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Insurance Law Committee response to FSA Consultation Paper "*Review of the client money rules for insurance intermediaries*" (CP12/20)

The City of London Law Society ("CLLS") represents approximately 15,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees. This response in respect of FSA Consultation Paper "*Review of the client money rules for insurance intermediaries*" (CP12/20) has been prepared by the CLLS Insurance Law Committee.

REVIEW OF THE CLIENT MONEY RULES FOR INSURANCE INTERMEDIARIES

Q1: Do you agree with the proposed frequency of client money calculation?

Although the FSA states in paragraph 2.8 of the Consultation Paper that it understands that some intermediaries may need the Non Statutory Trust Account (NST) model, the proposed frequency of reconciliations could cause a change in the current London business model and its use of NSTs. This change is likely to work against the interests of clients and the consequences may be as stated in our answer to Q3.

If the NST is, essentially, to work as a Statutory Trust Account, there needs to be a large publicity effort to bring this to the attention of all clients, and all Terms of Business Agreements (TOBAs) currently being used will likely need to be amended.

If the proposed change is intended not to be so radical, but to permit NSTs to continue, reconciliation once a month is sufficient. Too great a frequency either is costly in requiring more personnel in the finance function or potentially detrimental in that the numbers in the finance function do not increase but their workload does and it reduces the time such functions have to do other important tasks.

Q2: Do you agree with the proposed frequency of bank reconciliation?

No comment.

Q3: Do you agree with our proposal in relation to limiting the period where credit can be advanced in a NST including the weekly funding review?

We agree that the insertion of a time limit on the extension of credit from NSTs will assist with restoring negative client money balances where credit has been extended. However, this will leave intermediaries more exposed to late payment by insureds and insurers and remove the primary tool they have to manage this exposure under the NST, in the form of unlimited time periods for extending funds. Intermediaries may have to enforce premium payment terms more stringently in order to avoid incurring a liability to restore any credit extended from the NST. This would arguably cause a conflict between the intermediaries and their clients where there has been late payment. It does not seem equitable to us that an intermediary will be in breach of the CASS rules where it fails to restore any funds advanced from the NST when it is another party who is at fault, particularly where the other party is an insurer, which is also an FSA authorised entity.

Rather than a fixed time limit, we think that it is more appropriate to impose a positive obligation on firms to ensure that any money funded from the NST is collected from the relevant insured or insurer on whose behalf the credit has been extended within a reasonable time from the date the funds are advanced. In addition, where firms take the view that the relevant insured or insurer will not be able to repay the money that the insured or insurer has been advanced, firms should have a positive obligation to fund the NST immediately.

Q4: Do you agree with our proposal to move the £50,000 requirement from CASS to MIPRU?

We agree. This is a prudential issue.

Q5: Do you agree with our proposal in prohibiting conditional risk transfer?

We agree with the proposal to prohibit conditional risk transfer and provide guidance on the wording that risk transfer agreements could adopt to ensure that the grant of risk transfer is unconditional. The handbook should contain clear guidance as to what constitutes conditional risk transfer. For example, where an insurer states in an agreement that the intermediary must remit premium to it within 30 days, it does not cause risk transfer to be conditional. It is merely a contractual obligation between the insurer and intermediary as to when the payment will be passed on to the insurer. Such payment terms should still be permitted.

In addition to the proposed clarifications regarding risk transfer wording, we believe that there needs to be clarification as to when specific risk transfer wording is required. Where an intermediary is solely acting as an underwriting agent without any broking function on behalf of the policyholder, it is clearly the agent of the insurer and cannot be seen as holding money on behalf of the policyholder. Therefore any money which it receives by virtue of this relationship is held on trust for the insurer and not as client money. It is illogical for there to be a requirement to have specific wording in any binding authority agreement stating that it is holding money received

in relation to the insurance on a risk transfer basis or for it to have to inform policyholders that it will hold premium money received in that capacity.

Q6: Do you agree with our proposals relating to primary pooling events, including the period of no longer than three months for the optional mechanism whereby an IP can transfer a firm's business after its failure?

We can see the benefit in giving the Insolvency Practitioner (IP) more practical mechanisms in the event of a failure of an intermediary. Our view is that the handbook should contain further guidance on when it will be appropriate for the IP to use its reasonable endeavours to complete open transactions. Where a failed intermediary is holding client money and the only step outstanding is for the premium to be paid to the insurer, it seems sensible for the IP to be able to send premium to the insurer to complete the transaction for the client. However, we strongly disagree with the IP being able to complete transactions which require more substantial involvement, e.g. advising on the transactions to be completed or passing information between the insurer and insured in respect of the policy; such activities should be reserved for intermediaries with the relevant experience and access to the market in order to complete the transaction in the best interests of the client.

Q7: Do you agree with the proposed clarifications in relation to the secondary pooling event rules?

No comment.

Q8: Do you agree with our proposal on introducing rules to give the IP the option of deducting their reasonable costs of distribution from the post failure client money?

No comment.

Q9: Do you agree with our proposal on pre-consent for the transfer of business?

We agree with the proposal that firms should be able to obtain pre-consent to the transfer of client money if the intermediary's business is sold as a going concern. We are concerned that prior notification to the FSA of the transfer of client money may indicate FSA approval to the transfer of intermediary business. The sourcebook should contain clear guidance as to when and how the FSA could object to pre-consent. Our view is that giving clients the option to request that their money is returned to them should provide sufficient protection.

Q10: Do you agree with our proposal on limiting the amount of client money which can be held in a group bank to a total of 20 per cent of the total amount of client money held by the firm?

No comment.

Q11: Do you agree that the term 'designated bank account' should be replaced with 'designated client bank account' as defined in the Glossary?

No comment.

Q12: Do you agree with our proposal in relation to reconciliation down to individual client balances on an annual basis?

No comment.

Q13: Do you agree with our proposal on resolution pack?

We agree with the principle of preparing a resolution pack. The resolution pack will require regular compliance monitoring to ensure it will be available within 48 hours of failure. That deadline may not be practically realistic.

Q14: Do you agree with the proposal relating to credit write back, in particular, do you agree that the Rules should allow firms to take credit write back for unknown balances?

No comment.

Q15: Do you agree with our proposal on unclaimed client money?

In relation to paragraph 6.15 of the Consultation Paper, it seems to us wrong in principle, where a firm has taken reasonable steps to trace the client, insurance undertaking or third party concerned, after the expiry of the limitation period (which we agree in these circumstances would likely be six years), that the rules should impose a continuing liability on the firm to return client money. We do not consider that there could be a "valid claim" in these circumstances to which an undertaking could apply.

Furthermore, the intermediary effectively has a choice of either retaining unclaimed client money forever, or giving it to a charity but remaining liable to whomever might claim it, and for the costs of defending even claims that ultimately fail. This leaves an intermediary with little choice but to hold onto the money.

Q16: Do you agree with our proposal in relation to returning small amounts of client money in the form of postage stamps?

No comment.

Q17: Do you agree with our proposal on unallocated client money?

Our view is that the intermediary should also be required to ask the sender of the funds to ask the party that instructed them to send the funds (the "originator") to get in touch with the intermediary. There should be some form of obligation on the intermediary towards the originator, as the originator may be a client or a potential client.

Q18: Do you agree with our proposal in relation to client money held at third parties?

No comment.

Q19: Do you agree that the '12 month rule' should remain or do you think that it is more appropriate to link the period after which the firm may assume that the money has reached the insurer to the period of the insurance itself? Please provide reasons.

No comment.

Q20: Do you agree with our proposal on prudent over-segregation?

No comment.

Q21: Do you agree with our proposal on allowing client money to be held only in client bank accounts or money market funds?

No comment.

Q22: Under Chapter 7 of the Client Assets Sourcebook, firms can, on receiving any client money, promptly place this money into an account open with a qualified money market fund. Do you think that we should change money market funds under CASS 5 to qualified money market fund (as defined in the Glossary) in order to be in line with CASS 7? The rules for this proposal are currently drafted with reference to money market funds.

No comment.

Q23: Do you agree with our proposal on clarifying the Rules in relation to commission?

No comment.

Q24: Do you agree with our proposal in relation to same day draw down?

No comment.

Q25: Do you agree with our proposal on money due to a client from a firm?

We believe this proposal would create significant difficulties for an intermediary, both in complying within the timeframe proposed and on the firm's relationship with insurers, which will have been established on the basis of regular settlement in account. If the broker has already credited the insurer in account, then even if the client's money is still in the client account it should be deemed not to be there for the purposes of this provision.

Q26: Do you agree with [the proposal] that the maximum period should be no longer than three calendar months for firms to perform the reconciliation in relation to periodic segregation?

No comment.

Q27: Do you agree with our proposal on CASS oversight?

We agree with this proposal and the requirement in the draft rules that the person with CASS oversight be a director or senior manager holding a significant influence function. This will ensure that appropriate importance is given to CASS governance.

Q28: Which of the above options in relation to the submission of client money audit reports would you support and why? If you support the option of setting a threshold below which firms do not have to submit their client money audit reports to us, which of our proposed thresholds would you think is appropriate and why? If neither, what threshold would you suggest?

No comment.

Q29: Do you agree with the actions that we are proposing to require firms to do in relation to client money audit reports if they hold client money in an ST not exceeding £30,000 or do not hold client money at all when they conduct insurance mediation? If not, why not?

No comment.

Q30: Do you agree with the proposed delayed commencement of the draft rules, or do you think that a different date should be applied to any particular proposal(s)? Please provide reasons.

We agree with the delayed commencement of the draft rules as this will provide intermediaries with sufficient time to assess their current CASS systems in order to determine whether updates and adjustments need to be made or new systems acquired.

Q31: Do you agree with this approach of replacing the existing CASS 5 with a new CASS 5A?

No comment.

Q32: Are the costs outlined in the CBA realistic, especially for small firms? Please provide any explanations or evidence you have to support your view

No comment.

Q33: What are your views on the benefits and costs of the proposed policy measures?

No comment.

6 December 2012

THE CITY OF LONDON LAW SOCIETY
INSURANCE LAW COMMITTEE

Individuals and firms represented on this Committee are as follows:

Richard Spiller – Holman Fenwick Willan LLP (Chair)

Emily Benson – Clyde & Co LLP

Michelle Bramley - Freshfields Bruckhaus Deringer LLP

Beth Dobson - Slaughter and May

Christopher Foster - Herbert Smith Freehills LLP

Jonathan Goodliffe - Freshfields Bruckhaus Deringer LLP

Charles Gordon - DLA Piper UK LLP

Catherine Hawkins - Berrymans Lace Mawer LLP

Stephen Lewis - Clyde & Co LLP

Francis Mackie - Edwards Wildman Palmer LLP

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