

Financial Supervision Commission (Clients' Money) Regulatory Code

Statutory Document No's: 172/93 and 155/96



FINANCIAL SUPERVISION COMMISSION
(CLIENTS' MONEY)
REGULATORY CODE

The following Code is issued by the Financial Supervision Commission in exercise of the powers conferred on it by Section 6 of the Investment Business Act 1991, and all other powers enabling it in that behalf. All correspondence relating to this Code should be addressed initially to the Financial Supervision Commission.

Made by Financial Supervision Commission on 22 April 1993 and 27 March 1996

Coming into operation on 1 May 1993 and 1 April 1996

Approved by Tynwald on 18 May 1993 and 21 May 1996

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INVESTMENT BUSINESS ACT 1991

FINANCIAL SUPERVISION COMMISSION (CLIENTS' MONEY) REGULATORY CODE 1993

Approved by Tynwald 18 May 1993

Coming into operation 1 May 1993

In exercise of the powers conferred on the Financial Supervision Commission by Section 6 of the Investment Business Act 1991 (a), and of all other enabling powers, the following instrument is hereby made:-

1. CITATION, COMMENCEMENT, REPEALS, INTERPRETATION AND APPLICATION

1.1 Citation and Commencement

This instrument may be cited as the Financial Supervision Commission (Clients' Money) Regulatory Code and shall come into operation on 1 May 1993.

1.2 Revocation of Government Circular 398/91 and 97/92

The Financial Supervision Commission (Clients' Money) Regulatory Code 1992 (b) and the Financial Supervision Commission (Clients' Money) (Amendment) Regulatory Code 1992 (c) are hereby revoked.

1.3 Interpretation

A Guidance Note appended to a paragraph gives guidance as to how the Commission considers it would operate in particular circumstances. It is not part of the Code.

- (a) 1991 c.18
- (b) GC 398/91
- (c) GC 97/92

The glossary contained in the Financial Supervision Commission (General Requirements) Regulatory Code 10 applies for the interpretation of this Code.

Additional Interpretation

In this Code:-

- (1) **"Client"** includes all clients of a licenceholder who pay money to, or on whose behalf money is paid to, the licenceholder in the course of its investment business;
- (2) **"Client Bank Account"** means any account for the holding of clients' money as is opened in accordance with Code 4.1, and includes a "Designated Client Bank Account" and a "Designated Client Fund Account";
- (3) **"Clients' Money"** has the meaning as ascribed thereto in Code 3;
- (4) **"Code"** means this Financial Supervision Commission (Clients' Money) Regulatory Code;
- (5) **"Designated Client Bank Account"** is one which:-
 - (a) holds money of one or more clients;
 - (b) includes in its title the word "designated" (but not the words "designated fund"); and

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- (c) the clients whose money is in the account have each consented in writing to the use of the bank with which the client money is to be held;

Note:

In the event of the default of that bank, the account is not intended to be pooled with any other account or type of account.

- (6) **"Designated Client Fund Account"** is one whose characteristics are:-

- (a) the account holds at least part of the client money of one or more clients, each of whom has consented to such money being held in the same client bank accounts at the same banks (the client money of such clients constituting a "Designated Fund"); and
- (b) the account includes in its title the words "designated fund";

Guidance Note

A Designated Client Fund Account may be used for a client only where that client has consented to the use of that account and all other designated client fund accounts which may be pooled with it. A client who consents to the use of bank A and bank B must have his money held in a different designated client fund account at bank B from a client who has consented to the use of banks B and C.

Note:

In the event of the default of a bank with which part of a designated fund is held, each Designated Client Fund Account held with the defaulting bank is intended to form a pool with any other Designated Client Fund Account containing part of that same Designated Fund.

- (7) **"Investment Agreement"** means any agreement the making or performance of which by either party constitutes an activity which falls within Schedule 1 to the Investment Business Order 1991, or would do so apart from Part II of that Schedule;
- (8) **"Licenceholder"** means a holder of a licence under Section 3 of the Investment Business Act 1991 and, insofar as this Code applies to any recognised person, includes such recognised person;
- (9) **"Money"** means legal tender in the Island or elsewhere or anything which may be directly converted into legal tender and includes notes and coin, cheques, drafts and electronic transfers and "Clients' Money" shall be construed accordingly;
- (10) **"Recognised Bank"** means a banking institution licensed under Section 3 of the Banking Act 1975, or building society authorised pursuant to Sections 2 and 4A of the Building Societies Act 1986 or, if funds are held in a country outside the Isle of Man, a bank duly authorised under the appropriate legislation of that country, provided that the country has signified acceptance of the principles of the International Concordat on Banking Supervision issued by the Committee on Banking Regulation and Supervisory Practices and the Commission has no reason to believe that those principles are not being applied.

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(11) References to sections are to sections of the Investment Business Act 1991.

1.4 Application

This Code applies to all holders of investment business licences issued under Section 3 of the Investment Business Act 1991, [with the exception of holders of Category 5 investment business licences.]

Guidance Note

This Code is designed primarily for the protection of Clients' Money in relation to investment business in the event of the insolvency of the licenceholder. For this purpose "Clients" include all investors for whom or with whom the licenceholder transacts investment business.

1.5 Overseas Branches

This Code applies to overseas branches of a licenceholder unless the overseas branch is subject to regulations of a host country in respect of Clients' Money which the Commission has specified as being a country that, in its opinion, offers equivalent protection.

Guidance Note

The Commission considers the United Kingdom to be a territory offering equivalent protection.

2. INTRODUCTIONS TO NON LICENCEHOLDERS

Where investment business is introduced by a licenceholder to another investment business which is not a licenceholder and that business may lead to the holding or receiving of money for the client, the licenceholder should either:-

- (a) ensure that Clients' Money received by that other investment business is protected by segregation under trust or otherwise by statutory or other regulation, as effectively as it would be if this Code applied; **or**
- (b) warn the client in writing that his money may not be protected as effectively as it would be if this Code applied.

[] added by SD 155/96

3. DEFINITION OF CLIENTS' MONEY

3.1 General Definition

Clients' Money is money of any currency which, in the course of carrying on investment business, a licenceholder **holds or receives** under Code 3.2 or which it owes to a client under Code 3.3.

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Guidance Note

If a firm pays money, received from or due to its clients, into separate bank accounts each in the name of the client concerned or his nominee, it discharges its liability to the client in respect of that money. Such an account is not a Client Bank account even if the firm is mandated to draw cheques on the account, and money in the account is not Clients' Money. The client's protection does not then depend upon his rights in equity under a trust but upon his legal ownership of the money (or, strictly, of the debt due from the bank).

This, however, is not the case if the bank accounts are those of the firm with a client's name added to each by way of identification. Such bank accounts are Client Bank Accounts, and the money Clients' Money, and in the event of the firm's insolvency will be pooled in accordance with the Investment Business (Clients' Money) Regulations 1991.

3.2 "Holds or receives"

A licenceholder, or his agent, holds or receives money for the purposes of Code 3.1 if it enters or expects to enter into an investment agreement with or for a client, and holds or receives (in the Island or elsewhere) in respect of that agreement any money:-

- (a) which is not immediately due and payable on demand to the licenceholder for its own account; or
- (b) which, although so due and payable, is held or received in respect of any obligation of the licenceholder which has not yet been performed.

3.3 Money owing to a client

Where a licenceholder, or his agent, owes money to a client, and it is due and payable (whether demanded or not), that money becomes Clients' Money.

3.4 Payment to the client

Money ceases to be, or never becomes, Clients' Money if it is paid:-

- (a) to the client; or
- (b) into a bank or other account in the name of the client (not being an account which is also in the name of the licenceholder); or
- (c) otherwise at the direction of the client.

3.5 Licenceholders should instruct all their clients and other relevant parties to make such cheques, drafts and electronic transfers payable to:-

- (a) "[licenceholder] - Client Account"; or
- (b) "[licenceholder] - Designated Client Account"; or

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(c) "[licenceholder] - Designated Client Fund Account"

as appropriate.

3.6 Any licenceholder who is either:-

- (a) authorised to conduct only Category 1 investment business (within the meaning of the Financial Supervision Commission (Financial Resources and Reporting) Regulatory Code 6) and who receives Clients' Money; or
- (b) authorised to conduct Category 2 investment business and receives Clients' Money otherwise than as permitted by Code 6 of the Financial Supervision Commission (Financial Resources and Reporting) Regulatory Code, and who receives Clients' Money, shall immediately deposit or transfer such money into a Clients' Bank Account (in accordance with this Code) and shall on the date of receipt or the next working day notify the Commission of the facts, including the reason for the receipt of the money, the action taken and the arrangements for paying the Clients' Money out of the Clients' Bank account.

4. DUTY TO SEGREGATE

4.1 A licenceholder shall pay all Clients' Money coming into its hands for or from a client into a specially created Clients Bank Account which is segregated from any account holding money which is not Clients' Money. A licenceholder may, at the specific written consent of the client, open a "**Designated Client Bank Account**" or a "**Designated Client Fund Account**". A licenceholder may open as many accounts as it considers necessary for this purpose but it must open separate accounts for **marginied transactions** (See Codes 4.3 and 8) and may be permitted to open one or more separate bank accounts for **Clients' Settlement Money** (see Code 4.2 below). See Guidance Note in Code 4.3 below for summary of clients' accounts to be opened.

4.2 Clients' Settlement Money

Where the Commission is satisfied that the system of internal controls is adequate and the volume of transactions involving clients warrants such treatment, the licenceholder may adopt a system under which a separate segregated bank account is operated in which is held at any time the net balance required for the settlement of client transactions ("**Clients' Settlement Money**").

Guidance Note

The adoption of such a system permits a limited degree of temporary offset of credit and debit balances relating to individual clients.

Any application to the Commission for the maintenance of a Clients' Settlement Money system must include a description of:-

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- detailed records to be kept to identify all the amounts held in the Client Settlement Account;
- methods of calculating the net balance to be settled;
- reconciliation procedures.

The licenceholder will be required to instruct its auditors to report in writing to the Commission whether, in the auditor's opinion, the licenceholder has in place a system of internal control as described in the application. Any costs incurred by the Commission in reviewing the proposed alternative system are to be borne by the applicant, regardless of whether the application is accepted.

Where such a system has been adopted, the Commission will require an opinion on its adequacy throughout the financial year under review to be included in the opinion to be given in the auditor's annual report to the Commission. (See the Financial Supervision Commission (Audit Requirements) Regulatory Code).

4.3 Margined Transactions

For the purposes of this Code "***margined transactions***" means a transaction effected by a licenceholder with or for a client relating to an investment of any description referred to in paragraphs 7, 8 and 9 of Schedule 2 to the Investment Business Order 1991 (or any right to or interest in such investment) under the terms of which the client will or may be liable to make deposits in cash or collateral to secure performance of obligations which he may have to perform when the transaction falls to be completed or upon the earlier closing out of his position.

Guidance Note

This definition excludes purchased call or put options as there is no requirement to deposit cash or collateral to secure performance of the obligations of the transaction. Where the licenceholder intends to effect contracts which are not traded on and under a recognised or designated exchange, this should be specified in the client agreement. (See the Financial Supervision Commission (Conduct of Business) Regulatory Code 5.5(j)).

Guidance Note

Summary of when Clients' Bank Accounts are to be opened.

	Condition	Account to be opened	Purpose of Account
(a)	<i>If the firm may hold or receive Clients' Money.</i>	<i>At least one "Client Account".</i>	<i>For all Clients' Money not dealt with under items b), c) and d) below, but for no other money.</i>

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|------|---|--|--|
| (b) | <i>If the firm wishes to use a Clients' Settlement Money system.</i> | <i>In accordance with a system approved by the Commission. (See Code 4.2).</i> | <i>For Clients' Settlement Money which is for or in settlement of market investments.</i> |
| (c) | <i>If the client wishes to designate a particular bank where the account is to be held.</i> | <i>At least one "Designated Client Bank Account".</i> | <i>For one or more clients wishing to segregate their funds in a specific bank. This account will not be subject to pooling arrangements in the event of a failure of the bank with which the account is held.</i> |
| (d) | <i>If the client wishes to designate a number of banks where the account may be held.</i> | <i>At least one "Designated Client Fund Account".</i> | <i>For one or more clients wishing to segregate their funds in specific banks. In the event of a failure of the bank with which the account is held a separate pool shall be formed comprising all funds in the same Designated Account.</i> |
| (e) | <i>If the firm undertakes margined transactions -</i> | | |
| (i) | <i>under the rules of an Exchange and in the types of contracts traded thereon;</i> | <i>At least one separate "client account" for such transactions (in addition to that in item a) above).</i> | <i>For Clients' Money which is for settlement of on-exchange margined transactions.</i> |
| | <i>or</i> | | |
| (ii) | <i>not under the rules of an Exchange</i> | <i>At least one separate "client account" for such transactions (in addition to that in items a) and c)(i) above).</i> | <i>For Clients' Money which is for settlement of off-exchange margined transactions.</i> |

5. CLIENTS' MONEY TO BE HELD ON TRUST

- 5.1 Clients' Money, unless paid out for the client, shall be kept in an account at a bank recognised by the Commission (see Code 6.1 below) on trust for the client entitled to it. This applies:-

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- (a) where the Clients' Money is received or held by a licenceholder, or paid by it in accordance with this Code in the course of investment business carried on in or from the Island; or
- (b) where the money relates to an investment agreement entered into, or expected to be entered into, between the licenceholder and the client which is to be governed by the law of the Island.

Where Clients' Money is received or held by a licenceholder in circumstances in which a) and b) do not apply the licenceholder shall warn the client in writing that his money may not be protected as effectively as it would be if this Code applied.

Guidance Note

The Investment Business (Clients' Money) Regulations 1993, made under Section 7(1) of the Investment Business Act 1991, have the effect at law of declaring the trust over Clients' Money without action on the part of the licenceholder concerned, although Code 5.1 and the other relevant provisions of this Code must be complied with in order to protect respective clients' interests in the Clients' Money.

6. OPERATIONAL PROCEDURES

6.1 Opening the Bank Account

A licenceholder shall comply with the following:-

- (a) each Client Bank Account must be with a bank recognised by the Commission;

Guidance Note

For the purposes of this Code, the term " recognised" is as defined in Code 1.3(10).

- (b) The title of the Client Bank Account must include the words "client account" "Designated Client Bank Account" or "Designated Client Fund Account" (as appropriate) or, in the case of a branch of a bank outside the Island, such description in an official language of the country in question as is equivalent to "client account" or "Designated Client Bank Account" or "Designated Client Fund Account";

Guidance Note

It is important that the licenceholder ensures that the title of each of the Client Bank Accounts operated by it sufficiently distinguishes the money in the accounts from that of the licenceholder. Where designated accounts are concerned, a failure by the bank to use the correct title might have consequences for client entitlements in the event of a failure of that bank. Consequently, this Code requires the licenceholder to ensure that the correct title for any such account is recorded by the bank concerned.

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- (c) Subject to (d) below the recognised bank must acknowledge to the licenceholder in writing (with a copy addressed to the Commission) that: -
- (i) it understands that all money standing to the credit of the client bank account is held by the licenceholder as trustee and that the bank is not entitled to combine the account with any other account or to exercise any right of set-off or counter-claim against money in that account in respect of any debt owed to it by the licenceholder;
 - (ii) interest earned on the account will be credited to the account or to an account of the same type; and
 - (iii) the title of the account sufficiently distinguishes the account from any other account containing money that belongs to the licenceholder, and is in the form requested by the licenceholder.

(d) **Monies held in a Bank outside the Island**

In the event that the licenceholder's clients' account is held with a bank outside the Island, the licenceholder should ensure that Clients' Money paid into such an account is protected by segregation under trust or otherwise by statutory or other regulation, as effectively as it would be if held in a bank account in the Island. Alternatively, and where the bank concerned has not provided the acknowledgement specified in (c) above, the licenceholder should warn clients in writing that his money may not be protected as effectively as it would be if this Code applied.

6.2 **Payment of other money into a Client Bank Account**

Money which is not Clients' Money must not be paid into a Client Bank Account unless it is required:-

- (a) to open or maintain the account; or
- (b) to restore an amount withdrawn in error from the account.

If a cheque contains both Clients' Money and money to which the licenceholder is beneficially entitled it should be paid into the Client Bank Account and as soon as the net amount of the licenceholder's entitlement can be quantified, that amount must be withdrawn (see Code 6.3(a)).

6.3 **Payment out of a Client Bank Account**

6.3.1 Money may be withdrawn from a Client Bank Account only if:-

- (a) it is not Clients' Money; when a cheque or draft is paid into a Client Bank Account and that cheque or draft includes money which is not Clients' Money, that money which is not Clients' Money shall be withdrawn from the account as soon as cleared funds are credited to the account in respect of that cheque or draft;

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- (b) it is properly required for payment to or on behalf of a client;
- (c) it is properly transferred to another Client Bank Account or into a bank account in the client's own name; or
- (d) it is money held in an account for margined transactions, and is properly payable to an Exchange or an intermediate broker or (for relevant margined transactions) to the licenceholder's client account with the Exchange.

6.3.2 Special rule for interest

A licenceholder may not withdraw for its own account any part of the interest earned on a Client Bank Account that is then due to clients under Code 7.

6.3.3 Special rule for fees

A licenceholder may only withdraw money for or towards payment of its own fees or commission if:-

- (a) the fees or commission accord with the arrangements contained in the client agreement; or
- (b) the amount is agreed by the client, or finally determined by a court or arbitrator.

6.4 Accounting for and use of Clients' Money

6.4.1 A licenceholder shall account properly and promptly for Clients' Money and, in particular, shall ensure:-

- (a) that Clients' Money and other money do not become intermingled;
- (b) that it can at all times be sure how much Clients' Money stands to the credit of each client; and
- (c) that money belonging to one client is not used for another.

Guidance Note

The only exception to Code 6.4.1(c) arises in the case of Clients' Settlement Money (see Code 4.2). With this exception, bank accounts must not be overdrawn in respect of any individual client or used to extend credit to a client. If a licenceholder is obliged to pay money for a client to whose credit there is insufficient money in such a Client Bank Account, it must not pay the amount from that account, but must instead make other arrangements for giving or obtaining credit for him.

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When assessing whether the balance held in a Client Bank Account in respect of any individual client is overdrawn, this will normally be determined by reference to client balances making up the cash book balance. If there is reason to believe that a cheque or other payment received will not clear in the normal course of events, the licenceholder must take this into consideration when determining the balance held for any one client.

6.4.2 Reconciliation requirements

- (a) A licenceholder shall, at least once a month, reconcile the balance on each Client Bank Account, as recorded by the licenceholder, with the balance on that account as set out in the statement issued by the bank. All Client Bank Accounts must be reconciled to the same date.
- (b) As at the same date used in (a) above, a licenceholder shall also reconcile the total of the balances on all Client Bank Accounts, as recorded by the licenceholder, with the total of the corresponding credit balances in respect of each of its clients, as recorded by the licenceholder.
- (c) Any differences shall be corrected forthwith unless, in the case of (a) above, they arise solely as a result of normal timing differences.

Guidance Note

Normal timing differences would include:-

- (a) *lodgements recorded as receipts in the Cash Book but not credited in the bank statement until the following working day; and*
- (b) *unpresented cheques recorded as payments in the cash book but not debited in the bank statements.*

- 6.4.3 The licenceholder shall give written notice and details forthwith to the Commission if it has not carried out the reconciliation required by the Financial Supervision Commission (Clients' Money) Regulatory Code 6.4.2 or if, having done so, it is unable to correct any differences.

7. INTEREST ON CLIENTS' MONEY

The licenceholder must pay interest on Clients' Money in accordance with the terms set out in the client agreement. (See the Financial Supervision Commission (Conduct of Business) Regulatory Code 5.5(e)). If no interest on Clients' Money is to be paid to the client this must be clearly set out in the client agreement. In the absence of an agreement the licenceholder is still required to disclose to the clients concerned the treatment of interest earned on Clients' Money.

8. MARGINED TRANSACTIONS

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- 8.1 A licenceholder which undertakes margined transactions under the rules of an Exchange and in the types of contracts traded thereon shall open one or more separate client bank accounts in which shall be held all Clients' Money received in respect of such margined transactions and no other money. (See also Code 4.3).
- 8.2 The amount to be segregated should include initial margins calculated on each individual client's positions and should not be taken as the overall net position across all clients. Where margins required by an Exchange or intermediate broker in respect of any one client have not been received from the client concerned, the licenceholder must itself pay the required amount either into the relevant client bank account or direct to the Exchange or intermediate broker as the case may be. (See also the Financial Supervision Commission (Conduct of Business) Regulatory Code 7.3).

Guidance Note

For the purposes of this Code the initial margin requirement for any client at any time is the total amount which, under the rules of the relevant Exchange, the firm or intermediate broker would be required to deposit in cash or approved collateral as a fidelity deposit in respect of all that client's open positions in relevant margined transactions at that time, irrespective of any unrealised profit or loss on such positions.

- 8.3 If a licenceholder undertakes with or ^{42A} for a client margined transactions which are not undertaken under the rules of an Exchange and in the types of contracts traded thereon, it shall open a separate Client Bank Account in which shall be held all Clients' Money received in respect of such margined transactions and no other money.
- 8.4 When margined transactions are undertaken by the licenceholder with or for clients under the rules of an Exchange and in the types of contracts traded thereon, the licenceholder may pay Clients' Money to the Exchange or intermediate broker to be credited to the licenceholder's clients' account with the Exchange and to be dealt with in accordance with its rules and regulations.
- 8.5 **Margined transactions accounting requirements**

A licenceholder shall ensure that, on each business day, the aggregate of the amount described below as at the close of business on the immediately preceding business day is not less than the aggregate of all the licenceholder's clients' required contribution as at the close of business on the immediately preceding business day. (See also the Financial Supervision Commission (Conduct of Business) Regulatory Code 7.3).

The amount referred to above is the total of:-

- (a) the balance on the licenceholder's client bank account(s) in which is held margined clients' money;
- (b) the net aggregate of the licenceholder's equity balances with Exchanges and with intermediate brokers; and

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- (c) the value of approved collateral deposited with the licenceholder, whether held by it or by an intermediate broker.

A client's required contribution is the greater of:-

- (a) the amount of the client's initial margin requirement at that time; and
- (b) the aggregate of the client's equity balance at that time and the amount of the value of the approved collateral which the client has provided to the licenceholder.

Guidance Note

For the purposes of this Code, a client's equity balance at any time is the amount which the licenceholder would be liable to pay to the client or, where negative, the amount which the client would be liable to pay to the licenceholder, in respect of his relevant margined transactions if each of his open positions were liquidated at the closing or settlement prices. This definition of an equity balance applies correspondingly to a licenceholder's equity balance with an Exchange or with an intermediate broker.

Made by the Financial Supervision Commission this 22nd day of April 1993

D J Gelling
CHAIRMAN

J E Noakes
CHIEF EXECUTIVE