

Insurance

Changing Cash Operations and Solving the Client Money Conundrum

CASHFAC SECTOR LITERATURE



About Cashfac

Cashfac (www.cashfac.com) is a global leader in back office cash management and Virtual Account Management (VAM) solutions. Our platform is the world's most deployed virtual accounts solution, used by organisations across the global financial services sector from large banks and insurance companies to smaller non-banking financial institutions.

Our products help these financial institutions improve productivity and provide greater visibility, automation and control over their critical cash management operations including compliance with Client Money regulations. This is achieved by our open technology solutions plugging into existing client systems giving corporate and client operational accounting solutions which are fully integrated with your bank's records, virtually eliminating the need for reconciliation.

Introduction

Over the last few years the Financial Conduct Authority (FCA) has continued to ramp up its enforcement of CASS 5 client asset compliance for insurance brokers; driven in no small part by the poor results shown from its inspection visits.

However, the main engine for the increase in regulatory enforcement has been the introduction in 2015 of the "Client Asset Assurance Standard" by the Financial Reporting Council (FRC), the revised version of which came into force in January 2020. This standard has effectively required auditors to do their job more effectively and to ensure there is a proper Client Money control regime in place across the insurance sector.

Regulation is an important driver for improving an insurance firm's cash operations, but it is by no means the only or even the most important one. While the insurance industry has gone from strength to strength on the back of a growing economy and increased returns on investment in recent years, it still faces many longer-term challenges. Perhaps primary among these is making effective use of insurance technologies (InsurTech) in an increasingly competitive market. Furthermore, the opportunities (and challenges) being afforded to the industry by global open banking initiatives have created an opportunistic time for those running the cash processing and reconciliation teams in the insurance industry.

To meet these challenges and opportunities, rather than patch up existing approaches to CASS 5 and CASS 7, Cashfac offer a new method for the administration of money belonging to clients within the insurance sector, whether it is held in statutory or non-statutory trusts or under the risk transfer provisions.

4 Approaches to Protecting Client Money

The insurance sector adopts different approaches to protecting Client Money. We look at four areas:

- 1| Risk Transfer
- 2| Statutory Trusts
- 3| Non-Statutory Trusts
- 4| Hybrid Model

1| Risk Transfer

CASS 5.2 sets the rules where brokers do not have to protect money received to or from customers under Client Money rules. In general, this occurs when the broker/agent has the authority to commit the insurance company on whose behalf it acts. In this case, customers' money received by the agent/broker is not to be treated as Client Money as, in these circumstances, it is as if it has been given to the insurance company itself.

The risk of the broker defaulting and the customer's money being lost is not ended, rather it is transferred to the insurance company. How then can the insurance company minimise its exposure to its agents and brokers, reduce its risk to loss and fully know its client commitments?

2| Statutory Trust

CASS 5.3 sets out the default option for customer monies received by an insurance broker - the statutory trust. For this model, the rules do not permit a firm to provide credit or let their clients accounts go overdrawn. For example, a broker cannot pay a premium over to an insurance company on behalf of the client until the funds have been received from that client.

There are several challenges to administering this type of CASS regime, correctly controlling the accounts and preventing overdrawn positions. If we take the collection of premiums, the broker's cash operations must deliver:

- Identification and segregation of client funds particularly when collected through appointed representatives and field agents
- Management of payment clearance
- Allocation of cash against open debtor positions
- Splitting of funds between commission and premium - mixed remittances
- Prompt removal of commission due and payable from the Client Money account
- Onward payment of funds to the insurance company

The process of managing the payment of claims in the opposite direction has similar challenges.

3 | Non-Statutory Trust

CASS 5.4 covers the alternative approach to the statutory trust that is, the non-statutory trust (NST). The main difference between the two approaches is that with an NST, the broker can pay premium refunds and/or claim payments before the cash is received from the client or insurance company. Obviously, this represents a riskier model for the broker and therefore the FCA requires a higher compliance standard than for statutory trusts. It requires the broker to:

- Have adequate systems in place to monitor and manage the overdrawn/credit positions provided
- Obtain and maintain a written confirmation from an auditor that these systems are sufficient
- Appoint a manager to oversee compliance with the CASS regulations
- Maintain a capital resource requirement calculated in accordance with regulations in MIPRU 4.4.1 R, of no less than £50,000
- Ensure its terms of business adequately explain that funds will be kept in an NST and that the clients have given their informed consent to these arrangements

The NST model has all the same control challenges of the statutory model plus the administration of credit which includes:

- Determining and enforcing credit levels
- Sweeping cash to fund the credit positions
- Accounting and monitoring the ongoing credit

4 | Hybrid Model

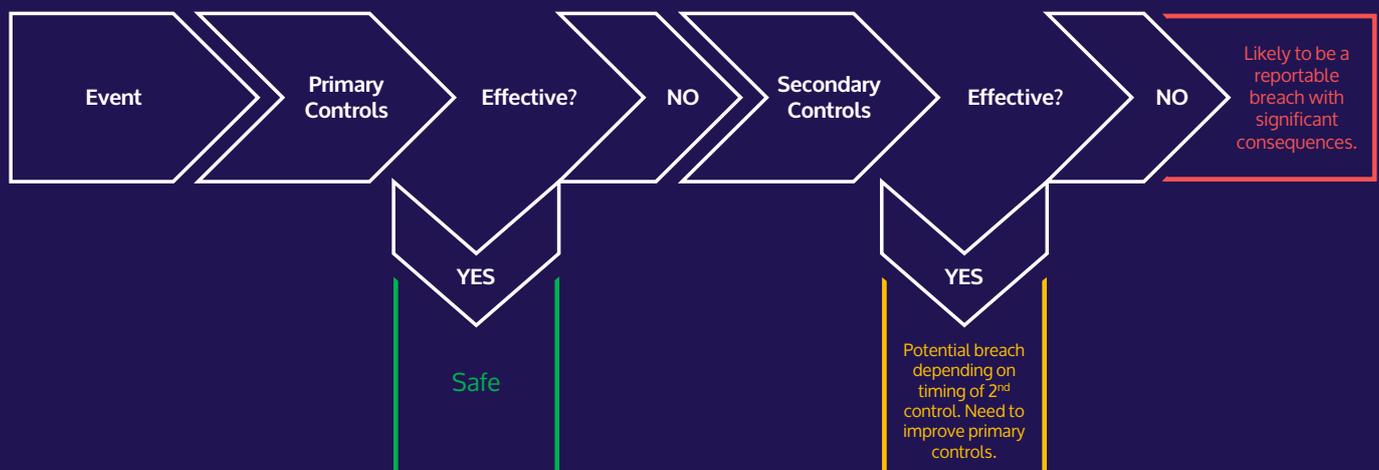
The greatest challenge arises in firms that have different books of business administered under some combination of the three protection regimes. The challenges around segregation, routing and protection of the funds and their correct classification and reporting are multiplied. In these circumstances the compliance challenges and therefore risk of breach can prove to be exponentially more difficult.

Client Money Calculation

“ You cannot adequately control Client Money with secondary controls like reconciliation if your primary controls, like input, checking and accounting, are inadequate. ”

Whether you use the statutory or non-statutory trusts, you still need to perform Client Money reconciliations and calculations, as at close of business, at least every 25 business days. However, this should be taken as a minimum standard as it is hard to see how an actively trading business could adequately control Client Money without reconciling daily.

You cannot adequately control Client Money with secondary controls like reconciliation if your primary controls, like input, checking and accounting, are inadequate. Reconciling should be a final check that everything worked. If it is more than that, then your firm needs to enhance its primary controls.



Controlling the Client Money Event

Under the CASS 5 regulations there are two methods available to perform the Client Money calculation - the Client Balance and Accruals approaches. Both methods rely on a well-reconciled set of accounting records if they are to be performed accurately within the 10 days allowed by the regulations, and with any discrepancies corrected as soon as possible.

Settlement Down the Broker Chain

A broker must still protect and cover Client Money if it is passed to another broker but has not yet been given to the client or the insurance company at the end of the settlement chain, or the firm itself if due as a commission. This can leave the broker funding the position until it is completely settled down the chain.

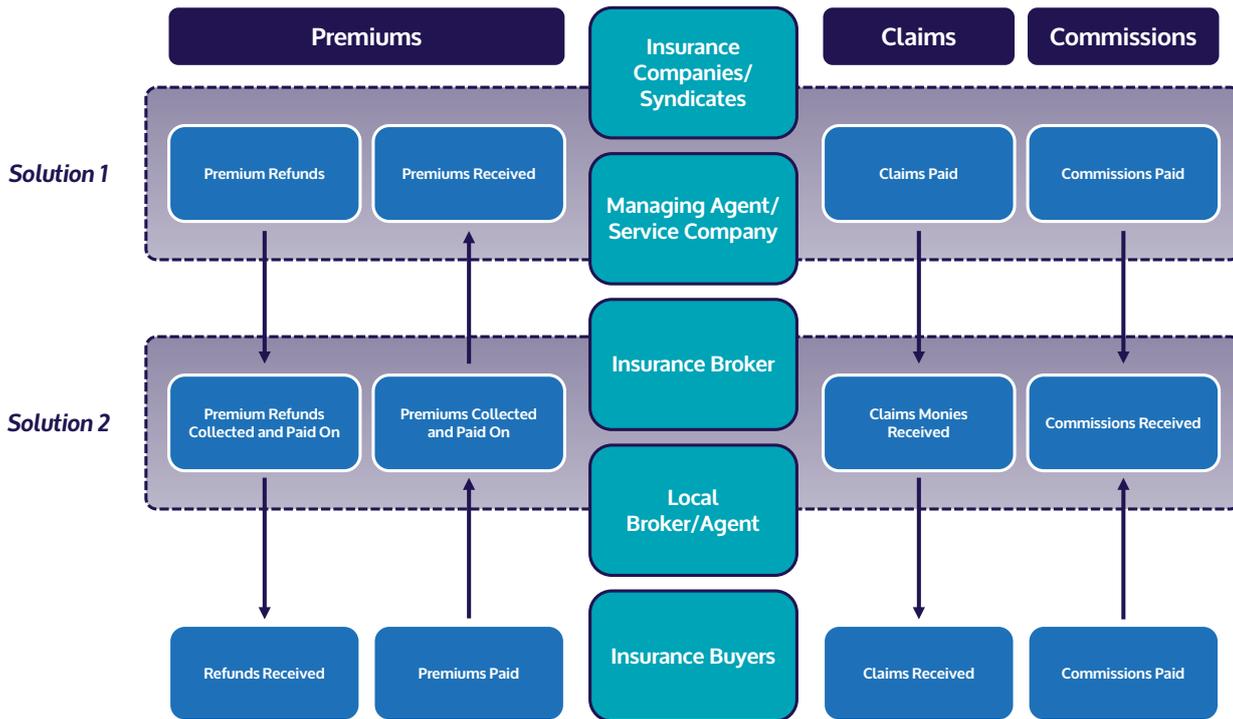
Cashfac Client Money

Cashfac Client Money offers a principles-based solution that actively manages customers' money to ensure it is correctly received, identified, allocated, accounted for and paid away. While doing these asks for reasons of good governance and solid accounting control, the solution also delivers the highest levels of compliance with the requirements of the FCA's Client Money CASS 5 regulations and other global regulatory rules.

We believe that good Client Money compliance is just one part of a strong and efficient money management regime. Cashfac Client Money does not just offer a reconciliation solution, it offers a full suite of accounting, banking and reporting functionality that can be quickly configured to bring your firm's cash operations up to best practice standard.

We offer two different solutions that can be tailored to individual firm requirements across the insurance sector value chain:

1. **Solution 1 - Insurance / Service Companies**
2. **Solution 2 - Brokers**



Insurance Sector - Cash Management Overview

How Can Cashfac Help?

1 | Account Structure - Automating Receivables

Insurance Company Solution:

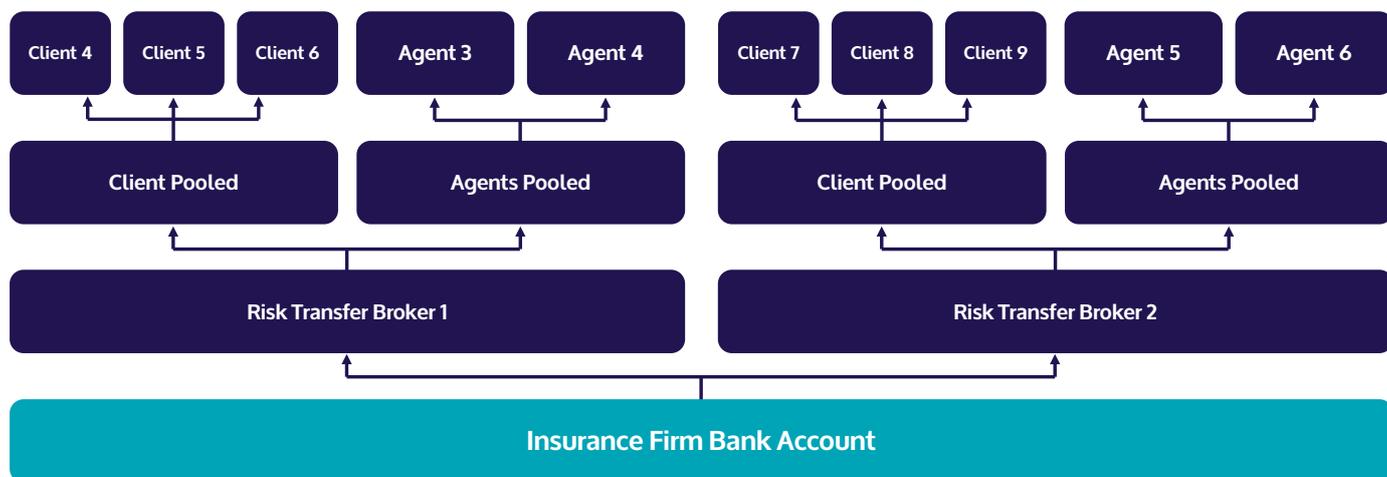
Cashfac's multi-currency virtual bank account solution plugs into your existing real bank account and allows you to run a multi-level ledger of virtual bank accounts from one real bank account. Your firm can easily and cheaply set up a virtual bank account on this ledger for each broker, agent and customer down the settlement chain.

Fully integrated into the banking network, these virtual bank accounts can be given their own IBAN or externally addressable account number. This in turn allows customers, agents and brokers to lodge funds directly to their own virtual bank account through the bank clearing network either by bank transfer, direct debit or, shortly Request-to-Pay.

The diagram below shows a typical virtual account configuration for insurance company operating a risk transfer model. The insurance company has one real bank account for collections. The insurance company can issue the brokers with a bespoke bank account structure to collect and route payments to the insurance company. In this case the broker is given one pooled account to accumulate their cash collected but they can issue further accounts to each client of the broker. These accounts can be made externally addressable with a virtual IBAN (VIBAN). Any money received into one of these accounts is instantly identified as belonging to only one client.

The broker may themselves use other brokers or agents and may wish to issue them with bank accounts for collections.

Money lodged by an appointed agent or ultimate client into their own virtual bank account is actually lodged to insurance company's real bank account and allocated to agent's or client's virtual account. If the money is client money it can be segregated and protected at that point however even if it is not Client Money, the insurance company is immediately aware of it and has control over it thus minimising its risk.



Example based on Risk Transfer Virtual Account Structure and is similar to a Statutory and Non Statutory client money segregation model

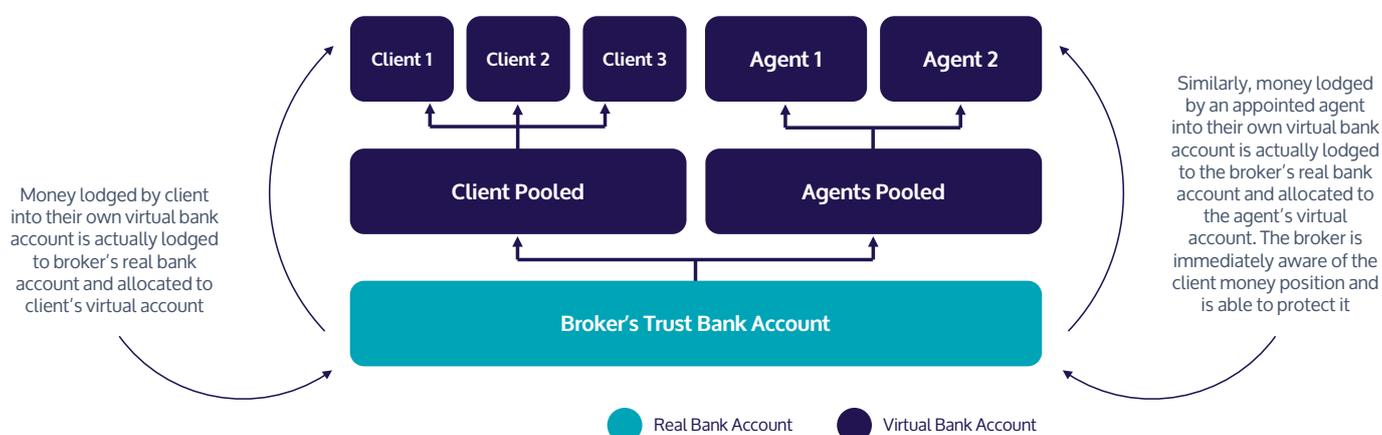
● Real Bank Account ● Virtual Bank Account

Money can then be manually or automatically swept between virtual accounts to settle transactions down the agent/broker chain to the client or insurance company.

Therefore, if you are an insurance company engaged with a broker in a risk transfer contract, you can issue that broker with their own virtual bank account into which all premiums for your policies must be lodged.

Broker Solution:

Brokers who do not operate under a risk transfer model can also set up a virtual account structure that as well as delivering efficient cash management and banking can also deliver a CASS compliant solution.



● Real Bank Account ● Virtual Bank Account

Broker Client Money Virtual Account Model

Alternatively, the broker may issue its own virtual bank accounts to agents and for clients' collections. Using this functionality, Cashfac delivers the key compliance and control requirements of identification, designation and segregation of client monies received and virtually eliminates the threat of errors.

Cashfac's solution enables the issuer of the virtual accounts, be it the broker or insurance company, to de-risk the collections process and gives them immediate access to and sight of the funds as they are received anywhere on the settlement chain.

2 | Fully-Regulated, Full Service Bank Accounts

Cashfac Client Money solutions are underpinned by fully functional bank accounts, allowing you to offer a complete Open Banking enabled service to your clients, brokers or agents from their virtual bank account.

The solutions can allow your clients to lodge or transfer money directly to the virtual Client Money bank account held with you with near 100% accuracy. Our system can also be configured to allow your clients, brokers or agents to log on to the virtual account, get a statement and, if required, initiate payments of money from the virtual account:

- Brokers can use it to pay money to the client for a claim, or insurance company for a premium
- Agents can use it to pay money to the client for a claim, or the broker for a premium
- Clients can use it to draw down claims money when required. The virtual account can even be paired with a prepaid credit card to allow the customer to pay the funds directly from the virtual account to a retailer when spending the proceeds of a claim

The solution also has the potential to resolve broker chain Client Money challenges. If broker 1 can issue broker 2 with a virtual bank account for broker 1's business, they could retain control of the Client Money while making it available to broker 2. Broker 1 would also know exactly when the settlement of proceeds has completed down the chain.

As well as adding to the insurance firm's product offering, this functionality allows the issuer of the virtual account to hold onto clients' funds for as long as possible and thus maximise its return on those funds through a full suite of interest rate management capabilities.

All types of payments are supported with comprehensive transaction authorisation models and audit trails to log user activity.



3 | Client Money Ledger/Client Account

Virtual bank accounts can also double as your firm's client or broker ledger if your core back office system does not have one. Alternatively, if your back office does have a client or broker ledgers, each virtual bank account can be paired with an existing ledger account on your back-office system. The virtual bank can update the back-office ledger account or reconcile it to actual clearance and settlement when that occurs.

Cashfac's virtual bank account is a hybrid account offering both a banking and accounting ledger on one account. Cash and accrued transactions (debtor and creditor transactions) are recorded but segregated in the one account giving a full range of accounting and control options through reporting. This also facilitates the Client Money calculation irrespective of whichever method your firm chooses to use.

However, the main use of this dual accounting record is to facilitate the settlement of positions. As cash moves onto a client's virtual account, Cashfac matches it against an open debtor position for that client, settling the premium due. The matched transaction information also allows Cashfac to split the receipt automatically into its firm and Client Money elements and route, one, to the firm money account and, two, externally to the insurance company. As part of this process, Cashfac can also manage a clearing hold for receipts made by cheque or direct debit.

Cashfac's automated functionality means that for statutory trust arrangements the system can be left to pay funds away only when they are received, preventing overdrawn positions occurring and giving the highest levels of service while reducing administration costs. While for NST the solution can take account of preconfigured client-level credit limits before executing the onward payments.

4 | Client Money Compliance: Internal & External Reconciliations

Virtual bank accounts can also double as your firm's client or broker ledger if your core back office system does not have one. Alternatively, if your back office does have a client or broker ledgers, each virtual bank account can be paired with an existing ledger account on your back-office system. The virtual bank can update the back-office ledger account or reconcile it to actual clearance and settlement when that occurs.

With near real-time updates from the banking network now available, Cashfac has transformed the internal reconciliation process. In addition to the static end-of-day reconciliation, it offers a risk monitoring function that reports overdrawn positions/negative balances in real-time. This solution is fully integrated into the banking and payment functionality, delivering automatic sweeping of cash between Firm and Client Money bank accounts throughout the day to remove commission or top up an NST account. Your Client Money protection is delivered using real-time calculation and updates throughout the day, making the minimum regulatory requirement easy to achieve.

With its accounting and reconciliation functionality, Cashfac can deliver a complete solution to your firm's Client Money calculation challenges irrespective of the method that your firm decides to use.

5 | Pooling & Projecting (Forward Cash Forecasting) for Treasury Management

Cashfac's liquidity management functionality allows you to achieve robust Client Money compliance while ensuring that you can make the maximum return from the fully pooled funds available for treasury investment (e.g. Notice and Fixed term Deposits) for the firm, client or both.

The client ledger functionality allows Cashfac to predict near- future cash positions, allowing you to manage your firm's liquidity while maximising that treasury return.

6 | Client Money General Ledger

Our virtual banking solution delivers a full "thick ledger" double entry accounting solution for Client Money. It is unlikely that your firm will be able to deliver robust Client Money protection without full double entry accounting to a general ledger. Therefore, if your firm's existing back office systems do not offer an effective operational general ledger, Cashfac's solution will integrate with that system to deliver general ledger functionality.

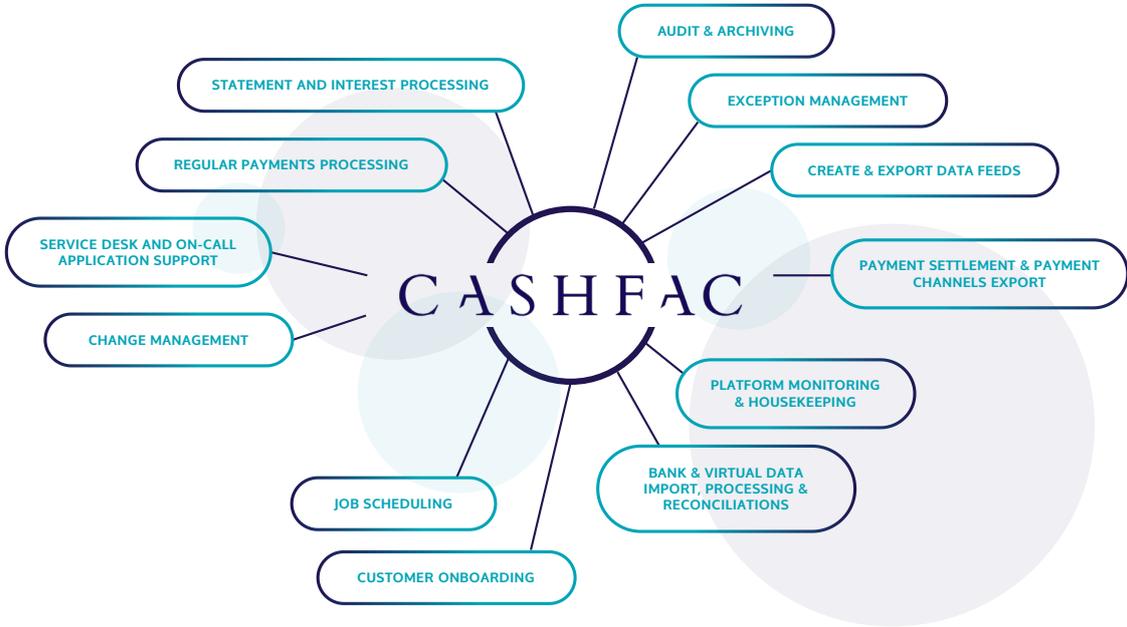
7 | Reporting

Cashfac Client Money offers a full range of static and real-time user dashboard reporting to give you full control and understanding of all aspects of the Client Money, credit monitoring and cash operations process and status. This allows the manager responsible for Client Money to have all the information they require to discharge their duties at a glance particularly for a NST operation.

These reports can be persisted or exported to help complete regulatory returns such as the RMA-C.

Managed Services

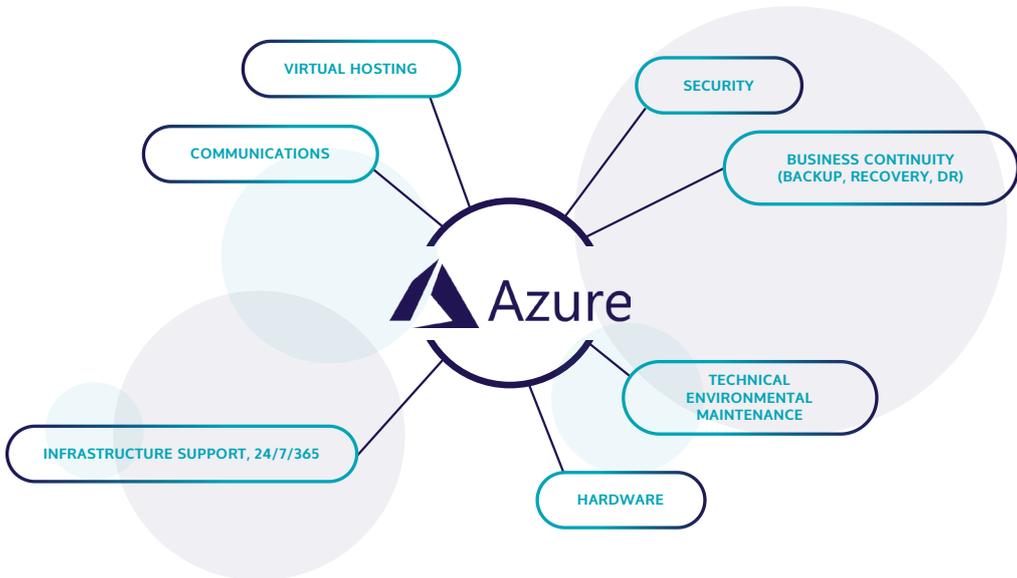
Cashfac Managed Service offers a single point of contact for all support issues, removing the need for employing dedicated customer staff to operate the virtual banking platform and thereby minimising change management and specialist training.



Hosted Services

Cashfac hosts the service via Microsoft Azure infrastructure and manages the entire release and upgrade process, including platform testing before release, and will assist you with your own testing.

Our deep knowledge of our product and a detailed understanding of the features that have been enhanced in each release, combined with proximity to the development team, ensure this process is executed with accuracy, knowledge and expediency.



For product information, to request a demonstration or to speak to us about your business needs, please contact us at www.cashfac.com/contact



CASHFAC

©Cashfac. All rights reserved. Cashfac PLC is a registered AIS (Account Information Service) and PIS (Payment Initiation Service) provider, reference no. FRN 805666 at fca.org.uk/register. Cashfac PLC is authorised and regulated by the Financial Conduct Authority.