

‘Please look after this money. It’s my client’s and I’ll need to give it back’ - The importance of acknowledgement letters

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Breaches of the CASS acknowledgement letter requirements often appear in our CASS audit opinions. And this is frequently highlighted by the FCA as being of particular importance, including in a recent Dear CEO letter. Given the importance of maintaining adequate client asset arrangements in the current environment, firms need to stay on top of this. But our data shows many are still going wrong.

In 2019 we created an acknowledgement letter ‘bot’, the CASSbot, which has transformed the way we audit acknowledgement letters. It has reduced the risk of human error by fully automating the review process and allowing us to review 100% of firms’ acknowledgement letters in just one click. The CASSbot has continued to highlight exceptions in this area, with 44% of our 2019 CASS opinions containing at least one acknowledgement letter breach, and many containing multiple breaches. Looking over what these results tell us about where firms go wrong has also allowed us to suggest how to avoid these common pitfalls.

So where do firms go wrong?

One of the key areas where the CASSbot has identified breaches is around the removal of ‘fixed text’. Although the CASS 7 annexes contain the required templates to use, ‘fixed text’ continues to be amended by firms. We have also identified instances where ‘variable text’ has either not been removed, included, or amended as appropriate. A firm not having a correct acknowledgement letter in place risks the timely recovery of funds, or not recovering any funds at all, in an insolvency situation.

Not all breaches of acknowledgement letters will result in a failure of the trust, but we continue to see examples where client money could potentially be at risk. Acknowledgement letters not addressed to the specific legal entity, whether that be the firm, or the bank, are likely to cause complications in an insolvency situation. Altering italicised variable text in a way that changes the meaning of the acknowledgement letter fixed text could also cause similar problems.

If a firm enters into the insolvency process and there are errors identified on one or more of its acknowledgement letters, this could result in long delays whilst the legal standing of the letter is established. Where an acknowledgement letter is deemed invalid, it could result in client money not being returned to clients and instead being used against the firm’s general creditors.

We also see scenarios where a firm has experienced breaches of CASS 7.18.6R relating to punctuation, which are seen by the industry as minor breaches. We do recognise that such instances, although breaching CASS 7.18.6R, would tend not to render the letter ineffective - however, firms should still take due care and attention when preparing these letters, review them annually and act in a timely manner to resolve any issues against the template regardless

of how these came to be known by management or their severity, in order to be fully compliant with the required CASS templates.

‘Reasonable endeavours’

A number of acknowledgement letter breaches we see relate to demonstrating ‘reasonable endeavours’ around the appropriateness of the countersignatures. We are seeing firms failing to take appropriate steps to ensure that the trust is legally binding with the most common listed below:

- Failure to obtain evidence that the letter from the third parties holding client money has been properly authorised. For example a documented power of attorney, list of authorised signatories, bank stamps or seals.
- Failure to identify the appropriate individuals who need to countersign the letter per the power of attorney. We have seen instances where the letter needs to be countersigned by two individuals, in order for the letter to be legally binding, however only one individual has countersigned it, thus putting the legality of the trust into question.
- Failure to identify clauses in the power of attorney, which would prevent the agreement from being legally enforceable, or failure to identify which clauses in the power of attorney would legally bind the bank to acknowledge the trust already established by the firm, which may result in failure to ensure that the appropriate countersignature is applied.
- Failure to confirm that the list of signatories provided is the latest one, especially after the acknowledgement letter has been active for a few years.

Although it might be common belief that the counterparty knows best who is able to countersign these letters, and acts so in good faith, firms should review these with their ‘insolvency hat’ on and ensure that these letters will stand up in an insolvency event. It is the firm’s responsibility to ensure that the structure for holding client money is both operationally and legally compliant in order to ensure client money protection.

Timely resolution of inaccuracies

We further see that although issues are flagged by firms either through their internal reviews or through external audit, these are not resolved in a timely manner in line with CASS 7.18.12R, with some firms being notified of the same breaches being in place in the following audit cycle. The repapering of erroneous letters should take place as soon as possible, as without appropriate active letters, firms could be putting client money at risk.

So what can firms do to avoid some of the common pitfalls we see?

We have some tips to reduce the number of exceptions on your acknowledgement letters:

- Involve your legal team to look through any power of attorney or similar documentation supplied alongside the acknowledgement letter. Ensure that this is legally binding and not in conflict with the CASS rules or the FCA template.

- Ensure you understand which clauses in the power of attorney give rise to authority to countersign the letters. This will make sure that you have the correct countersignature in line with these clauses.
- Consider performing (and recording) additional checks, such as contacting the switchboard or general number of the third party with which you intend to hold client money when confirming the appropriateness of the countersignatures. Never just reply to an email if you are unsure of its origin.
- For each type of acknowledgement letter template, in line with Annex 2 to 4, create a pdf form which only allows the variable text of the template to be amended/filled in. In this way the template can be reviewed once before being applied to multiple acknowledgement letters. This will lead to fewer mistakes in your letters, but also free up operational capacity and enable your teams to focus on more judgemental areas of the acknowledgement letter process such as the reasonable endeavours under CASS 7.18.9R.
- Where possible and your business model allows, issue one letter for multiple accounts with the same counterparty. This will reduce the risk of multiple incorrect letters with the same counterparty.
- With remote working we have seen a rise in electronic signatures, which is an opportunity to speed up re-papering procedures as letters can be re-papered in a matter of days rather than months. But remain vigilant - make sure you can substantiate the source of your countersignature.
- Remember four eyes are better than two - ensure you have a robust review process and foster an environment where exceptions are identified and rectified early on.