self-assurance questions are intended to assist licensees' considerations of their Client Money arrangements:

| No. | Question   |
|-----|--|
| 1   | Have all Client Money Bank Accounts been appropriately identified and categorised according to the definitions at 13.1(2) of the COB Rules?  |
| 2   | Are Client Money Bank Accounts reconciled at least monthly in accordance with the requirements of rule 9.5 of the COB Rules?   |
| 3   | How often have your Client Money Bank Accounts gone overdrawn in the past year? What steps are you taking to avoid a repeat next year?   |
| 4   | Is there clear communication with your banking provider(s) regarding both quantum of transaction charges, and quantum and timing of bank service charges?  |
| 5   | How do your policies and procedures relating to Client Money adequately reflect the requirements of the COB Rules?   |
| 6   | Are your policies and procedures regarding Client Money: <ul style="list-style-type: none"><li>i. clear;</li><li>ii. accessible;</li><li>iii. applicable to local regulatory requirements; and</li><li>iv. adequately embedded within your organisation?</li></ul> |
| 7   | Are there appropriate tests within your CMP covering Client Money and your compliance with the COB Rules?  |
| 8   | Is Client Money being held with an Approved Bank? If not, having exhausted all options, have you considered submitting a modification request to the Commission for alternative arrangements?  |

## Glossary of Terms

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| Term                      | Description  |
|---------------------------|--|
| Analysis firm             | Firm interviewed for the purpose of this Thematic Review   |
| Approved Bank             | Per 13.1(2) of the COB Rules, a person who is licensed under The Banking Supervision (Bailiwick of Guernsey) Law, 2020, or is registered under The Banking Business (Jersey) Law, 1991, or authorised under the Isle of Man Financial Services Act 2008, or is authorised to carry on a banking or deposit-taking business under the law of the UK, of any EU member State, or under the law of any country or territory which may be listed in notices issued by the Commission |
| Bailiwick                 | Bailiwick of Guernsey  |
| Client                    | Any person with, or for whom, a licensee carries on a controlled investment business   |
| Client Money              | Per 9.2(1) of the COB Rules Money, in any currency, which in the course of carrying on controlled investment business a licensee holds for, receives from, or owes to a client. Client money may be held in different currency to that of receipt  |
| Client Money Bank Account | Per 13.1(2) of the COB Rules, an account at an Approved Bank in the name of a licensee which includes, in its title, an appropriate description to distinguish the money in the account from a licensee's own money  |
| CMP                       | Compliance Monitoring Programme  |
| COB Rules                 | The Licensees (Conduct of Business) Rules, 2021  |
| Commission                | The Guernsey Financial Services Commission   |
| IOSCO                     | The International Organization of Securities Commissions   |
| POI Law                   | The Protection of Investors (Bailiwick of Guernsey) Law, 2020  |
| Thematic Review           | Refers to this Thematic Review   |