

CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

Investment Operations Certificate

Transfer Agency Administration and Oversight

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THE TA FORUM

CISI CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT APPROVED WORKBOOK

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Welcome to the Chartered Institute for Securities & Investment's Transfer Agency Administration and Oversight study material.

This manual has been written to prepare you for the Chartered Institute for Securities & Investment's Transfer Agency Administration and Oversight examination.

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Workbook Version: 3.1 (July 2025)

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It is estimated that this manual will require approximately 100 hours of study time.

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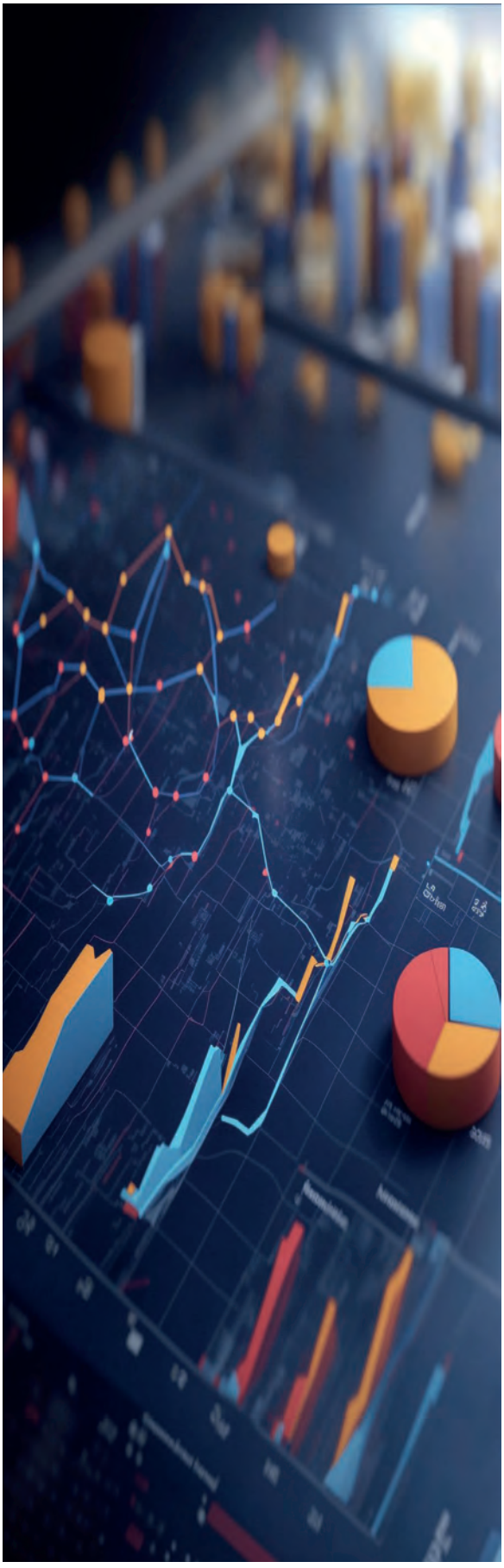
Billy Snowdon, Team Leader, Brewin Dolphin

Chapter One

The Transfer Agency (TA) Framework

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This syllabus area will provide approximately 18 of the 100 examination questions



1. Transfer Agencies (TAs)

1.1 Terminology

The term 'transfer agency' (TA) has become the standard term to cover functions that have also been known as 'fund administration', 'third-party administration' (TPA) or 'register administration'. Typical activities carried out by a TA include:

- **transaction** processing (the placing of subscriptions, redemptions, switches, conversions and transfers)
- investor and account data validation
- anti-money laundering (AML) and know your client (KYC) processing
- box management
- **settlement** and associated reconciliation
- banking activities, including control of **client money**
- document management (workflow and record keeping)
- **registration** updates and maintenance
- call centre and investor servicing
- distribution processing and corporate actions
- management and financial accounting
- **agent** maintenance and commission processing
- **annual management charge (AMC)** rebates, and
- output management, contract notes, distribution vouchers, periodic statements, for example.

The following terms are typically used in the UK funds industry:

- **transfer agent** is synonymous with an administrator, but the term makes no presumption that the role contains or does not contain the regulatory obligation of the fund manager
- **'in-house' transfer agent or 'in-house' administrator** can be used where the role is performed by the same entity as the fund manager or the same group entity, and
- **third-party administrator (TPA)** would refer to the role of transfer agent or administrator performed outside of the direct control of the fund manager (who retains the regulated responsibility) and is operated via a contractual arrangement. A fund manager can choose to outsource all, or some of, the activities of the TA depending on their in-house preferences and the contractual agreement they have in place with the TA.

The TA Forum is an organisation which was set up to help support the TA industry by recommending best practices and, where possible, influence change where operational efficiencies can be improved across the UK investment management industry. The TA Forum hosts a number of working groups on specific operational subjects, with industry specialists invited to provide input. The members of the TA Forum all perform administration services to funds and most (but not all) provide services to firms outside of their group entity.

In the remainder of this workbook, the term 'transfer agent' will be used to refer to the role of administrator to the fund manager.

TAs offer multiple options to their clients, including full or partial business process outsourcing (BPO) services, supplying teams that can provide a personalised service who act as if they were an employee of the fund manager to the end client.

In the UK, the role of the **authorised fund manager** (AFM) is a regulated activity and funds that are marketed to retail investors must also be authorised by the **Financial Conduct Authority (FCA)**. These regulations are applied through the AFM, as the regulated **firm** and the responsible party, and shape the way that funds are administered.

It is a fundamental principle of the FCA regulations that the regulated firm cannot contract out, eg, to another firm, its regulatory obligations to any other party. Therefore, while the administration function might be performed by the TA, the AFM's regulatory obligations remain unchanged, although the TA may have its own regulatory responsibilities.

As the responsible party, the fund manager firm and the regulated entity will ensure that the services provided by the administrator in conjunction with the services provided directly by the firm itself meet their regulatory obligations. The services provided by the administrator to the regulated firm will be defined in detail in documented agreements between the firms.

While at one level the documented agreements for administration services may cover very similar areas and provide essentially similar services, there can be substantial differences in the detail of how the services are performed, the interaction required with investors and the reporting requirements to third parties. This can be for several reasons, including differences in distribution channels, scale and fund structures.

1.2 The Services and Responsibilities of the Transfer Agent

Learning Objective

1.1.3 Know the high-level responsibilities of the transfer agent

The services performed by a transfer agent will be set out in agreements between the TA and the AFM. The contract will define the scope of the services performed and the standards (quality and timeliness) to which those services are to be performed. For the TA, the 'client' is the party (eg, the fund manager) to whom they are contracted to provide services. A client of a TA might also be a manager of a product, eg, an **individual savings account (ISA)** manager.

The interactions and communications of a transfer agent can include services provided to many other parties, but each service is performed by the transfer agent for and in respect of their client to whom they are contracted. For example, a TA would commonly answer a telephone call from the fund manager's investor as the fund manager would themselves, and written communications from the TA would be on the fund manager's headed paper. At the same time, the services of a TA will be known by clients, especially corporate or institutional. To provide a more efficient service, TAs will often offer an administration service where institutional clients will interact directly, which will allow a single point of entry or standardised reporting for multiple AFMs.

1.3 TA Services

Learning Objective

1.1.1 Know transfer agency business models

The typical administration functions carried out by a TA would include the provision of services in respect of some or all of the following fund structures and product types:

a. **Funds** structures
   - FCA-authorised funds – an authorised fund established in the UK must take one of the following legal forms:
     - Authorised Contractual Scheme (ACS)
     - **Authorised Unit Trust** (AUT)
     - **Investment Company with Variable Capital (ICVC)**

     and be classified as one of the following marketing strategies:

     - an **Undertaking for Collective Investment in Transferable Securities** (**UCITS**) scheme
     - a non-UCITS retail scheme (NURS)
     - a **qualified investor scheme (QIS)**
   - other **alternative investment funds (AIFs)**.

b. Product structures
   - direct register holdings otherwise known as unwrapped holdings
   - indirect holdings, eg, wrappers. An ISA is a type of **wrapper**, but not all wrappers are ISAs.

In the UK market, processing teams at transfer agencies would typically be using terms such as **open-ended investment company (OEIC)**, unit trust (UT), property authorised investment fund (PAIF), tax transparent fund (TTF), **investment trust (IT)** and **exchange-traded fund (ETF)** as the vehicles that they administer.

The services provided in respect of the agreed fund and products (see above) might include some or all of the following:

a. Services provided to the AFM's investors
   - acquiring the investor – anti-money laundering (AML) and other know your client (KYC) procedures
   - maintaining the registered details of the investor
   - processing of transactions and confirmation of the outcome of those transactions
   - periodic reporting to investors on their accounts
   - liaising with the investor's personal representatives as necessary
   - making and receiving payments to investors on behalf of the AFM.

b. Services provided to the AFM's funds and/or **trustee**/**depositary**
   - box management
   - reporting the number of units/shares to be created or liquidated
   - make creation payments and receive liquidation proceeds
   - reporting total units in issue
   - reporting total income (distributions paid) and equalisation
   - arranging money movements due to distributions.

c. Services provided to the client (eg, the transfer agent's contractual counterparty)
   - administering the investor's cash and assets in accordance with the agreed procedures
   - administering the client's holding and transactions in accordance with the requirements of the Conduct of Business regulations (COBS)
   - report potential breaches of the FCA rules
   - complaint reporting
   - call centre and client correspondence support
   - prepare audit samples and support oversight visits
   - prepare audit samples and support external audit requirements
   - report the performance against the agreed standards defined in **service level agreements (SLAs)** and key performance indicators (KPIs)
   - His Majesty's Revenue and Customs (HMRC) reporting
   - suspicious activity reporting (SAR)
   - provide invoice and supporting material
   - support change management activities
   - paying of retrocessions including annual management charge rebates and commissions
   - supporting digital channels that facilitate automated transaction processing
   - provision of management information.

1.4 TA Interactions

Learning Objective

1.1.4 Know the roles and interactions that form the entire transfer agency process

1.1.5 Understand the interaction between the transfer agent and the other various players and their respective roles in the transfer agency process

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The TA provides the primary contact between investors and the companies or trusts managing their investments. Investors generally fall into three broad categories:

1. **Retail investors**, including trusts. These will show on the **register** as a person or a company with a name and address.
2. **Aggregators** hold investor level records themselves but will typically have an aggregated account with the AFM to hold assets belonging to the underlying investors. These will usually show on the register as a holding in the name of a **nominee** company that is owned/controlled either by the regulated aggregator or that of a **platform service** provider.
3. **Institutional investors** such as charities, local government entities and pension/insurance companies where the account will typically show on the register in the name of the legal entity.

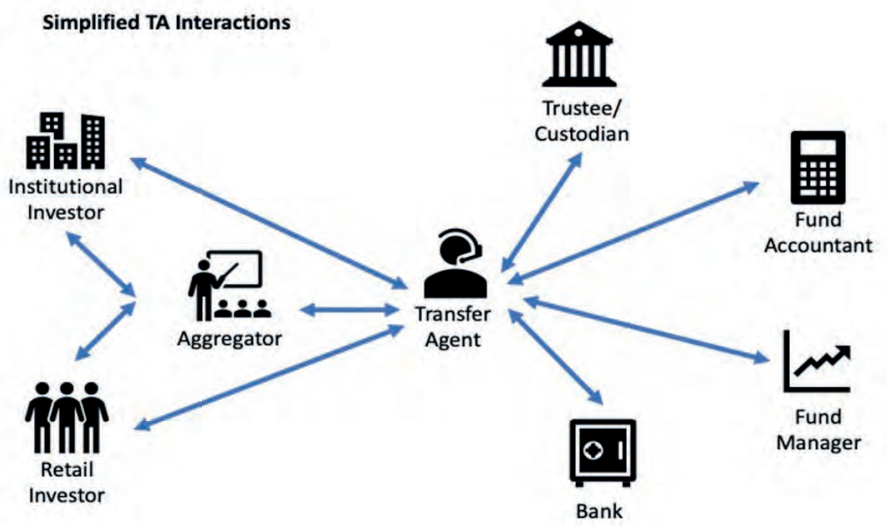
Firms are required to have measures in place to identify and verify the identity of a customer. This customer due diligence is performed by the TA but can be outsourced to a third party. The TA will also validate requests to change addresses and banking details received from clients. In this, the TA plays a major role in protecting investors from fraudulent activities.

The TA is often the first point of contact for investors when complaints are raised regarding any aspect of the service the client is receiving. Where the complaint does not relate to the activities of the TA, the TA may work with the relevant party to address and respond to the complaint.

By virtue of administering the client register with contact details, the TA is responsible for the distribution of information to investors. Contract notes for deals, dividend **tax vouchers** and cheques, statements on investments and communications on changes to products are among some of the 'mailings' managed by the TA.

Other key TA interactions are:

- **fund manager** – extensive interaction in an outsourced environment
- **bank** – to instruct money movements and receive data for reconciliation purposes
- **trustee/custodian** – instruct fund movement after dealing cut off and receive distribution data, and
- **fund accountant** – instruct fund movements after dealing cut off and receive prices for funds.



1.5 Transfer Agency Structure

Learning Objective

1.1.2 Know how transfer agencies are structured

There is no common structure used across different TAs, with some structured so that single departments carry out many processes and some (typically larger) TAs are organised so that there is a separate department for each process, such as dealing, error correction, registration and complaint handling.

The structure of the TA needs to meet the requirements for **segregation** of duty regulations to minimise the risk of fraud to the end investor and to the organisation. This would typically lead to a structure where a single processor could not be solely responsible for some processes. For example, placing a redemption and arranging for payment to a certain bank account without a second person being involved in some way.

2. Depositaries and Trustees

Learning Objective

1.2.1 Know activities undertaken by depositaries

1.2.2 Know activities undertaken by trustees

1.2.3 Know how depositories and trustees interact with transfer agents

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The depositary/trustee is a company who must be independent of the fund manager. There will usually be a separate division within large banking organisations. From a TA's perspective, the key difference between the depositary and the trustee is that an OEIC has a depositary, whereas an authorised unit trust has a trustee. Further details on the responsibilities of depositaries and trustees can be found on the Depositary and Trustee Association (DATA) website at http://www.datasoc.co.uk.

The trustee of an authorised unit trust (AUT) will be appointed as a result of entering into the **trust deed** with the AFM and derives their authority from that document. The depositary of an open-ended investment company (OEIC) will be appointed under contract by the **Authorised Corporate Director (ACD)** on behalf of the OEIC.

The depositary/trustee's purpose is to safeguard the investor's assets and money invested within a scheme by ensuring that the funds' assets are held independently from the investment manager. The depositary also ensures that the fund managers' activities adhere to the terms of the FCA Sourcebook scheme documentation (or as defined by a trust deed and scheme particulars, or **Instrument of Incorporation** and **prospectus**). This includes ensuring that the investment objective, investment restrictions of the scheme, such as investment and borrowing power limits, and the functions that may have been outsourced to a TA, such as processing subscriptions and redemptions (dealing), settlement to shareholders and distributions are all completed within the regulatory timeframes.

Oversight of the transfer agent and any of the work that has been delegated (dealing or interaction with investors) is undertaken by depositary and continually monitored through regular annual reviews/inspection limits. These can be both in conjunction with the AFM or independently arranged. A responsibility of the trustee/depositary is the requirement to produce a monthly report to the FCA summarising all breaches of FUND (Investment Funds) or COLL (Collective Investment Schemes) that came to their attention during the previous month. Therefore, visits are not always regular and can be undertaken on an as and when basis, highlighted via the reporting of increased volumes of breaches, complaints or service legal agreements (SLAs) that do not meet the required standard set out.

A trustee/depositary must:

- be a body corporate in the UK or an EU state
- be an authorised person under FSMA 2000
- be independent of the OEIC and its directors, and managers in the case of AUTs, and
- act solely in the interests of the unit/shareholders.

While the trustee/depositary acts in the interest of the shareholder, they will have little, if any, direct interaction as the investor will deal directly with the AFM. However, as expected, the AFM and the trustee/depositary will work closely as part of the management structure of the scheme.

As stated above, the depositary/trustee will usually be part of a large financial institution:

- They must be authorised and regulated by the FCA whose regulations require that their gross capital should be at least £4 million.
- The trustee/depositary must take all reasonable steps to ensure that the AFM complies with FCA regulations.
- If the trustee/depositary suspects that the AFM is not acting in the unit/shareholder's interests, they have the power ultimately to replace them.
- In order to fulfil these obligations, the trustee/depositary carries out regular compliance audits of the AFM's operations.

The trustee/depositary must take reasonable care to ensure that the scheme is managed in accordance with the FCA Sourcebook and the requirements of the scheme documentation (trust deed or Instrument of Incorporation, as applicable) and the prospectus. In particular, the trustee/depositary will review:

- the initial offer, issue, cancellation, sale, and redemption of units/shares
- the pricing of shares
- all investments to ensure they are appropriate per the prospectus for the fund
- any use of a dilution levy
- the valuation of the scheme property
- the accounting periods
- the calculation of income available for allocation
- the allocation, payment or retention of income
- any unclaimed distributions, and
- investment and borrowing limits.

Once appointed, the trustee/depositary will commence a **due diligence** process on the AFM's control systems and procedures (including record keeping) and will expect to have full understanding of an AFM's TA capabilities. On an annual basis, they will review the AFM's valuation procedures and controls, focusing on significant changes to procedures. This is conducted via visits to the AFM's offices and third parties. The result of these reviews will be written up as a report that requires formal responses and remediation if required. Remediation responses must focus on the remedy of faults, weaknesses in systems and controls including the plan and timescales of the rectification.

The trustee/depositary has a responsibility for the safe custody of the assets of a scheme. The scheme itself does not hold assets in its own name and instead they are held on behalf of the scheme in the name of the trustee/depositary. Regulations allow the appointment of a third-party custodian; however, this is for practical purposes only, with the trustee/depositary remaining liable to the scheme for any loss or damage caused by that third party.

On an annual basis, the trustee/depositary will prepare reporting for the schemes annual report and accounts.

As part of the ongoing reporting, the trustee/depositary must notify the FCA on matters which include, but are not limited to, any circumstances that they become aware of while undertaking functions or duties that the FCA would view as significant.

Any breach of the rules detailed within the **Collective Investment Scheme Sourcebook (COLL)** 6.3 should be immediately reported to the FCA when they are considered to be material.

3. Custody

3.1 Custodian Duties

The duties of a custodian are to:

- hold in safekeeping assets/securities (such as stocks, **bonds** or commodities such as precious metals) and cash (in both domestic and foreign currencies)
- arrange settlement of any purchases, sales and deliveries in/out of such securities and currency
- collect information on, and income from, such assets (dividends in the case of stocks/**equities** and interest payments (sometimes known as 'coupons') in the case of bonds) and administer related tax withholding documents and foreign tax reclamation
- administer voluntary and involuntary corporate actions on securities held, such as stock dividends and stock splits
- provide information on the securities and their issuers, such as annual general meetings (AGMs) and related proxies
- maintain currency/cash bank accounts, effect **deposits** and withdrawals and manage other cash transactions
- perform foreign exchange transactions as required or when instructed.

Custodians often perform additional services for particular clients, such as investment fund services (eg, fund accounting, administration, legal, compliance and tax support services).

Custodians are often referred to as 'global custodians' if they service assets for their clients in multiple jurisdictions around the world. A global custodian might either use its own local branches or (if it does not have a branch in a particular jurisdiction) other local custodian banks in each market to hold accounts for its respective clients. The individual local banks in such a model are referred to as 'subcustodians', and the whole operation is referred to as a global custody network. Subcustodians are often, but do not have to be, member firms of the same organisation as the global custodian.

When a global custodian selects a **subcustodian** it should perform a due diligence review to ensure that the subcustodian:

- has the necessary regulatory approval, as well as the skills and resources, to administer assets in the jurisdictions in which it is operating, and
- has sufficient financial resources to perform these activities.

3.2 The Register

Learning Objective

1.3.1 Know the requirements for the establishment, maintenance and contents of a register or sub-register

1.3.8 Know regulation and best practice in relation to processing new business, transfers and account closure: permitted transfer of assets – cash and non-cash; different types of customer specific regulations in accordance with current relevant legislation; transition management; new products; rules for closing business; roles of the custodian, investment manager and consultants; residual income

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For unit trusts, OEICs and companies there is a legal duty to maintain, in legible form at all times, a register of unitholders/shareholders. In practice, the register is kept on a computer system with the facility to produce a printed copy as and when required. The systems employed vary between the firms due to variables such as the size, number, and type of funds being administered.

The AFM has a duty to ensure that the register is maintained to show the correct number of units/shares held by each unitholder/shareholder. The data held on the register must include:

- the name and address of each holder – up to four names may be registered per holding (as with property generally under English law and as specified under the OEIC Regulations 2001)
- the date each unitholder's/shareholder's name was entered on the register
- the number of units/shares (including any fractions of units or smaller denomination shares, when applicable) of each type held by each holder – this should also reflect any different denominations of units/shares issued, and must be updated regularly (usually daily), and
- the number of units/shares of each type in issue and represented by bearer certificates and the numbers of those certificates.

The AFM must ensure that the information contained in the fund's register is always complete and up to date. It is the AFM's specific responsibility to obtain the registration details and update the register promptly. For example, the AFM must obtain the necessary details to enable the entry of new unitholders onto the register – sending a registration form for completion by the unitholder and updating the register within a reasonable period after the information is provided.

As the entry on the register is deemed to be evidence of ownership, it is important that any reported errors in the register are thoroughly investigated and resolved. The AFM has a duty to ensure that the register is maintained in a complete and accurate manner.

Due to the laws noted above, it is usual for assets to be registered in up to four names, though each holder should be a legal entity having contractual capacity. Children, for example, would not have contractual capacity. Where a firm allows an adult to hold an asset for their child, for example, it is usual to register the asset in the adult's name, though some designation code (such as the initial letters of the child's name) might be used so the adult can differentiate between holdings. The assets can usually be re-registered in the child's own name upon turning 18.

3.2.1 Who can be Registered as a Holder of Units/Shares?

Learning Objective

1.3.2 Know: who can be registered as a holder of an investment; the status of the register as proof of ownership; the requirements for the collection of beneficial holder details

To ensure there is certainty as to who has authority to deal with a holding of units/shares, the style of the registration of units is limited to legally recognised persons, including individuals and corporate bodies. Examples are John Robert Smith, John Smith ltd and John Smith plc. There are some unusual corporate bodies which are also acceptable, such as NHS trusts which, despite the name, are in fact corporate bodies, and certain government bodies such as the Public Trustee and the Treasury Solicitor who both generally execute documents under seal.

Partnerships, unincorporated bodies such as clubs and official capacities such as *'The Trustees of...'* or *'The Treasurer and Secretary of...'* would all normally not be accepted for registration. Limited partnerships (ie, those registered with the Registrar of Companies) are acceptable.

Holdings of units/shares may be designated for the convenience of the holders, but normally such designations are limited to an eight digit alpha/numeric format (eg, 'ABC' or '123'). Names are not permitted because of the possibility of an implied trust and the problems arising from confusion with the registered holder(s). An example where a holding may be designated is that of units held on behalf of a child, eg, using the child's initials – 'AB' account.

No notice of any trust (express, implied or constructive) is binding on the AFM and trustee and, although such notice may be entered on unit trust registers, such practice is prohibited in the case of a company register and most unit trusts adopt the same approach. This means that only the registered holder(s) has authority to deal with the units/shares. Documents, such as Deeds of Appointment, where the holders may be trustees of a private trust and the trustees are changing, are not sufficient to instruct a deal on the register. In this situation, a stock transfer form will be completed and signed by the existing registered holders.

3.2.2 Rectification of Registration Errors

Learning Objective

1.3.3 Know the process for rectification of registration errors

If an error is found in the register, the data must be corrected. Such corrections may require units/shares to be issued or cancelled, which requires the appropriate instruction from the AFM. Errors to the way holdings are registered can be identified internally by TAs or, more commonly, notified to the TA by the investor.

While the AFM will generally absorb such a correction into the issue/cancellation instructed at the next **valuation point (VP)**, there is an option for the AFM to modify a previous issue/cancellation instruction within the settlement period for an issue or cancellation. Such modifications require the approval of the trustee/depositary, who must be satisfied that the purpose of modification is to rectify the consequence of an error, and that the AFM's control systems are unlikely to allow this to happen again.

The AFM should, therefore, ensure that it has established a proper internal checking/audit system for registering entries and changes, which could include a quality check by a second person for any changes made or the dual keying of all changes to ensure they are entered correctly.

3.2.3 Registration Treatment of Third-Party Assets

Learning Objective

1.3.4 Know the registration treatment of third-party interests

We have already seen that the regulated platform operator, such as a fund supermarket, places an aggregated deal with the underlying collective investment scheme (CIS) representing the underlying transactions of multiple investors. The scheme's register does not, therefore, record units/shares as being held by the various individual investors – it shows a single position for the platform. The **platform** must keep its own records to evidence how many of its units/shares are actually held on behalf of each investor. If the platform's records were to become corrupted, it would be impossible for the investors to prove to the AFM that certain units registered to the platform had in fact been purchased by them through the platform.

This is an example of a third-party interest, ie, a person who is not the legal/registered owner of an asset, and who was neither of the parties to the contract that purchased the asset, but who has a claim to some or all of the benefits that the asset provides. As they have a claim on the benefits, such a person is often referred to as a **beneficial owner**.

It has become important in recent years for some beneficial ownership details to be captured by financial services firms as part of increased detail in AML controls. It is not, however, necessary for a regulated firm to obtain the details of underlying beneficial owners if its client is a regulated firm or its nominee.

3.2.4 Nominee Companies

Learning Objective

1.3.5 Understand the different types of custody model and how they are used: pooled; segregated; multiple nominees; investor's own name

Nominee companies exist to be the registered owner (or legal owner) of assets on behalf of investment firms (including platform operators).

As the nominee company has no business activities, it is unlikely to become insolvent even if the investment firm using its services runs into financial difficulty; this helps reduce the risk for beneficial owners of their interest not being reflected on the ultimate asset register.

A platform operator may own a nominee company or may retain the services of an external party. Three forms of nominee accounts are possible:

- **One single pooled nominee account** – the platform uses one large nominee account to hold all assets relating to all its client holdings across all the wrappers it offers. This approach offers maximum **aggregation** of transactions and minimises the number of asset positions maintained. It is generally the most cost-efficient model to operate.
- **Multiple pooled nominee accounts** – on occasion, a platform operator might wish to separate assets held within one wrapper from those held in another. For example, prior to the personal savings allowance being introduced, it was common for ISA holdings to be registered in a different nominee account from holdings in a **general investment account (GIA)**. This was beneficial because ISA assets could receive gross interest payments, providing the payer knew that the assets related to ISA accounts. Separating the assets between multiple nominee accounts enabled gross payments to be received.
- **Segregated nominee accounts** – also known as designated nominee or sole nominee accounts. The stocks are still registered in the name of the nominee company, but no aggregation takes place. Instead, a designation (like an account code) is used to differentiate the assets held for each different investor using the platform. This is a more expensive model, as it generates no economies of scale; every new client gained increases the number of asset positions held and the number of nominee accounts to reconcile. However, where events such as corporate actions allow each investor to choose from certain alternative options for their future asset ownership, a segregated nominee structure enables the platform to readily process the different instructions that each client may provide.

In respect of platforms, two of the servicing aspects affected by the choice of nominee structure adopted are as follows:

- **Elective corporate actions** – at times, the issuer of an asset may offer holders some choice (eg, a vote regarding a potential corporate takeover). Where a segregated nominee structure is in place, each platform client's holding is distinct, so their choice/decision can readily be provided. However, where a pooled nominee model is in place, the platform will need a mechanism to receive and aggregate the elections made by the relevant underlying clients.
- **Asset transfers between spouses** – it can be common for spouses to transfer assets between them as a means of tax management. If the platform has adopted a segregated nominee model, then every such spousal transfer would need to be instructed externally so that the register could be updated. Where the platform uses a pooled nominee structure some or all of these spousal transfers can be completed purely by updating the platform's internal records.

FCA rules would also allow a platform to register assets in the client's own name. However, this would be an unusual model for a platform to implement:

- the asset register would not recognise the platform as owning the asset
- the investor would receive direct communications about each asset held, rather than such information flowing through the platform, and
- the investor might transact without the platform being aware.

3.2.5 Internal/External Transfers

Learning Objective

1.3.6 Know the methods by which internal/external transfers take place

Moving an asset between wrappers on a platform may require the platform to re-register the asset (ie, when different nominee accounts are used for the different wrappers). However, re-registration may also be necessary if an investor chooses to move their affairs from one platform to another.

This could be for a number of reasons, including the following:

- An investor has changed their financial adviser and the new adviser uses a different platform.
- An adviser has decided that all or some of its clients would be better served by a different platform.
- An investor who does not use an adviser has decided to use a platform that is less expensive, or more suited to their needs as the portfolio grows in size and/or complexity.

If multiple substantial portfolios are involved, re-registration of this kind can become difficult to coordinate between the two platforms concerned.

In 2011, the then UK regulator, the **Financial Services Authority (FSA)** became concerned about the robustness of this process given some low levels of client service being seen across the market. The FSA viewed it as unacceptable that the transfers of some clients were taking months to be processed and challenged the industry to take steps.

As a result, the Tax Incentivised Savings Association (TISA – the former industry body since rebranded as the Investing and Saving Alliance) established the **TISA Exchange (TeX)** to facilitate the electronic transfer of wrappers and fund units/shares. Fund managers, platforms, wealth managers and any firm which holds assets on behalf of investors can use TeX to improve the reregistration process.

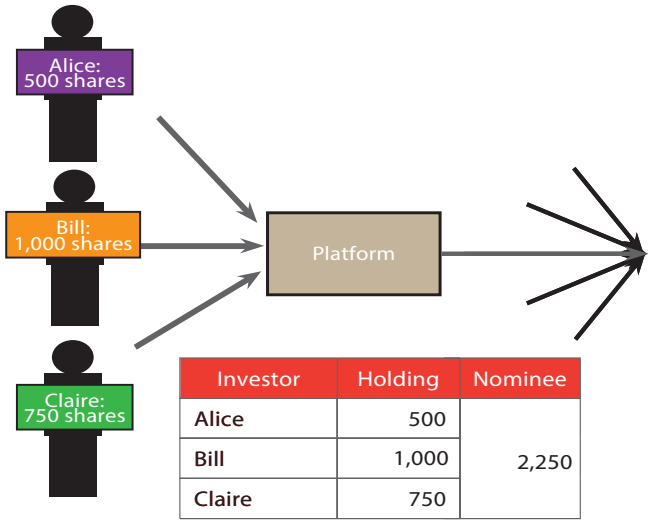
TeX's purpose is to make these transfers accurately, within five working days, using standardised agreements and contracts that are based on **straight-through processing (STP)** principles. It mandates common standards to cover liability issues, service level agreements (SLAs) and a dispute resolution process and has achieved cross-industry support and agreement to use standard messages to transfer assets and wrappers between platforms of all types.

3.2.6 The Chain of Relationships with Custody

Learning Objective

1.3.7 Understand the chain of custody

The chain of relationships with custody can be relatively complex and we will begin by looking at an AFM example before looking at the longer custody chain experienced where a custodian and its subcustody network are involved.



Investor	Holding	Nominee
Alice	500	2,250
Bill	1,000	
Claire	750	

Registered Unitholder	Holding	Units in Existence
Mr Smith	1,000	5,450
Mrs Jones	1,500	
Platform Nominee ltf	2,250	
Ms Black	250	
Mr White	450	

The AFM sees only 'Platform Nominee ltd' among its list of registered unitholders. However, Alice, Bill and Claire are all beneficial owners of the units registered to the nominee.

At the other end of the chain, Alice, Bill, and Claire know their own holding but rightly have no awareness of the total aggregate number of units held by the nominee at the AFM. Each party knows only the activity in the adjacent links of the chain.

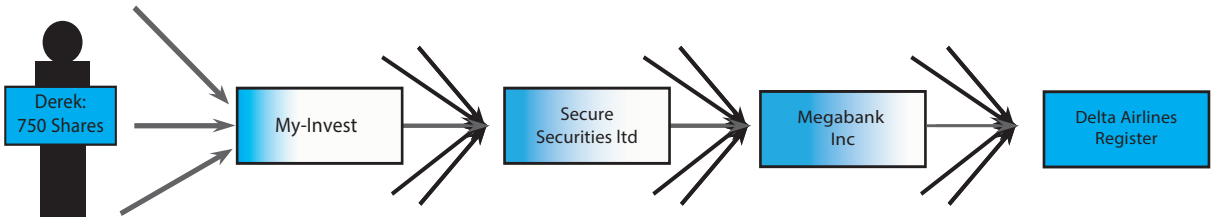
Even if the platform had chosen to use a segregated nominee structure, the registered owner on the AFM's register would be the nominee, though there would be three holdings rather than one, each being designated in some way (such as by the use of initial letters of the investor's name).

3.2.7 Custody Chain with Regard to Equity Holdings

Unlike units or shares in funds, equity positions must effectively be held with a custodian resulting in a longer chain of custody.

Suppose that Derek wants to buy some Delta Airlines' shares through his UK platform. Assuming the platform uses a UK custodian, then these US shares will be held by the US subcustodian which would appear on the asset register.

If we call the platform 'My-Invest', the UK custodian 'Secure Securities ltd.', the US subcustodian a part of 'Megabank Inc', and assume each of them uses a similarly-named nominee company, then the chain of custody would look like this:



Investor	Holding
Derek	750
Erin	500
Fran	1,250
Total	2,500

Custody Client	Holding
—	3,000
—	2,250
My-Invest Nominee ltd	2,500
—	1,750
—	1,000
Total	10,500

Custody Client	Holding
—	15,000
—	10,000
—	14,500
—	8,000
Secure Securities Nominee ltd	10,500
Total	58,000

Registered Holder	Holding
—	55,000
—	22,000
—	18,750
—	43,250
Megabank Nominee	58,000

In reality, there would often be an additional link near the end of the chain, as in many countries the registered shares are held within a **central securities depository (CSD)** – which in the UK is called **CREST**. The local subcustodian would have the direct relationship with the CSD of its jurisdiction.

4. Fund Accounting

Learning Objective

1.4.1 Know how unit trust units and OEIC shares: are priced; the publication and notification requirements; the impact of pricing errors on client investments

1.4.2 Know how shares and units are bought and sold

1.4.3 Know the control processes that may apply in relation to investment pricing: listed assets; private assets

1.4.4 Know how collectives are settled

When an investor buys or sells units/shares in their holdings of a unit trust or OEIC, the value they receive is based on the **net asset value (NAV)** of the fund. However, pricing is more complicated as the AFM will determine whether a fund is single- or dual-priced and if charges are to be applied to the transaction. The decision to single or dual price a fund is determined at the outset, and while possible to change a fund's pricing structure, this would be a significant capital event and not one that could be changed on a regular basis.

Dual pricing has been the standard method for the pricing of unit trusts and **single-pricing** for OEICs. However, it is worth noting that there are single-priced unit trusts in existence, and while regulations do allow for dual priced OEICs, these are uncommon.

4.1 Dual-Pricing

A dual-priced fund allocates a separate price to a transaction depending on whether it is being bought or sold – these two prices are known as 'bid' and 'offer' and the difference between the two is known as the **bid/offer spread**. The fund will also calculate a creation and cancellation price, these are used when the AFM settles transactions with the fund via the trustee.

The bid/offer spread of a fund will generally consist of:

- an **initial charge** to buy the fund
- the pricing of buying and selling the underlying investments, and
- broker and market costs involved in the buying or selling

The offer price is allocated to those investors that are buying and the **bid price** allocated to those investors selling funds. As a dual-priced fund has a spread, an investor will, therefore, require their holding to increase by this difference/value prior to selling to avoid a loss.

The pricing basis of the fund will be determined once the overall net movement (the difference between all sales and redemptions) is understood. If the fund has experienced more outflows, the AFM will need to cancel units with the trustee – so as not to lose money, they will want to pay the holders redeeming units the lowest price (a bid basis). Similarly, if the net movement of the fund is positive, it will move to an offer basis which increased the maximum amount of initial charge.

The maximum price at which the fund manager is able to sell new units is prescribed by the FCA. It is known as the maximum buying price and, under dual pricing, comprises the creation price (ie, the price the manager must pay to the trustee to create new units, which broadly consists of the value of the underlying investments and an allowance for dealing costs) plus the fund manager's initial charge.



The price at which the fund manager will repurchase units is calculated in a similar manner. From the investor's viewpoint it is referred to as the selling price, and the minimum selling price is also the cancellation price, ie, the price received from the fund by the manager when they cancel the units, using as its starting point the value of the portfolio at bid prices. Again, the manager has flexibility about the price that is set, subject to it being no less than the minimum selling price. For dual-priced funds, the AFM must notify the depositary or trustee of the cancellation, bid, issue and offer prices to assist with their oversight responsibilities and ensure the fund manager's records are accurate.

With a dual-priced fund, the AFM will make a profit on the spread with each trade made. This is easily highlighted with a single sale for ten units as a single redemption for ten units took place at the same valuation point (VP), therefore there is no movement in the box.

In this case, the AFM would make a box profit (the difference between bid and offer price) even though there has been no investment activity for the fund manager as the units have effectively been resold to a different client.

In April 2019, the FCA judged that this type of profit is no longer acceptable and while an AFM has the right to retain the initial charge element of the spread, any profit that has been determined as 'risk-free' should either be returned to the unitholder or as more practical, paid to the fund to benefit all unitholders. The risk-free profit is only gained if the fund's net movement is acted upon as a single daily decision. Some AFMs have now taken steps to make both a cancellation and creation each day, automatically passing the market spread to the trustee.

4.2 Single-Pricing

Whereas a dual-priced fund utilises a bid and offer price (most commonly seen in unit trusts), OEICs are more usually a single-priced fund. While underlying assets may still have a dual-priced element and the fund valued in this way, the quoted pricing is simplified, producing a mid-market price which is normally equidistant between the two.

To protect shareholders within a single-priced fund, against costs incurred from any significant inflows or outflows, a dilution levy can be applied. It is worth noting that this cannot be applied to create a profit or negate a loss. Any values created from applying these are paid back into the fund and cannot be retained by the fund manager.

For single-priced funds, the fund manager must notify the depositary or trustee of the fund price and of any dilution levies or adjustments to assist with their oversight responsibilities and ensure the fund manager's records are accurate.

4.2.1 Dilution Adjustment (Swinging Price)

When applying a dilution adjustment (swinging price), the fund is still given a mid-value price (investors get the same price regardless of buying or selling), but the fund moves to either a bid or an offer-based price. Note that this process affects all deals in the fund for that day:

- In times of large inflows, the share price is adjusted up to the price the AFM pays for the underlying investments. Therefore, investors buying shares in the fund are paying the same price as the fund manager. This is also the price paid to any shareholders leaving the fund who will by default receive a higher price than they would have done under normal mid-market pricing.
- In reverse, should there be large outflows, the share price is adjusted down to equal the price the fund manager receives from the trustee. Investors selling shares in the fund will receive the same price as the fund manager and those buying shares in the fund will buy shares at a lower price.

4.2.2 Dilution Levy

A dilution levy is a separate, explicit charge that AFMs can choose to apply to specific client deals to cover any dealing or other costs they may incur when buying or selling shares in the fund. It does not affect any other deals made that day. Any potential use of a dilution levy must be declared in the fund prospectus.

4.3 Charges

An investor in a CIS faces several charges, some of which will be explicit such as the initial charge made for the investment that we have already seen and the annual management charge (AMC), which is applied to cover the ongoing costs of the management and administration of the fund.

Other charges, however, will be less explicit as they are incurred in the necessary management of the fund, such as any audit costs for the fund. Managers of funds are entitled (under the terms of their management agreements) to charge certain other costs to the fund. These include:

- brokers' commission for trades undertaken
- legal and audit fees, and
- fees for specialist taxation advice.

The size of these other charges can have an impact on the performance of the fund.

UCITS funds are required to publish an ongoing charges figure (OCF) and quote this in the **key investor information document (KIID)**. It includes all types of expenses incurred by the UCITS, such as the costs of the UCITS management company, the depositary, the custodian and any investment adviser. It also includes costs for outsourced services as well as registration fees, regulatory and audit fees, and payments to legal and professional advisers. However, it does not include any initial or exit charges or any performance fees.

Other funds may still publish a **total expense ratio (TER)**. The TER consists of the AMC and other charges such as the fees paid to the trustee, depositary, custodian, **auditors** and **registrar**. It also includes any performance fees, although they may be shown in a separate field.

4.4 Dealing and Settlement

Investors can buy or sell unit trust or OEIC in a number of ways:

- directly with the fund manager (either by telephone, via the internet or by post)
- via their broker or financial adviser
- through a fund supermarket, platform or another third-party aggregator.

Whether an investor wishes to buy or sell his units, they will be either bought from, or sold back to, the AFM. There is no active secondary market in units or shares, except between the investors (or their advisers/intermediaries) and the fund manager. The key point to note, therefore, is that units in AUTs and shares in OEICs are bought from the managers themselves and not via a stock market.

A fund supermarket or **platform** is an organisation that specialises in offering investors easy access to a range of unit trusts and OEICs from different providers. They are usually based around an internet platform which takes the investor's order and processes it on their behalf, usually at reduced, or nil, commission rates. They offer online dealing, valuations, portfolio planning tools and access to key features documents and illustrations. Investors can look at their various holdings in different funds in one place, analyse their performance and easily make switches from one fund to another.

Settlement currently takes place directly with each fund group. For purchases, once the investment has been made and the amount invested has been received, the fund group will record ownership of the relevant number of units or shares in the fund's share register. When the investor decides to sell, they need to instruct the fund manager (or ask their adviser or the supermarket to instruct the fund manager), who then has up to four days from receipt of the instruction and necessary paperwork in which to settle the sale and remit the proceeds to the investor.

Traditionally, this instruction had to be in writing but, since 2009, managers have been able to accept instruction via the internet or over the telephone, using appropriate security checks.

When an order to buy or sell units is undertaken by an organisation that provides dealing services, such as a fund supermarket, it is likely to use a systems platform to place those orders with the fund management group such as Euroclear's EMX System or Calastone's Transaction Network.

Further details regarding the regulatory requirements and recent changes for settlement are covered later in chapter 5, section 4.1.

4.5 Impact of Pricing Errors on Client Investment

While numerous controls and checking procedures will be in place at the TA to ensure the prices received and ultimately loaded onto the systems are correct, there will still be occasions where a price received is later found to be inaccurate.

The most common cause of such cases is where the price of a CIS fund has been inaccurately calculated. For authorised CISs, the COLL rules impose obligations on the AFM to ensure the accuracy of the prices calculated, and, in some circumstances, it will be obliged to correct a pricing error identified. Clients dealing on a day when prices were affected may require the AFM to recalculate the deals and pay compensation (in either cash or units) to rectify those trades identified as being incorrect.

4.6 Price Publication

The fund manager has a regulatory requirement to ensure that prices are made public in an appropriate manner. This includes ensuring that prices are available to investors:

- at a reasonable cost
- in reasonable timeframes
- documented in the fund prospectus, and
- presented in a consistent manner.

This normally leads to prices being made available:

- on the internet
- in national newspapers, or
- via a local rate or free telephone number.

Most platforms and large institutional investors receive prices electronically, either via a specialist supplier or directly from the fund manager.

4.7 Control Processes in Investment Pricing

The TA relies on receiving accurate pricing to ensure it can effectively and efficiently update its systems for onward transmission to the registered holders in the fund. Impacts of pricing errors, as we have seen above, can be costly, both in compensation and in the effort and work hours a TA may have to invest to correct the register as they could impact many thousands of deals.

While incorrect pricing of underlying stocks that relate to small differences in pricing can be hard to identify at the TA, there are several controls in place to mitigate pricing errors on a day-to-day basis.

The Transfer Agent (TA) frequently utilises the services of a pricing provider for listed assets. This provider submits a daily pricing file that has undergone several controls to ensure data accuracy. While these controls cannot validate the underlying price of the stock or investment of the funds, they can identify issues such as:

- **Static/stale prices** – Instances where today's price is the same as the price from the prior day.
- **Large movements** – Situations where the percentage movement in the price exceeds a specified tolerance.

The TA will also receive prices for private assets. The difference here is that the AFMs typically provide these prices directly. AFMs conduct a valuation of privately held companies to determine a 'fair value' on a periodic basis, eg, quarterly, and as such these prices will remain static for a length of time. Fair value is the estimated exchange price considering the current market conditions for buying and selling similar types of assets. The fair value is determined by a valuation committee, which is independent from the investors, and is often validated by an independent third party. As the fair value takes time to assess, the prices are typically provided monthly, quarterly or semi-annually, which will result in a stale price in the interim periods.

4.8 Taxation on Collective Investment Schemes (CISs)

Learning Objective

1.4.6 Know the basis on which collective investment schemes (CISs) are taxed

A collective investment scheme (CIS) is liable to pay income tax on any taxable revenue that the CIS receives. The current rate of income tax for a CIS is 20%. Taxable revenue includes, but is not limited to, interest distributions received from bond funds, interest received directly from bonds, bank interest and revenue received from certain derivatives. Expenses paid by the CIS can be offset against any taxable income received. If the expenses paid in a period exceed the amount of taxable income received, then the excess expenses can be carried over into the following period.

Example

If a CIS receives £100,000 of taxable income in a period but has also paid expenses of £60,000 in that same period, then the income tax payable would be calculated as follows:

Taxable income = £100,000

Minus expenses = £60,000

Taxable income = £40,000

Income tax payable (£40,000 x 20%) = £8,000

Excess expenses to carry forward into the next period = £0.

Example

If a CIS receives £100,000 of taxable income in a period, but has also paid expenses of £120,000 in that same period, then the income tax payable would be calculated as follows:

Taxable income = £100,000

Minus expenses = £120,000

Taxable income = £0

Income tax payable (£0 x 20%) = £0

Excess expenses to carry forward into the next period = £20,000

Any income tax payable will be paid as part of the mandatory annual tax return submitted to HMRC.

4.9 Reconciliations

Learning Objective

1.4.5 Understand the use of reconciliations and resulting accounting and reporting processes

Reconciliation is the process of ensuring that two sets of records (usually the balances of two accounts) are in agreement. In fund accounting, it is important that the accounting records are in line with those of the custodian and trustee, any differences should be investigated and corrected to make sure that the net asset value (NAV) is correct. The financial reporting team rely on the daily reconciliations to produce annual/interim accounts and other reports to the FCA.

Example reconciliations:

- **Bank** – bank balances and transactions reflect the physical holdings held at the custodian. Any differences are investigated, narrated and cleared prior to NAV dissemination.
- **Income** – income (eg, bond interest or dividends) is reconciled to the custodian and third-party (eg, Bloomberg) records. Any differences are investigated, narrated and cleared prior to NAV dissemination.
- **Expenses** – expenses in the fund are reconciled daily to offline accrual calculations in Excel. Any differences are investigated, narrated and cleared prior to NAV dissemination.
- **Stock** – all holdings are checked to the custodian records. Any differences are investigated, narrated and cleared prior to NAV dissemination.

5. Offshoring

Learning Objective

1.5.1 Know how firms manage the oversight of offshore activities: key risk indicators (KRIs); key performance indicators (KPIs)

The offshoring of TA activities is now commonplace in the UK fund industry, with offshoring destinations including India, the Philippines and Thailand. The primary reasons for offshoring are lower costs, accessibility of skills and using the time difference to increase the number of hours that can be covered during the working day.

To support offshore processing, TAs will either use an offshore-based third party or an offshore element of their own organisation. In either case, putting in place the correct contractual and oversight model is essential. The TA must be able to demonstrate oversight of the offshore location and ensure that staff in the offshore location have the correct skills to be able to process work effectively. The TA will put in place the SLAs and KPIs to affect an oversight model. These measures would normally include the numbers of regulatory breaches being caused and the timeliness of processing.

6. Outsourcing

Learning Objective

1.6.1 Know the risks and benefits associated with outsourcing

TA outsourcing is relatively common in the UK market with a number of suppliers competing for business. TA may be outsourced as a larger outsourcing deal that also covers areas such as custody and fund accounting, or on a TA-only basis. TA is usually outsourced to gain access to specialist skills at a lower cost than that achievable by an in-house service, as well as to reduce overall operational risk.

Outsource providers may offshore some of the outsourced work either to another group company or even to a third-party organisation.

Regulation with respect to outsourcing is covered by the FCA in the **Senior Management Arrangements, Systems and Controls handbook** (**SYSC**). The FCA is very clear that a firm cannot outsource their regulatory obligations to a third party and must put in place a framework to oversee and supervise any outsource arrangements. Any 'material outsourcing' must be notified to the FCA before it takes place. Outsourcing of TA arrangements would typically meet the criteria for material outsourcing.

Before a firm outsources its TA activities to a third party, a number of steps must be taken to ensure the suitability of the supplier. These include:

- conducting due diligence on the financial stability of the supplier
- ensuring the supplier has the correct levels of expertise
- ensuring a smooth transition can take place between the current TA arrangements and the new supplier
- considering the concentration risk of the new supplier as the new supplier may also supply others in the market
- ensuring supplier business continuity plans are adequate
- reviewing the supplier's policies on information and data security to ensure they meet the outsourcing firm's needs.

In agreeing terms of a contract with a TA supplier, the firm must ensure that SLAs are in place giving qualitative and quantitative information regarding the services being provided. The SLA information will be an integral part of the oversight arrangements, and a selection of the SLAs may be deemed to be KPIs which may lead to financial penalties on the supplier if they are not met, or to the outsourcing firm gaining contract termination rights over the supplier in extreme cases.

Day-to-day oversight of the supplier will be undertaken by the first line of defence, but formal oversight by the firm's second and third lines of defence will also be undertaken and ensuring that these lines of defence have access to the supplier will be a contractual requirement of the outsourcing agreement.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **List the terms typically used in the UK funds industry.**

   Answer reference: Section 1.1

2. **Name the three broad categories investors fall into.**

   Answer reference: Section 1.4

3. **List the requirements to be a trustee/depositary.**

   Answer reference: Section 2

4. **What is a global custodian?**

   Answer reference: Section 3.1

5. **Who is responsible for ensuring that the register is maintained in a complete and accurate manner?**

   Answer reference: Section 3.2

6. **List the three possible forms of nominee accounts.**

   Answer reference: Section 3.2.4

7. **What is the standard method for the pricing of unit trusts and open-ended investment companies (OEICs)?**

   Answer reference: Section 4

8. **List three less explicit costs that collective investment scheme (CIS) investors could face that the managers of the funds are entitled to charge.**

   Answer reference: Section 4.3

9. **Describe a fund supermarket/platform.**

   Answer reference: Section 4.4

10. **List the reasons for offshoring transfer agency activities.**

    Answer reference: Section 5

11. **With whom do the regulatory obligations lie with when a firm outsources its TA activities?**

    Answer reference: Section 6

Chapter Two

The Regulatory Framework

1. **International Standards and Regulations** 31
2. **UK Regulation** 37
3. **Investor Communications** 42

This syllabus area will provide approximately 5 of the 100 examination questions



1. International Standards and Regulations

1.1 Markets in Financial Instruments Directive (MiFID)

Learning Objective

2.1.1 Know the responsibilities of transfer agencies in complying with European standards and regulations

The latest regulation in relation to **Markets in Financial Instruments Directive (MiFID)**, MiFID II and the equivalent regulation Markets in Financial Instruments (MiFIR) came into force in January 2018 and were incorporated in UK law through the European Union (Withdrawal) Act 2018 which effectively onshored the EU legislation. There are areas of the legislation that directly impact TAs in the UK market. Although some fund managers define themselves as out of scope for MiFID, others do not. Those that consider themselves out of scope may still choose to comply with some areas of the regulation in the name of best practice or because they believe compliance to be advantageous to their investors.

The areas are:

- **Cost and disclosure (pre- and post-sale)**
  - There is a requirement to disclose the costs and charges incurred by investors on an annual basis. There is no clarity in the regulation as to how to calculate costs and charges for funds and there are a number of definitions available in the market, including one from the TA Forum. Fund managers can choose to use one of the documented techniques for calculation or define their own method.

- **Client money and assets reporting (and quarterly reporting requirements)**
  - For MIFID II firms or products, the transfer agent should agree the additional disclosure narratives with the relevant firm for quarterly reporting in relation to:
    - how and when money will be held
    - execution venue, execution policy and dealing time, and
    - which instruments are MiFID/non-MiFID.
- **Call recording**
  - For transfer agents processing deals in relevant financial instruments on behalf of firms which are in scope, recording all calls received on dealing lines would be a minimum requirement. It is up to firms to decide if they wish to record all calls (eg, internal calls and conversations with depositaries) but firms may find it more practical to do so. Requirements are:
    - have a written call recording and retention policy
    - record relevant calls made on the firm's equipment
    - prevent staff from using their own phones (eg, mobiles) for relevant calls
    - notify clients up front that calls are being recorded
    - maintain records for up to five years (seven at the request of regulator) and make available to clients on request, and
    - perform risk-based compliance monitoring to ensure relevant calls are recorded and maintained.

1.2 General Data Protection Regulation (GDPR)

Learning Objective

2.1.2 Know the responsibilities of transfer agencies in complying with the General Data Protection Regulation (GDPR)

The General Data Protection Regulation (GDPR) came into effect on the 25 May 2018 and applies to both:

- **controllers** – the person (or business) who determines the purposes and way in which personal data is processed, and
- **processors** – the person (or business) who processes personal data on behalf of the data controller (excluding the data controller's own employees).

The regulations now place specific legal obligations in respect of handling personal data with significantly more liability on the data processor, should they be responsible for a breach. In the past, this liability fell to the data controller as the 'owner' of the data.

However, data controllers are not relieved of their obligations when outsourcing to a TA (or any third party). Both data controllers and processors must ensure that anyone processing client data on their behalf does it in accordance with their own policies and has robust data protection management and security in line with regulatory obligations.

It should be noted that there are both an EU GDPR and a UK GDPR, with UK GDPR being incorporated into UK Law as part of the Data Protection Act 2018 following the UK's withdrawal from the European Union. While both share the same principles, there are a few key differences. UK GDPR applies to organisations processing personal data of individuals within the UK, while the EU GDPR applies to organisations processing personal data within the EU. For organisations which operate, have customers or monitor individuals within both the UK and EU, they must follow both the UK and EU GDPR requirements.

1.2.1 GDPR Applicable Information

Personal Data

Like the Data Protection Act, the GDPR applies to 'personal data'. However, the GDPR's definition is more detailed and makes it clear that information such as an online identifier – eg, an IP address – can also be personal data. The more expansive definition provides for a wide range of personal identifiers to constitute personal data, reflecting changes in technology and the way organisations collect information about people – this applies to both automated and manual filing systems.

Sensitive Personal Data

The GDPR refers to sensitive personal data as '*special categories of personal data*'. These categories are broadly the same as those in the DPA, but there are some minor changes including special categories in respect of genetic and biometric data where an individual can be identified.

Personal data relating to criminal convictions and offences are not included, but similar extra safeguards apply to its processing.

The Right to be Forgotten/The Right to Erasure

Under Article 17 of the GDPR, individuals have the right to have personal data erased. This is also known as the 'right to be forgotten'. The right is not absolute and only applies in certain circumstances. This can cause issues, especially if the TA utilises digital images of work items.

An individual can request the right to erasure if:

- the personal data is no longer necessary for the purpose which it was originally collected or processed for
- the firm is relying on consent as the lawful basis for holding the data, and that individual withdraws their consent
- there is a legitimate interest as the basis for processing, the individual objects to the processing of their data, and there is no overriding legitimate interest to continue this processing
- the personal data is processed for direct marketing purposes and the individual objects to that processing
- the personal data is processed somehow unlawfully
- the firm must do it to comply with a legal obligation, or
- you have processed the personal data to offer information society services to a child.

The right to be forgotten is intended to explicitly target technology companies where incorrect, or even libellous data, could remain accessible permanently but it should not supersede other regulatory obligations.

As with the example of the types of systems utilised in workflow and digital imaging, the Information Commissioner's Office (ICO) recognises that data deletion is often not possible without significant cost and complexity and will, therefore, accept a process of putting the information 'beyond use' provided that the data controller holding it:

- is not able, or will not attempt, to use the personal data to inform any decision in respect of any individual or in a manner that affects the individual in any way
- does not give any other organisation access to the personal data
- surrounds the personal data with appropriate technical and organisational security, and
- commits to the permanent deletion of the information if, or when, this becomes possible.

The ICO states that it will not require data controllers to grant individuals subject access to the personal data provided that all four safeguards above are in place and will not take action against the controller.

In respect of the above, there are generally considered to be two alternatives to deletion, described in section 1.2.2 and 1.2.3.

1.2.2 Data Anonymisation

Anonymisation allows data to be stored and processed, while completely preserving its privacy. Anything that can identify the data subject must be in some way removed or made illegible to any person or system viewing it. This allows systems to be preserved in relation to the integrity of their databases.

1.2.3 Data Pseudonymisation

As per anonymisation, this is a technique that retains the data, but in such a way that it can no longer be attributed to a specific 'data subject' without the use of additional information (such as data keys or indexing), again allowing systems to preserve the relational integrity of the databases while making reidentification almost impossible. However, it is not considered as secure as full anonymisation.

It is important for firms to be aware that undertaking a strategy of data anonymisation/pseudonymisation introduces a new specific risk and the process of reversing anonymised data or providing the means by which an employee or associated party can reverse engineer the data is a criminal offence in the UK.

As we have seen above, should an investor retract their consent for data to be held (assuming no other reasons for processing their data) – they have the right to erasure.

Where companies experience a serious data breach, they must – without undue delay, and where feasible, no later than 72 hours after becoming aware of it – inform the ICO or, if appropriate, EU data protection authorities. They have to give details of how the breach occurred, how it is being managed and the planned next steps.

1.3 Foreign Account Tax Compliance Act (FATCA)

Learning Objective

2.1.3 Know the responsibilities of transfer agencies in complying with the Foreign Account Tax Compliance Act (FATCA)

The Foreign Account Tax Compliance Act (FATCA) is a piece of US legislation designed to help counter tax evasion by US entities, both for individuals and corporations, requiring them to report their worldwide income to the US Internal Revenue Service (IRS) on an annual basis, regardless of whether or not they currently reside in the US.

It places reliance on financial institutions (foreign financial institutions or FFIs) to identify all reportable US persons within their client base and provide information on such accounts to the appropriate tax authorities.

FATCA has a vast scope and applies potentially to every FFI, to every intermediary and to the end beneficial owner of an investment. FFIs will be required to register with the IRS to comply with FATCA or confirm that their FATCA classification does not require them to register.

FFIs include:

- banks
- investment funds
- distributors
- custodians
- investment managers
- financial advisers
- insurance companies, and
- other entities must consider whether they are subject to FATCA.

An Inter-Governmental Agreement is an agreement between the US and another jurisdiction which defines how compliance with the FATCA regulations will be implemented. All countries are in scope of FATCA and 100+ have signed IGAs to make compliance with FATCA mandatory for financial institutions in their jurisdiction.

The TA will need to identify and prepare reporting on an annual basis to highlight all US reportable investors to the relevant tax authorities. The FATCA classification of an investor that is captured during new account on-boarding, maintenance of their accounts and pre-existing due diligence must be used to identify reportable accounts. Given these rules, and the impact of non-compliance, it is highly likely firms will attempt to simplify reporting and any challenges that arise by restricting holdings of their UK (and cross-border) funds to US investors as part of their terms and conditions regardless of their status or reporting abilities.

1.4 Automatic Exchange of Information (AEOI)

Learning Objective

2.1.4 Know the responsibilities of transfer agencies in complying with Automatic Exchange of Information (AEOI) agreements

Automatic Exchange of Information (AEOI) rules aim to tackle tax evasion by requiring financial institutions to identify who their account holders are and report this data to their local tax authorities for exchange with other authorities. AEOI encompasses:

- FATCA, and
- the OECD's Common Reporting Standard (CRS).

AEOI applies to financial institutions domiciled in the UK. Authorised fund managers (AFM), therefore, have exposure to both financial and reputational risk through failure to meet the requirements of AEOI.

AEOI requires a firm to submit information on **reportable persons**, an individual or entity that is resident in a reportable jurisdiction under the tax laws of that jurisdiction (ie, it is determined by the tax residency of the account holder). In some cases, the management company will have gained specific information that confirms the person's tax residency; in other cases, a self-certification by the holder will be used via a W8 or W9 US tax form.

The TA will need to prepare and support the management company (ManCo) to submit reporting which should cover the calendar year from 1 January to 31 December (rather than the financial year), and these should be submitted to His Majesty's Revenue and Customs (HMRC) by 31 May. HMRC is then required to support exchange of the UK's data by 30 September each year. In addition to the personal details required, the financial information included in the report should include:

- account balances
- sales proceeds, and
- investment income (which here includes interest and dividends).

2. UK Regulation

Learning Objective

2.2.1 Know the responsibilities of transfer agencies with respect to: market abuse; Senior Managers and Certification Regime (SM&CR); Consumer Duty

2.1 Retail Distribution Review (RDR)

The RDR came into effect on the 1 January 2013 and is a piece of UK specific regulation that focused both on the qualifications required of an **independent financial adviser (IFA)** and also the way in which they were paid for their services.

Prior to the RDR, commission payments were made by the AFM at the point of the introduction of the business. Initial commission covered the costs of providing and executing the advice and renewal commission (or trail) was paid in respect of the continued working relationship with the client, essentially ensuring the clients financial needs were being met.

The RDR highlighted a number of problems in this area and, therefore, brought about new regulations restricting commission payments. Commission could still be paid on existing investments (if they remained undisturbed) or if the work carried out by the IFA was deemed as 'execution only', outside of that, commission in the traditional sense was banned.

IFAs still require payment for their services. Fees now have to be agreed directly with the client at either a fixed or hourly rate. This makes the process far more transparent as they cannot be hidden within the processing of a deal. The RDR achieves what it set out to as investments made by IFAs on behalf of their clients can now be both unrestricted, in respect of the provider chosen, and unbiased – ie, not based on the level of commission available.

The RDR also prompted AFMs to review their share class charging structure. Where share classes offered by AFMs had higher initial charges and/or AMC to cover commission payments, IFAs would simply request that this charge was discounted, allowing the investment to buy additional units/shares. AFMs, therefore, began to launch a series of cheaper share classes with significantly reduced, or even zero, upfront charges (eg, clean or super clean) these allowed direct investors to benefit from the lack of commission payments being made.

2.2 Market Abuse

EU Market Abuse Regulation (MAR) was enhanced by the FCA in 2016, and was onshored in UK Law as UK MAR in 2018 through the European Union (Withdrawal) Act 2018. In 2019, further enhancements were made to UK MAR to ensure it would function effectively after the UK's withdrawal from the EU. The regulation focuses primarily on the abuse of the instruments and asset classes that fund managers buy and sell rather than funds themselves. This does not mean that TAs do not have a role in preventing market abuse when providing TA services for funds, simply that many of the rules are less relevant to day-to-day TA activity.

There are two key areas where TAs require vigilance in terms of market abuse, both in relation to market timing. As fund prices are calculated at a fixed point in time, often daily at 12 noon in the UK market, accepting instructions to deal after this point is deemed unacceptable as the investor could use the 12 noon market information to estimate what the price of a fund will be to work out whether to buy or sell the fund and, thus, gain an advantage over other investors.

The second key area relates to information that the TA may have before it is released to the market, specifically around plans to suspend funds, which if made more widely available, could cause some investors to redeem holdings to ensure they have access to the money they have invested.

For TAs who are also administering products that are exchange-traded, such as investment trusts, then further insider information relating to the product may also be known to the TA before the general market and release of this information may breach the market abuse regulations.

2.3 Senior Managers and Certification Regime (SM&CR)

SM&CR was introduced in 2016 to cover UK banks but was extended towards the end of 2019 to include all UK FCA-regulated entities and this included all asset managers and transfer agents with regulatory permissions (although some asset managers are also banks and implemented SM&CR in 2016). The aim of SM&CR is to ensure individual responsibility and accountability and to clearly define within organisations who has responsibility for particular areas.

To implement an effective SM&CR framework, firms must first work out what category of firm they are according to the FCA definitions. These definitions divide firms into the following categories:

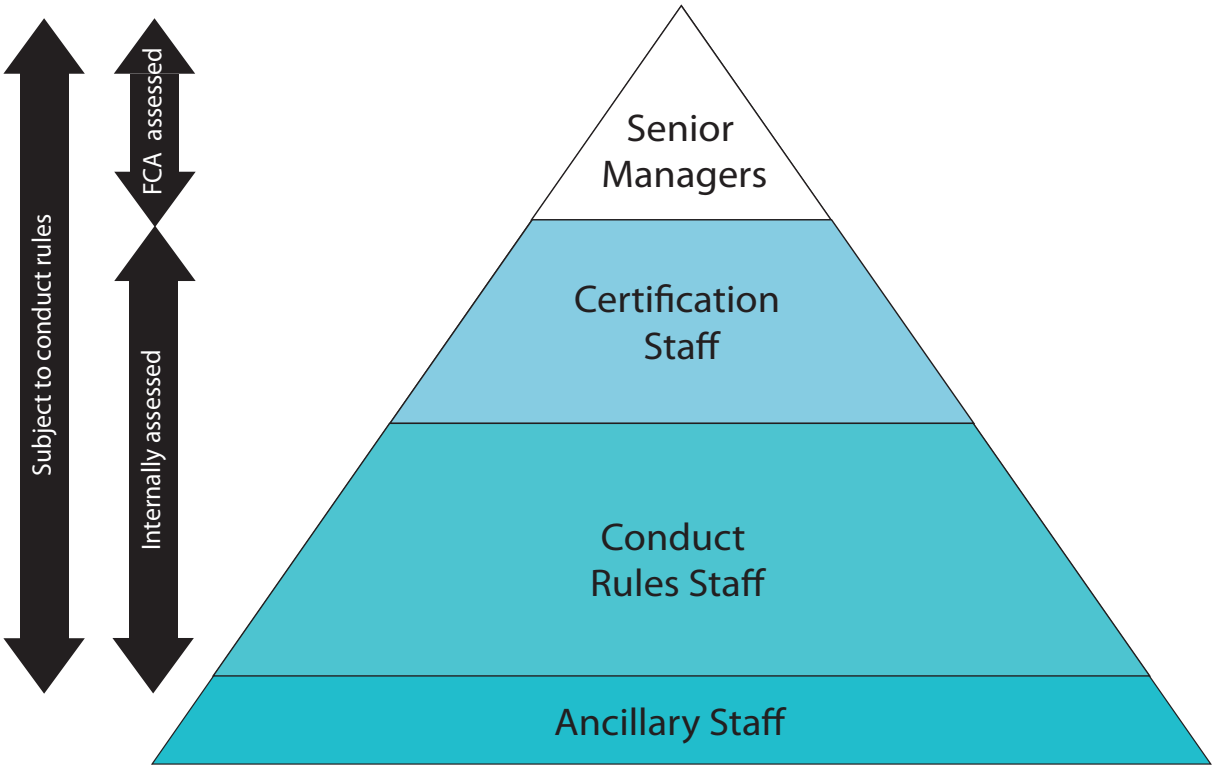
- enhanced firm
- core firm, and
- limited scope firm.

For each firm category, there are a number of senior management functions (SMFs) that are defined and must be allocated to individuals within the firm. Enhanced firms have an extended list of SMFs, but for example, for core firms, the following SMFs are required:

- **SMF1 – chief executive** – this is the person(s) with responsibility, under the immediate authority of the governing body, for the conduct of the whole of the business (or relevant activities). Note that although the chief executive is the most senior member of an executive team, it does not mean that a firm's governing body cannot allocate specific responsibilities to other senior managers.
- **SMF3 – executive director** – a director of a firm, other than a non-executive director.
- **SMF27 – partner** – a partner in a firm, other than a limited partner in a partnership registered under the Limited Partnership Act 1907.
- **SMF9 – chair** – the person with responsibility for chairing, and overseeing the performance of the role of, the governing body of the firm.
- **SMF16 – compliance oversight** – this is the person responsible for the compliance function in the firm and reporting to the governing body on this.
- **SMF17 – money laundering reporting officer (MLRO)** – this is the person who has responsibility for overseeing the firm's compliance with the FCA's rules on systems and controls against money laundering.

SM&CR effectively divides an organisation's employees into four categories:

- **Senior management** – those who are in an SMF function.
- **Certification staff** – individuals who are in 'significant harm functions'.
- **Conduct rules staff** – those who are performing something other than purely ancillary roles.
- **Ancillary staff** – individuals in roles that are not directly related to the financial services business such as security guards, drivers, personal assistants and catering staff. These are effectively out of scope of SM&CR.



2.3.1 Senior Management

Senior management must be pre-approved by the FCA, and the extent of approval is dependent on the role and responsibility within the firm. The scope of each senior management role must be documented in a Statement of Responsibilities (SOR). The SOR is an important document clearly defining what areas of responsibility the senior manager has. Each senior manager has a duty of responsibility which requires them to avoid the occurrence or continuation of a breach of a regulation in the area that they are responsible for. Senior management also have a responsibility to ensure that any delegation of their responsibilities is to someone who is appropriate and that they oversee the person to whom they delegated to make sure they are completing the delegated activity to the correct standard. Formal conduct rules are defined by the FCA for people in SMF roles. These are:

- **SC1** – you must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively.
- **SC2** – you must take reasonable steps to ensure that the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system.

- **SC3** – you must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively.
- **SC4** – you must disclose appropriately any information of which the FCA or Prudential Regulation Authority (PRA) would reasonably expect notice.

2.3.2 Certification Staff

Any staff who do not fulfil an SMF role but do have a 'significant harm function' need to be certified by the firm that they are fit and proper to fulfil their role on an annual basis. These employees will often be those who complete delegated activity on behalf of the SMF holder. Fit and proper checks will include a formal and documented performance management process and criminal record checks.

2.3.3 Conduct Rules Staff

All non-ancillary staff are subject to conduct rules and these rules are defined by the FCA as follows, you must:

- act with integrity
- act with due care, skill and diligence
- be open and cooperative with the FCA, the PRA and other regulators
- pay due regard to the interests of customers and treat them fairly, and
- observe proper standards of market conduct.

2.4 Treating Customers Fairly (TCF)

The FCA has regulation in place to ensure the fair treatment of customers and states that:

'All firms must be able to show consistently that fair treatment of customers is at the heart of their business model'.

The FCA defines six consumer outcomes that firms should strive to achieve to ensure the fair treatment of customers. These are:

- **Outcome 1** – consumers can be confident they are dealing with firms where the fair treatment of customers is central to the corporate culture.
- **Outcome 2** – products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.
- **Outcome 3** – consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.
- **Outcome 4** – where consumers receive advice, the advice is suitable and takes account of their circumstances.
- **Outcome 5** – consumers are provided with products that perform as firms have led them to expect, and the associated service is of an acceptable standard and as they have been led to expect.
- **Outcome 6** – consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.

2.5 Consumer Duty

The Consumer Duty rules are in effect for all new and existing open products and services from 31 July 2023 and for new products from 31 July 2024.

At the core of Consumer Duty is the new enforceable Principle for Business (Principle 12) which states that *'a firm must act to deliver good outcomes for retail clients'*. The new requirements are further outlined in three cross cutting rules, and further detailed expectations are set out in four consumer outcomes:

- Products and Services
- Price and Value
- Consumer Understanding
- Consumer Support.

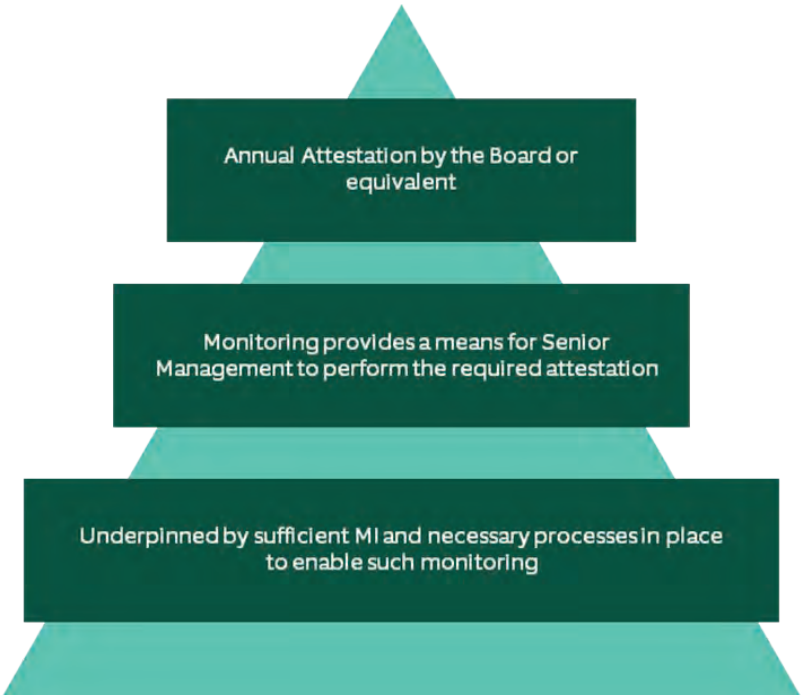
Consumer Duty Structure



Source: A new Consumer Duty: Feedback to CP21/13 and further consultation (fca.org.uk)

The compliance with the new Consumer Duty is to be demonstrated by an annual attestation at the Board (or equivalent) level. This attestation will need to be supported by relevant management information and monitoring.

Consumer Duty Attestation



Source: A new Consumer Duty: Feedback to CP21/13 and further consultation (fca.org.uk)

3. Investor Communications

Learning Objective

2.3.1 Know the FCA requirements in relation to: reports and accounts; unit/shareholder meetings; proxy voting requirements; disclosure requirements

2.3.2 Know the requirements of the Statement of Recommended Practice (SORP) in relation to the content of the half-yearly reports and accounts: the statement of total return; the statement of changes in unit/shareholders' net assets; the balance sheet; the portfolio statement; notes to the accounts; distribution tables; comparative table

3.1 FCA Reports and Accounts Requirements

After each annual and **interim accounting period**, a retail scheme under COLL must prepare reports and accounts as defined by the **Statement of Recommended Practices (SORP)**. It is commonly known as the 'long report' and must be made available to any shareholder who requests a copy. It is worth noting that the term 'long report' reflects that there was also a short report, however this is no longer a requirement.

From launch, if the first annual accounting date is less than 12 months, a half-yearly interim report is not required, providing that the first accounts are published within 18 months.

The annual long report must contain the following items:

- the audited full financial accounts, for the annual accounting period, prepared in accordance with the SORP as detailed in section 3.2
- the AFM's report (including a portfolio statement) – broken down by sub-fund where relevant
- a statement of the AFM's responsibilities
- the trustee's/depositary's report, detailing that the scheme has been operated in line with the regulations
- the auditor's report, giving their opinion of the financial accounts
- a comparative table (for each sub-fund), and
- annual audited financial statements for each sub-fund, including the distribution table.

For an umbrella scheme, the long report must include the separate accounts of each sub-fund. It is not necessary to include an aggregated set of accounts.

The interim (or half-yearly) long report contains less data. It need not contain a comparative table or a trustee's/depositary's report and, as the interim accounts are not subject to audit, no auditor's report will be included. While no notes need be included, the interim long report should include a statement prepared on the basis of the accounting policies set out in the most recent set of annual financial statements.

The interim report will include:

- the AFM's report (including a portfolio statement), and
- for each fund or sub-fund:
  - the number of units in circulation and net asset value per unit
  - interim financial statements (excluding the notes)
  - for an umbrella scheme, the interim report must include the separate accounts of each sub-fund, together with an aggregated interim set of accounts.

3.1.1 Unit/Shareholder Meetings and Proxy Voting

As set out in COLL, the FCA allows the AFM, depositary or directors of an ICVC to call a general meeting of unit/shareholders at any time, giving at least 14 days notice. Unit/shareholders may also request the convening of a general meeting by a requisition. This requisition must state the purpose of the meeting, be dated, signed by registered unitholders representing no less than 10% in value of all units in issue, and be deposited at the head office of the ICVC or the depositary of an AUT. Upon receipt of a requisition which complies with the requirements, the AFM, depositary or directors of an ICVC must convene a meeting no later than eight weeks from the date of receipt.

The meetings can take place in the format of a:

- physical meeting
- hybrid meeting, or
- virtual meeting.

The quorum required to conduct business at a meeting is two unitholders, present either in person, by proxy or remotely. If, at the time for the start of the meeting, the quorum is not met, the meeting, if convened by requisition of unitholders, must be dissolved. In all other cases, the meeting will be adjourned to a day and time at least seven days later, at a place appointed by the chair.

Resolutions at meetings can be passed by a simple majority of unitholders votes cast at the general meeting. The voting rights of each unit are proportionate to the total units in issue. Unitholders are not required to use all their available votes and do not need to cast all votes in the same way. A unitholder can appoint another person, a proxy, to attend the general meeting and vote on their behalf.

3.2 Statement of Recommended Practice (SORP) Requirements

The **Investment Association (IA)** is the SORP-making body and, therefore, defines the **statement of recommended practice (SORP)** for authorised funds. The objective of the SORP is to provide recommendations for the preparation of the financial statements of all authorised funds as detailed in sections 3.2.1 to 3.2.5. It provides the interpretations of accounting standards and other legal/regulatory requirements establishing principles for distributions and taxation. The FCA regulations expects the SORP requirements to be applied to the preparation of all long reports.

The following sections highlight the details of requirements of what is expected on both the annual and interim reports.

The SORP reflects the COLL requirement for the AFM (and, in the case of an OEIC, one other director, where other directors in addition to the ACD are appointed as appropriate) to sign the report.

3.2.1 Statement of Total Return

This summarises the results of the fund by confirming the net investment gains or losses, together with the revenue earned after tax, expenses and charges. It identifies that part of the total return which is to be distributed in accordance with the regulations.

The statement of total return must show:

- income – net capital gains/losses
- net revenue – expenses, interest and charges
- total return before distributions for the period
- distributions, and
- change in net assets attributable to unit/shareholders from investment activities.

The statement of total return must also include comparative figures for the equivalent period in the previous year.

3.2.2 Statement of Change in Assets Attributable to Unit/Shareholders

This statement summarises and reconciles opening and closing balances (the changes) in net assets. It highlights the impact of the transactions against those attributable to unit/shareholders from investment activities and shows the extent to which the fund has grown or contracted from a fund management perspective by reviewing the net of the creation or cancellation of units/shares.

It should include as a minimum:

- opening net assets attributable to shareholders
- net unit movements:
  - dilutions levy
  - **Stamp Duty Reserve Tax (SDRT)**
  - net asset change from investment activity
  - retained and unclaimed distributions
- closing net assets attributable to shareholders.

The statement should be presented along with the financial statement of total return; this provides unit/shareholders a summary of the **principal** features of the scheme's results for the period.

It should also include comparative figures for the previous equivalent period.

3.2.3 Balance Sheet

The balance sheet provides a consolidated statement of the schemes:

- **total assets**
  - fixed
    - land and buildings/property
  - current
    - debtors
    - cash and bank balances
- **total liabilities**
  - investment
  - provisions
  - creditors
    - overdrafts
    - distributions payable.

3.2.4 Statement of Cash Flows

The cash flow statement provides the information to detail items where a fund's investment strategy could restrict its cash flow – this is often seen in funds that are invested wholly in property. However, if an authorised fund meets the following conditions, it is exempt from needing to prepare such a statement:

- substantially all of the fund investments are highly liquid
- substantially all of the fund investments are carried at fair value, and
- the fund provides a statement of change in net assets.

With the above requirements, a UK equity fund would not need to produce the statement where a property fund would.

3.2.5 Notes to the Financial Statements

Notes should be prepared and confirm that the statements have been prepared as required by the OEIC regulations or the FCA COLL Sourcebook, together with the accounting policies, distribution policies and risk management policies, and any other information that is required for the accounts to give a true and fair view.

Accounting Policies

A summary of the significant accounting policies should be made together with a description of any judgements made by the AFM. The notes should state the title of the SORP, whether the accounts have been prepared in accordance with the SORP and details of any departures from the SORP.

Distribution Policies

A description of the distribution policies that are material should be disclosed, in particular, those that relate to adjustments to net revenue after taxation together with a statement explaining the consequential impact on the value of capital if a distribution is increased. If policies are specific to each class these should also be disclosed.

Comparisons from the previous period should advise.

Risk Management Policies

Disclosures are required to enable the user of the financial statements to evaluate the risks of financial instruments and how they are managed.

Risks will include:

- market risk
- **liquidity** risk
- credit risk.

For each type of risk that arises, the disclosures should include a description of:

- the exposures to risk and how they arise, and
- objectives, policies and processes for managing the risk and the methods used to measure the risk.

Again, a comparison is required if there are any changes between the above from the previous period.

Distribution Table

The financial statements must include a table of the distribution rate per unit/share of each unit/share class in issue for both Group 1 and Group 2. The table shows the following items in pence per unit/share:

- gross income (for interest distributions)
- income tax (for interest distributions)
- net income
- equalisation
- distribution payable, and
- distribution paid in the equivalent comparative period (annual or interim) 12 months earlier.

While funds now only issue gross interest distributions to all investors, many firms will continue to show a gross and net figure in their reports and accounts to emphasise this treatment – particularly as comparisons might be made against prior periods.

If there is a significant difference between net income shown in the statement of total return and the amount distributed, the AFM has the option to explain the difference, but this is not compulsory.

Portfolio Statement – A Statement of Assets and Liabilities

This statement (required within the AFM's report, and defined by the SORP) essentially lists all the investments of the scheme, reconciling the total to the total net asset value (NAV) of the scheme as per the statement of change in net assets and the balance sheet. It must show the portfolio according to the most appropriate criteria to assess the assets (eg, by country or by industrial/market sectors such as retail, pharmaceuticals and manufacturing).

The statement must show the:

- number, quantity, description and value of each asset
- percentage of value of property of the scheme each holding represents
- net value of each derivative position
- total value of all assets in the scheme (which should agree with the balance sheet).

The portfolio statement should detail, and distinguish between, assets that are approved or unapproved securities, and also distinguish those that are admitted to official stock exchange listing. It is considered that a geographical analysis of the portfolio would give an adequate indication of the official stock exchanges on which the securities are listed, provided any individual securities traded on a different exchange (or not listed) are clearly indicated.

The portfolio statement must include comparative figures for each category as at the end of the proceeding financial year, though need not provide comparative figures for each security.

Comparative Table

Comparative figures should be given for all items in the statement of total return, statement of change in unit/shareholders' funds and the balance sheet, and the notes to each, and for sector percentage totals in the portfolio statement.

The table should cover each unit class and cover the last three financial years or every year since launch if it is less than three years old. Figures should be apportioned on an appropriate basis if the scheme was launched within a reporting period and all figures should be expressed 'per unit':

- an illustrative performance of unit value over the period
- the opening NAV
- operating charges
- return (before and after applying those operating charges)
- distributions on income units (where applicable)
- closing NAV
- retained distributions on **accumulation units** (where applicable)
- the number of units/shares of each class in existence/issue
- percentage return after charges
- closing NAV in sterling terms
- closing number of units
- operating charges in percentage terms, with any performance-related fee disclosed separately
- the highest and lowest unit price during the period.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **Who does the General Data Protection Regulation (GDPR) apply to?**
   Answer reference: Section 1.2

2. **What is data pseudonymisation?**
   Answer reference: Section 1.2.3

3. **What is the purpose of the Foreign Account Tax Compliance Act (FATCA)?**
   Answer reference: Section 1.3

4. **Who does the Automatic Exchange of Information (AEOI) apply to?**
   Answer reference: Section 1.4

5. **What new regulations restricting commission payments were introduced as a result of the Retail Distribution Review (RDR)?**
   Answer reference: Section 2.1

6. **List the three possible categories that firms can be divided into to implement an effective Senior Managers and Certification Regime (SM&CR) framework.**
   Answer reference: Section 2.3

7. **List any three of the conduct rules that non-ancillary staff are subject to, as defined by the FCA.**
   Answer reference: Section 2.3.3

8. **What are the four consumer outcomes?**
   Answer reference: Section 2.5

9. **What must an interim report include?**
   Answer reference: Section 3.1

10. **What must the statement of total return show?**
    Answer reference: Section 3.2.1

11. **When is an authorised fund exempt from needing to prepare a statement of cash flow?**
    Answer reference: Section 3.2.4

Chapter Three

Products

1. **Collective Investment Schemes (CISs)** **53**
2. **Unit Trusts (UTs)** **60**
3. **Open-Ended Investment Companies (OEICs)** **61**
4. **Investment Trust Companies** **62**
5. **Wrappers** **64**

This syllabus area will provide approximately 12 of the 100 examination questions



1. Collective Investment Schemes (CISs)

Learning Objective

3.1.2 Know how collective investment schemes are launched; the alternative constitutional structures of authorised collective investment schemes; the types of funds and how they are classified (UCITS/NURS); tax considerations; investing, lending and borrowing powers

A collective investment scheme (CIS) is a form of investment vehicle that is made up by pooling together the savings of many clients for the purpose of investing into a portfolio of assets with the aim to deliver either capital growth or a regular income depending on the funds' **investment objectives** within the prospectus.

1.1 Open-Ended and Closed-Ended Schemes

Learning Objective

3.1.1 Know the difference between open-ended and closed-ended collective funds

The most common type of investment that is administered and within UK regulations, is generally offered in two forms:

- an open-ended investment company (OEIC), or
- an authorised unit trust (AUT).

Authorised contractual schemes (ACSs) are a third type of CIS but are less common.

Authorised CISs are open-ended, ie, the number of shares/units in issue is not fixed and will change on the dealing day depending on the net movement of all sales or redemptions (and is reflected in the creations or cancellations within the book process).

If the AFM has more requests to buy shares/units than to sell back, the net movement can be covered by the AFM issuing further shares to satisfy these requests. It is as a result of this that the price of each share/unit is directly related to the pooled underlying assets of the fund and is calculated at each valuation point. An OEIC issues shares, whereas an AUT issues units.

One of the responsibilities of the AFM is to calculate the share/unit price at each valuation point (VP) and, therefore, the fund price of each share/unit, this though is likely to be outsourced to the fund accountant. The trustee or depositary will ensure that the valuation pricing is in line with regulatory requirements.

1.2 Closed-Ended Funds

Unlike an AUT or an OEIC that has variable capital (shares or units can be created or cancelled), a closed-ended fund raises a fixed amount of capital at launch, creates a number of shares in relation to this capital and the number of these remains fixed.

Shares within a closed-ended fund may not always be available to buy as existing investors may hold the entire allocation. Listed closed-ended funds are traded throughout the day and valued based on supply and demand, unlike an OEIC or AUT which has a fixed valuation point. The price that the closed-ended fund trades for is determined entirely by supply and demand and the changing values of the securities in the fund's holdings.

If the fund is traded on an exchange, there are times that it could be valued as greater than the sum of its investments which is known as a 'premium to its NAV' which is often due to the fund being invested in a popular sector. At the same time, the fund could be worth less than the sum of its investments due to a lack of investor demand or a poor **risk profile**. This is known as 'trading at a discount'.

1.3 AUT and OEIC Tax

Although AUTs and OEICs have different structures, they share the same tax treatment. The tax rules aim to put the investor in a similar position as if they had invested directly rather than via a fund.

Investors may receive income from their investment in the form of interest or dividends, depending on the mix of underlying assets within the fund, which will determine how the income is taxed.

Interest payments are made from funds which are made up of more than 60% fixed interest securities or cash. Non and basic tax rate payers may receive up to £6,000 (£5,000 starting rate for savings and £1,000 personal savings allowance) taxed at 0%, while higher tax rate payers can receive £500 at 0%. Additional rate tax payers have no personal savings allowance. Interest is then taxed at 20%, 40% and 45% (basic, higher and additional rate taxpayers).

Dividend distributions are made from funds which are made up of 60% or less in cash or fixed interest, eg, an equity fund. The first £500 of dividend income is tax free as it's covered by the dividend allowance. Amounts over £500 are taxed at 8.75%, 33.75% and 39.35% (basic, higher and additional rate taxpayers).

Additionally, any capital growth when an investor sells their units/shares is subject to **capital gains tax (CGT)**. This also includes fund switches, however switches between share classes within the same fund are not treated as disposal for CGT. Tax is only payable where the gains in the year exceed the annual CGT allowance of £3,000. For individuals, the gain is added on top of their total income to determine the rate payable. For disposals after 30 October 2024, any part of the gain which falls within the basic tax rate band is taxed at 18% and the balance at 24%. For disposals prior to 30 October 2024, any part of the gain within the basic rate band is taxed at 10% and the balance at 20%.

1.4 Authorised Contractual Schemes (ACSs)

An authorised contractual scheme (ACS) is a UK-authorised, tax transparent fund structure, which provides a flexible alternative to open-ended investment companies and authorised unit trusts. The fund type is useful for managers of institutional assets including:

- pension funds
- insurance companies
- real estate managers or investors seeking a UK authorised alternative to offshore property vehicles
- asset managers with multiple funds with common asset classes
- managers operating segregated mandates with similar investment objectives but different tax statuses.

1.4.1 Structuring an ACS

An ACS is typically structured with a number of sub-funds, which can be managed by several investment managers across a wide range of asset classes and investment strategies. Master feeder arrangements can also be used allowing retail monies to be pooled with institutional funds. In the event of insolvency, strict ring-fencing exists between sub-funds within the structure. ACS schemes can be set up as co-ownership or partnerships (essentially operating the same as a regular LP) and can invest, and be managed, as a UCITS, non-UCITS retail scheme (NURS) or qualified investor scheme (QIS) fund.

In essence, an ACS structure can be used by any institutional investor looking to simplify their investment structures and pool assets with the aim of improving returns and reducing costs. According to the FCA there are now nine operating fund ranges using the ACS structure, comprising 78 sub-funds, with more in the pipeline.

1.4.2 Tax Benefits

One of the major benefits of the ACS structure is tax transparency:

- Withholding tax is applied with reference to the source investors rather than taxing investors on income generally. As an example, for pension funds the withholding tax on certain overseas equities (eg, US) can be as much as 30% lower using an ACS structure compared to non-transparent funds.
- No stamp duty is owed when transferring assets into an ACS including no **stamp duty land tax (SDLT)**.
- There is a potential VAT saving since the management of an ACF is exempt from VAT.

1.5 Establishment of a Scheme

European, HM Government and the FCA are the three levels of regulations in respect of collective investment schemes (CIS). They should be viewed as a hierarchy of rules that, at each level, deal with specific areas of regulation.

- **Level 1** **European:**
  - UCITS Directive
  - Alternative Investment Fund Managers Directive (AIFMD)
- **Level 2** **Government legislation:**
  - Financial Services and Markets Act 2000 (FSMA)
  - OEIC Regulations 2001 (as amended)
  - Financial Services Act 2012
- **Level 3** **FCA Regulations:**
  - COLL (Collective Investment Schemes Sourcebook)
  - FUND (Investment Funds Sourcebook).

If a UK scheme complies with the provisions of the Undertakings for Collective Investments in Transferable Securities (UCITS) Directive, it is therefore a UCITS scheme and subject to local registration requirements, can be promoted throughout the EEA. While not all regulated schemes are UCITS, they are still permitted to be established under HM Government legislation and FCA regulations.

COLL rules apply to three legal structures of fund:

- AUTs
- OEICs
- ACSs.

1.6 Direct vs Indirect Investing

Learning Objective

3.1.3 Know the comparative features, advantages and disadvantages in contrast to other forms of investment (direct and indirect)

When deciding to invest into stocks and shares, investors have two options open to them:

1. invest directly into the stock market, purchasing individual company shares, or
2. invest managed via a CIS and picking specific fund ranges/products.

Investors will consider a number of points prior to making this decision, as each has its own advantages and disadvantages, depending on requirements of the investor.

The list below is by no means exhaustive and there could be many factors which determine the investor's decision:

- When operating CIS funds, AFMs will often allow small initial investment lump sum amounts. Direct investing with the stock market tends to have higher charges, making small investments less economical.
- Investing in a CIS ensures the investment has a much wider diversification as each CIS fund will invest in multiple company shares. This has the benefit of lowering the risk to considerable market fluctuations in any one stock line. Conversely, this risk reduction and diversification also means that the exposure to any chosen stocks that increase in value is also reduced.
- Direct dealing has significant costs associated to each trade, which depending on the value could be a high percentage. An investment manager deals in significantly larger volumes securing lower average dealing costs. When dealing direct, these costs will be captured as part of the deal transaction, however in the case of a CIS, costs will form part of the annual management charge.
- Assuming a client's investment is within a local or well-known exchange, access to live share prices will be a simple process throughout the day, allowing the investor to strike deals as and when they believe the time to be right. A CIS is often quoted only daily at a single valuation point.
- Internal transactions within a CIS protect investors from capital gains tax (CGT), allowing for the CIS to change their portfolio and potentially grow more quickly. The investor within a CIS is only subjected to a potential liability of CGT when they decide to sell their holding (unless invested within a wrapper such as an ISA).

1.7 Unit/Share Classes a CIS Issue

Learning Objective

3.1.4 Know the permissible share and unit classes issued by schemes

Under the Collective Investment Schemes (COLL) Sourcebook, the rules enable AFMs to propose any type of unit/share class, providing that it is fair to all holders and can be explained in terms of its nature and operation to prospective investors.

Each sub-fund may offer a number of different share classes – with each class having a specific charging structure. However, there are other features that would be determined at a class-level.

Common share classes issued in the UK market are as follows.

- **Accumulation shares/units** – these shares or units reinvest any income earned by the scheme back into the fund, increasing the overall value of the investment.
- **Income shares/units** – these shares or units distribute income generated by the scheme to investors. The income may come from dividends, interest, or rental payments earned by the underlying assets.
- **Distribution shares/units** – similar to income shares/units, these classes aim to distribute income to investors. However, unlike income shares/units, the distribution is set at a fixed amount or percentage of the investment value.
- **Institutional shares/units** – these classes are designed for institutional investors such as pension funds, insurance companies, or other large entities. They may offer lower fees or specific features tailored to institutional requirements.

- **Retail shares/units** – these classes are typically available to individual retail investors. They may have lower minimum investment requirements and more accessible terms compared to institutional classes.
- **Class-based shares/units** – some collective investment schemes may offer different classes of shares/units with distinct features, such as different fee structures, voting rights, or investor restrictions. These classes allow investors with different preferences or investment objectives to choose the most suitable option.
- **Hedged shares/units** – these classes are designed to mitigate currency risks for investors. They may employ hedging strategies to protect against adverse exchange rate movements.
- **Investor-specific shares/units** – in certain cases, collective investment schemes may issue shares/units designed specifically for certain investors or groups, such as employees of a particular company or members of a specific organisation.

1.8 UCITS and Non-UCITS Retail Schemes (NURS)

Learning Objective

3.1.5 Know the purpose and principal features of collective investments: scope; eligible investments; investment and borrowing limits; liquidity management; risk management requirements; diversification

Within the investment industry, there are numerous regulations that are designed to protect the interests of the investor, ensuring confidence is maintained. Some of the regulations govern the permissible investments and documentation an investor can expect to receive.

In order to promote a single market within the industry the European Union (EU) have issued a number of directives which now heavily influence UK regulation including the COLL and Investment Funds Sourcebook (FUND).

UCITS stands for 'Undertakings for Collective Investment in Transferable Securities' and refers to a series of EU regulations that were originally designed to facilitate the promotion of funds to retail investors across Europe. A UCITS fund, therefore, complies with the requirements of these directives, no matter which EU country it is established in.

Most AUTs and OEICs comply with UCITS regulations ensuring that they can be freely marketed within the EU without needing to register with the regulator in each country. In fact, it is expected that a firm will initially seek authorisation first as a UCITS fund. The regulations are strict in respect of a fund's power to borrow and to ensure that it diversifies its investments widely (not focusing on a small number of assets) and at the same time, these assets must be easily priced and sold.

Although UCITS regulations are not directly applicable outside the EU, other important jurisdictions, such as Switzerland and within Asia will recognise UCITS as a measure of the quality in which the fund is expected to be run and administered when funds are applying for registration to sell into those countries/regions.

The principal features of UCITS are as follows:

- **Diversification** – UCITS funds are required to adhere to strict diversification rules. These rules generally limit the amount that can be invested in a single asset, reducing the concentration risk.
- **Liquidity** – UCITS funds must ensure that investors can easily buy and sell their shares on a frequent basis. This requirement enhances liquidity for investors.
- **Eligible assets** – UCITS funds are typically permitted to invest in transferable securities, money market instruments, and other liquid financial instruments. The allowable assets are specified under the UCITS framework and may vary slightly across different jurisdictions.
- **Risk management** – UCITS funds must employ adequate risk management techniques to protect investors' interests. They are required to have ongoing risk monitoring processes in place to identify and manage risks effectively.
- **Disclosure** – UCITS funds are obliged to provide investors with a prospectus or offering document that includes essential information about the fund, such as investment objectives, risk profile, charges, and historical performance. Regular reports are also provided to investors.

1.8.1 Non-UCITS Retail Schemes (NURS)

Non-UCITS retail funds or NURS funds are generally more complex and are not regulated in this way, resulting in them being more difficult to market in various European markets, the UK regulator would deem these funds as being permitted for marketing to retail investors, but they do not follow the strict guidelines of the European UCITS directive.

Assets may be more illiquid and be more focused on particular areas and asset types unavailable to a UCITS fund. This type of fund will often be deemed as a riskier investment, with the ability to invest in securities listed on unregulated markets with greater borrowing powers. However, it is also common for funds that invest directly into property (due to the subjective nature of the pricing or the illiquid asset) to be run as a NURS fund.

The principal features of NURS are as follows:

- **Greater flexibility** – NURS funds offer greater flexibility in terms of eligible assets and investment strategies compared to UCITS. They can invest in a wider range of assets, including property, derivatives and unlisted securities, subject to certain limitations and disclosure requirements.
- **Investor protections** – while NURS funds offer increased flexibility, they are subject to additional regulations to ensure investor protection. They must provide clear and comprehensive information to investors about the fund's characteristics, risks and investment strategies.
- **Simplified regulation** – NURS funds operate under a simplified regulatory framework compared to UCITS. They are regulated by the Financial Conduct Authority (FCA) in the UK, rather than being subject to the European UCITS Directive.

1.9 Hard and Soft Closures

Learning Objective

3.1.6 Know the difference between hard and soft closure

Soft closure is a technique used by the AFM to reduce or stop the flow of new money into a CIS. This is typically because the AFM feels that the CIS is no longer able to efficiently invest new money into the underlying assets that make up the fund due to the availability of suitable new investments or to the size of investments in existing assets. The primary methods for implementing a soft closure are to increase the minimum investment level (perhaps to £1 million) and to increase any initial charges to the maximum allowable on the CIS to levels making it uneconomic for investors to invest in the CIS. In a soft closure situation, existing regular **savings plans** may be left in place and repurchase transactions will still be permitted.

The hard closure of a fund simply stops all new money into the fund for whatever reason. Repurchase transactions will still be permitted. Hard closure is rare in the UK market.

2. Unit Trusts (UTs)

Learning Objective

3.2.1 Know the definition and legal structure of a unit trust

3.2.2 Know the role of the: manager; trustee

Unit trusts first appeared in the early 19th century in the US and were known as mutual funds. Following the stock market crash of 1929, investors were incredibly wary of the risk of direct investment into the stock exchange, therefore, to encourage investment back, the unit trust was created.

A modern unit trust scheme is an open-ended CIS (meaning units can be created or cancelled) under which the underlying assets are held in trust and the unitholders are the beneficial owners.

It is constituted by a trust deed, entered into by the unit trust manager and the trustee, who must in the same way as an OEIC and depositary, be independent of each other. As mentioned in chapter 2, the trustee is assigned to ensure that the fund manager adheres to the fund's investment goals and objectives. It is also the trustee's job to safeguard the assets of the trust.

The unit trust manager is responsible for:

- the management of the investments of the fund, however this is often delegated to an investment manager
- providing a market of the units by direct dealing with investors who wish to buy or sell units, and
- carrying out the pricing of the units at the valuation point, again this is often delegated.

The AUT does not have a separate legal personality and cannot, therefore, sue or be sued in its own name, everything is done on its behalf by the trustee or AFM.

Unit trusts may be established without being authorised by the FCA. While the legal structure of such unauthorised funds is similar to that of authorised funds, they cannot be marketed to the general public.

3. Open-Ended Investment Companies (OEICs)

Learning Objective

3.3.1 Know the definition and legal structure of an OEIC/ICVC/SICAV

3.3.2 Know the role of the: authorised corporate director (ACD); depositary

An OEIC is a type of company that is structured to invest in other companies. The investor of the OEIC is a shareholder and, therefore, holds shares. The term ICVC or investment company with variable capital is an interchangeable term for the same.

Section 262 of FSMA empowers the Treasury to make regulations that enable the establishment of OEICs, known as the OEIC Regulations. The OEIC is constituted by an Instrument of Incorporation, ie, it is a corporate body, and the Regulations require such a company to have at least one director. If the OEIC has only one director, then it must be a corporate director authorised under FSMA and is referred to as an authorised corporate director or ACD. The role of the ACD is in respect of the day to day management of the fund which includes managing the investments, providing valuations, pricing, and dealing with the investors, all of which can be undertaken by themselves or delegated out.

The OEIC must appoint a depositary to hold the scheme's assets and provide oversight of the operation of the scheme. In contrast to investors in a unit trust, the shareholders in an OEIC will have no direct beneficial interest in the scheme's underlying portfolio, only through their shareholding in the OEIC. Also, in contrast to a unit trust, the OEIC as a corporate body does have its own legal personality and can sue or be sued.

3.1 SICAV

A **SICAV** or Société D'investissement à Capital Variable is a fund structure that is extremely similar to an OEIC in the UK in the respect that it is an open-ended investment company with variable capital. UK TAs will sometimes administer SICAVs, but they are not a core part of the UK TA market and are generally administered by TAs based in Luxembourg or Ireland.

While available to buy in the UK, they are predominantly distributed within Europe.

Taxation rules of the fund are applied depending upon the country they are domiciled from and unlike an OEIC which generally has one director, the SICAV will have a board of directors (usually three or more).

4. Investment Trust Companies

Learning Objective

3.4.1 Know the characteristics of an investment trust: share classes; gearing; real estate investment trusts (REITs); pricing; trading; investor rights and protections

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An investment trust company is a listed company with directors and shareholders. However, unlike open-ended funds such as an OEIC or unit trust, an investment trust has a number of features open to them when managing the fund that the authorised CIS above does not.

- Due to the fact that the fund is closed-ended, the investment trust managers are not forced to sell underlying investments to fund redemptions when markets become stressed, which often has a negative effect on the portfolio.
- **Gearing** the portfolio. This allows money to be borrowed for the trust's benefit with the objective of earning a better return than the cost of that gearing.
- The company-based structure of the fund allows investment trusts to grow dividend payments and smooth out their distribution. They are permitted to retain a portion of the income (up to 15%) earned from their portfolio in their revenue reserve. This enables an investment trust to put money aside during the better years which ensures that income levels and dividends to shareholders can be maintained when actual income levels may have fallen.

An important feature of an investment trust is the existence of an independent board. This group is independent of the appointed investment manager and provides governance of the fund. They ensure that the fund is managed in the best interests of the shareholders by considering the activities of the investment manager and taking whatever action they deem necessary to ensure that the interests of shareholders are protected – they may even replace that investment manager if it feels necessary.

4.1 Share Classes (Split Capital Investment Trusts)

A trust can issue three types of share classes. A zero dividend preference (ZDP) share is, as its name suggests, the share class that offers zero income. The expected level of growth is set over the life of the fund – usually five or seven years. At the point at which the investment trust winds up, the preference element of the share class means that it will be first in line when the assets of the company are wound up. We must be clear that the return is not guaranteed, but given that this share class is dealt with first, it is more secure than ordinary shares.

Ordinary shares will receive all the dividend income payments from the underlying assets throughout the life of the investment trust. Income from assets, which would normally be payable to all shareholders, is increased as it contains the portion which would have been allocated to the ZDP shareholders. In addition, at the point of winding up, the ordinary share will also receive any capital left over after the ZDP shares have been paid out to the value of the expected level of growth.

To ensure that investors are appropriately informed, the investment trust will issue a 'hurdle rate'. This is the expected level of growth required for the remaining years in the underlying assets of the fund to ensure the advertised growth is achieved for the zero shareholders and for the return of the ordinary shareholders investment. At some point, the fund may be performing well so as to confirm a negative hurdle rate. In this instance, the fund has already achieved what it set out and assets could actually fall in value without affecting the expected outcomes.

Capital shares receive the capital from the wound-up fund that is in excess to the values paid to the zero and ordinary shareholders. Given that the expectation of these shares is for the fund to significantly over perform, they are a relatively high-risk investment.

A split capital investment trust can consist of multiple asset classes of a mix of the aforementioned types.

4.2 Real Estate Investment Trusts (REITs)

A real estate investment trust (REIT) is a company that owns and most likely operates income-producing real estate such as a property rental business. Holding shares within a REIT allows investors to benefit from income produced throughout various commercial ventures from the ownership and rental of office space, such as apartments and shopping centres. A REIT may also engage in financing real estate.

Regulations dictate that at least 90% of all rental income is distributed to the shareholders. This will be taxed as if the shareholder had received the income directly from the properties themselves.

REITs should have a minimum of three properties of which no property should equate to more than 40% of the total value of the properties involved. Other more detailed rules also apply to REITs, which are not relevant to the TA administration activity.

4.3 Investment Trust Pricing and Trading

As discussed earlier in section 1.2, investment trusts are traded on an exchange, such as the London Stock Exchange (LSE) and priced based on their share price, which is influenced by market supply and demand. This is similar to how shares of any other company are valued and means the price can fluctuate throughout the day based on buying and selling activity.

Investment trusts also calculate a net asset value (NAV) which represents the total value of the trust's investments minus liabilities, divided by the number of shares outstanding. This is a more fundamental measure of the trust's worth as it reflects the value of the trust's underlying assets.

The share price may differ from the NAV and trade above NAV at a premium, or below NAV at a discount. This can help investors assess its value and potential for future gains or losses.

4.4 Investor Rights and Protection

Investors in investment trusts have important rights that help safeguard their investment and give them a say in key decisions.

The key rights include:

- **Voting power** – ability to vote on major corporate decisions such as the election of the trust's directors.
- **Access to dividends** – depending upon the share class type invested, per section 4.1, Investors may receive dividends when a company distributes profits.
- **Ability to inspect company records** – have the right to inspect annual accounts and financial statements.
- **Legal action** – can sue the company for wrongful management and acts, such as fraud.

5. Wrappers

Learning Objective

3.5.1 Know the range of wrappers typically available and the advantages they provide

3.5.2 Know regulatory limitations and restrictions associated with wrappers

3.5.3 Know the ISA rules surrounding: subscriptions; uninvested funds; transfers; eligibility; open market prices; withdrawals/flexibility; stock lending; using an ISA as security for a loan; additional permitted subscriptions (APS); deceased partner's inheritances; child maintenance deduction orders; income and tax claims; correcting errors and compensating investors; HMRC direct recovery of debts; JISAs

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A wrapper is a product that allows a client to invest in funds, typically in a tax-efficient way. In the UK, the two most common wrappers would be an ISA or a pension.

Each wrapper has distinctive regulatory characteristics that limit the type of investment allowable, the value and level of subscriptions or the flexibility which allows access to the savings. The tax advantages vary significantly between each wrapper and can also vary within each wrapper product, which is discussed in section 5.1. This allows investors to maximise their tax-free allowances.

5.1 Individual Savings Accounts (ISAs)

ISAs were introduced by the UK Government in 1999 as a replacement to a PEP (personal equity plan). Investments within an ISA are made from after-tax income.

To summarise the benefits of an ISA to an investor:

1. There is no UK income tax liability on UK distributions for taxpayers.
2. All gains are free of capital gains tax (CGT).
3. Interest on fixed-interest securities in the stocks and shares component and within deposits in the cash component is free of income tax.
4. Individuals do not need to declare details of their ISAs to His Majesty's Revenue and Customs (HMRC) (though the ISA manager makes regular reporting).

The above characteristics of an ISA can make them particularly attractive for higher rate taxpayers.

There are strict guidelines as to how many ISAs an investor can have in any one year and the amount that can be invested as defined in the ISA regulations and guidance notes. This is controlled via a number of reports that are made by the ISA manager (with input from the TA) to HMRC on a regular basis.

There are five types of ISA available to the UK investor depending on their age or their main goals which are detailed further on in this chapter.

5.1.1 Eligibility

An ISA investor must be a UK resident (including those stationed outside of the UK with the armed forces), and to invest in a cash ISA, must be over the age of 18 (raised from 16 in 2024). This brings the age requirement in line with a Stocks and Shares ISA, a Lifetime ISA (LISA) (if they are under 40 years of age) or Innovative ISA.

In addition to the above, children (under the age of 18) may invest, or have invested on their behalf by a parent or legal guardian, into a **Junior Individual Savings Account (JISA)**.

An investor is not limited to a single product in any one year as long as they remain within the prescribed ISA limits.

5.1.2 ISA Allowance (Limits)

The ISA allowance refers to the investment limits for each financial year into which an investor may contribute – the limit for an ISA is £20,000. It is defined by HMRC for the period 6 April–5 April and within the limit for each product it is reviewed annually. Often investors do not contribute to their ISA evenly throughout the year and the TA will see a significant spike in subscriptions as the **tax year** end approaches as subscription limits are maximised.

While limits are based on subscriptions for tax year, if an ISA manager offers flexibility, the investor may withdraw cash from their plan and replace it within the same financial year with the same value. This allows for disinvestment in periods of financial market insecurity.

5.1.3 Investing in an ISA

To invest, a client will need to apply direct to the ISA manager. As part of the application process a client must confirm the following:

- this is the first of this ISA they are applying for in this tax year
- full personal details (name, address, date of birth, National Insurance (NI) number), and
- the type of ISA they are applying for.

In addition to the above, an investor must confirm, by signing the application highlighting the appropriate area on an online form, that this is the only ISA (of this product type) that they are applying to during the year, and that all information is correct. In the case of a telephone application an agent will readback the declaration and a physical copy would be sent as part of the **contract note**. Applications can be made online, without recourse to a physical signature with the investor confirming all details via the online process.

In the case of a regular saving plan, where the investor pays an amount into the ISA each month by direct debit, there is no requirement for a new ISA application each tax year.

5.1.4 ISA Products

There are multiple ISA products, all of which have slightly differing investment rules and eligibility criteria and qualifying investments. However, all have the same premise of being a tax efficient wrapper around a series of assets.

Cash ISAs

A cash ISA can be viewed as a savings account, paying interest on the amount invested.

Cash ISAs are often offered by high street financial institutions (banks in general). The two main types of cash ISA are fixed and variable. A fixed-rate Cash ISA will usually offer higher rates of interest, however, this higher rate is often at the expense of flexibility for the investor. There is an expectation that the product will not be closed prior to the end of the fixed-rate term, five years in practice, and if so, there are considerable penalties.

Stocks and Shares ISAs

This type of ISA product wrapper is, as its name suggests, one that hold its underlying investments in OEICs, unit trusts, investment trusts and other types of equity investments. Although it is possible to hold a cash pot – this should not be confused with a cash ISA.

Lifetime ISAs (LISA)

Lifetime ISAs have been available to investors since the 6 April 2017 and only for those aged 18–39. Subscriptions can be made up to the client's 50th birthday. Lifetime ISAs were created to give investors financial help when buying their first home or boosting any possible retirement savings and, therefore, have strict rules in respect of removing cash from the wrapper.

It is possible to subscribe up to £4,000 every financial year which can be invested in stocks and shares or a cash pot – this counts towards to the total ISA limit for the year. In addition to the normal growth that would have been received, the government adds a further 25% to any subscription amount. This is made on a monthly basis, providing even further compound growth opportunities.

However, unlike many other ISA products, there are significant terms on which these bonuses are paid and how withdrawals are dealt with.

Investors may not remove their savings without paying a government withdrawal charge (which is 25% of the amount withdrawn) unless:

- the amount withdrawn is being used to buy the investor's first house. (In addition, the property cannot be valued at greater than £450,000), or
- the saver has reached 60 years old and funds will, therefore, be utilised towards retirement.

Junior ISAs (JISA)

JISAs are available for children under the age of 18. A parent or legal guardian may open a JISA for a child and once the product is open, investments can be made by anyone on behalf of the child. The product can be invested in both stocks and shares, and cash, with the maximum investment limit for tax year 2025/26 of £9,000.

The product matures when the child turns 18. At this point, the TA's system should flag the account and the JISA will automatically become an ISA and be reported as such.

Flexible ISAs

A Flexible ISA is a type of tax-efficient savings account that allows you to withdraw money from your ISA and replace it later in the same tax year without affecting your annual ISA allowance.

This means that you can make the most of your annual tax-free allowance without losing out if you need to access some of your savings temporarily.

For example, if you have contributed £10,000 to your flexible ISA, and you withdraw £5,000, you can replace that £5,000 in your ISA in the same tax year without it counting towards your annual allowance. However, if you replace more than you withdraw, only the amount you withdrew can be replaced without affecting your annual ISA allowance.

5.1.5 Transferring an ISA

As mentioned above, subscriptions to a Single ISA type may only be made to a single ISA manager in any tax year. However, this does not mean that the client has to remain with that ISA manager and the range of assets available to them. Should a client wish, they may instruct a transfer of their ISA to another provider allowing them to both transfer assets and continue subscriptions with that provider.

It is, therefore, possible to transfer between ISA providers. In addition, investors may transfer between a cash ISA and a stocks and shares ISA, or vice versa. Individuals are also able to transfer savings from other ISAs as one way of funding a Lifetime ISA (LISA).

Although it is a legal requirement for ISA providers to permit transfers out, there is no corresponding rule for accepting transfers.

While previous tax years can be transferred in part or in full, the current tax year may only be a full transfer which simplifies reporting and ensures that the Single ISA manager rule relating to the current tax year still applies.

To instruct a transfer, it is the client's responsibility to inform the new plan manager by completing a 'transfer in' application form. This form has a number of sections, one of which provides authority for the old plan manager to release personal details, confirmation of the types of account(s) held, and the investments made.

Information requested by the new plan manager will be provided in a format specified by HMRC which ensures that all the appropriate data is captured for ongoing reporting. A key element is, of course, the current years' subscriptions.

This value is carried over to the new plan, it is not related to the transfer value received. This information is required within 30 days of the transfer but is often sent as part of the transfer out process as the information will already be known.

Settlement of an ISA transfer must always be made between plan managers. It is important to note that a client cannot simply sell their holdings and pass the value onto a new plan.

5.1.6 Voiding and Repairing an ISA

Due to the strict guidelines when making an investment around the value of the subscriptions, the eligibility of the investor or the number of ISAs held, errors still happen regardless of the declaration made up front by the client. In this situation, HMRC will, through a series of reports made by the ISA manger throughout the year, determine the nature of the error and if required will instruct the plan manager to void the ISA, removing any tax benefits that are no longer justified.

5.1.7 Additional Permitted Subscriptions (APSs)

Additional permitted subscriptions are investment limits that are granted to the surviving civil partner or spouse of a deceased ISA holder with the expectation that at the point of death they were:

- in a civil partnership or married
- not legally separated or likely to become legally separated (a resident in a care home would not generally be considered as legally separated), and
- at least 16 or over.

These additional subscriptions permit the civil partner/spouse to invest in addition to, and without affecting the normal annual ISA limits. The subscriptions do not need to be from the assets of the ISA and in fact, the assets from the ISA holding need not even have been inherited by the surviving partner. While all providers must calculate the APS, it is worth noting that not all ISA providers accept APSs.

Rules differ, depending on the date of death of the ISA holder, and while it is of value to understand the differences, time will ensure that the rules are becoming standardised.

1. The partners of an ISA holder who died between 3 December 2014 and 5 April 2018 are eligible for an additional ISA allowance which is equal to the value of the ISA on the date of death.
2. Complexities with the rules are applied to those investors who died on or after 6 April 2018, in this case, the ISA will become a 'continuing ISA'. It keeps this status until the earliest of:
    - up to 180 days following the completion of the administration of the estate (when the personal representatives have distributed the assets – whichever is the later)
    - the third anniversary of the date of death
    - the closure of the ISA due to all the funds being withdrawn.

At this point, the APS is equal to the higher of the value of the ISA on the date:

- of the investor's death, or
- it stops being a 'continuing ISA'.

It is also worth noting that where an investor held separate ISAs, with multiple companies, an APS value will be available for each ISA held.

An APS does not need to be invested into the same plan manager as the deceased's holding.

5.1.8 Deceased Partner's Inheritances

If the deceased partner's ISA was held in their name, and their spouse or civil partner is the beneficiary, the ISA can be transferred to the surviving spouse or civil partner as an APS. This means that the surviving spouse or civil partner can inherit the ISA and retain its tax advantages by subscribing additional funds to their own ISA, up to the value of the deceased partner's ISA at the time of death.

In some cases, the deceased partner's ISA can be transferred to a new ISA in the name of the beneficiary, regardless of their relationship. This option is available for both cash ISAs and stocks and shares ISAs. However, the transfer must be made within a specified period after the date of death, usually within the tax year following the partner's death.

5.1.9 Child Maintenance Deduction Orders

The Child Support Collection and Enforcement (Deduction Orders) Amendment Regulations 2009 enable the Child Support Agency (CSA) to claim money from the accounts of customers who have outstanding debts with them.

The CSA will instruct financial institutions to freeze a lump sum for a 21-day appeal period. After this period the money will either be paid over to the CSA or, if the appeal was successful, the freezing order will be cancelled.

Where an enforcement order is attached to an ISA account the funds will remain in the beneficial ownership of the investor during the 21-day appeal period. The frozen funds may therefore remain in the account and the account will remain an ISA.

If the manager transfers the sum covered by the enforcement order to a suspense account pending resolution of the appeal, that sum can be paid back into the ISA without counting as a fresh subscription if the appeal is successful and the enforcement order is cancelled.

Any amounts removed from a Lifetime ISA in these circumstances will be treated as a withdrawal and may be liable to a charge.

Where, in the circumstances described above, an appeal is successful and the enforcement order is cancelled, the sum can be paid back into a Lifetime ISA without counting against the Lifetime ISA payment limit but will not be a qualifying addition on which a bonus can be paid.

The investor can apply to HMRC for the repayment of any withdrawal charge that has been made in respect of the removal of the sum.

5.1.10 Correcting Errors and Compensating Investors

Where, in error, a manager fails to purchase (sell) specific investments within an ISA as required under the customer agreement, and the value of those investments has subsequently changed, the manager will compensate the investor. Compensation to put the investor in the position they would have been in had the investment been purchased (sold) at the right time may be paid into the ISA. The payment will not count towards the subscription limit or the Lifetime ISA payment limit and will not be a qualifying addition for the purposes of a Lifetime ISA bonus and should not be recorded as such, but the manager should retain evidence of the circumstances in which the compensation was paid.

Any compensation paid in respect of a delay in transferring an ISA, in order to put the investor in the position they would have been in had the ISA been transferred without delay, may also be paid into the ISA. The payment will not count towards the subscription limit or the Lifetime ISA payment limit and will not be a qualifying addition for the purposes of a Lifetime ISA bonus and should not be recorded as such, but the manager should retain evidence of the circumstances in which the compensation was paid.

Any compensation paid in respect of a delay in opening an ISA, or in accepting a subscription to an ISA must be paid to the investor outside the ISA as the funds in question are not held within the ISA wrapper (unlike in respect of a delay in purchasing (or selling) specific investments as required under the customer agreement or a delay in transferring an ISA). The compensation can be subscribed to the ISA by the investor but will count as a subscription for all purposes.

5.1.11 HMRC Direct Recovery of Debts

HMRC's debt collection powers allow the direct recovery of debt from cash held in the bank and building society accounts of debtors who have the means to pay but choose not to do so.

This includes cash held in cash ISAs, but not cash held in stocks and shares, innovative finance or Lifetime ISAs.

Once debt recovery has been initiated there will be a 30-day window for the debtor to lodge an objection. Where the ISA manager holds the funds temporarily in a suspense account during this window, it can be paid back into the ISA, together with any interest, without counting as a fresh subscription if the debt recovery is subsequently cancelled.

Where a direct debt recovery is made from a flexible ISA, this will not count as a withdrawal of cash by the investor and cannot be replaced without the subscription counting towards the annual subscription.

5.2 Investment Trust Savings Schemes

Purchasing an investment trust would normally require the client to interact with a broker and buy shares directly on the London Stock Exchange (LSE), the same way in which other company shares are listed. To ensure the needs of the retail investor are met, and especially those that wish to invest small regular amounts, investment trusts will offer 'share saving schemes' – these provide investors with similar capabilities and dealing options offered as part of open-ended funds, with online access and regular direct debits. An ISA may also be available as part of the investment trust savings scheme.

When dealing via a saving scheme, the TA must engage with the broker and deal on the client's behalf. As noted earlier, there is no specific valuation point for an investment trust, however, to allow the TA to consolidate all the dealing on a particular dealing date, the scheme will require a dealing cut-off (much like a VP) before which dealing instructions must be received and an attempt made to place a single aggregated deal including those instructions received, with the broker.

5.3 Pensions Transfers

Learning Outcome

3.5.4 Know considerations for transfer agencies in relation to pensions

When it comes to transfer agencies in relation to pensions, particularly in the UK, there are several critical considerations that must be addressed to ensure compliance, protect members, and maintain operational integrity. These considerations span regulatory, operational and advisory domains.

5.3.1 Regulatory Due Diligence

From 30 November 2021, strict due diligence protocols must be followed before processing pension transfers. The regulations require due diligence to be carried out on statutory transfers and to refuse a statutory transfer or refer the member to MoneyHelper guidance if the assessment flags certain risk indicators.

No single piece of due diligence can definitively rule out pension fraud, and decisions should be taken using all the evidence gathered.

After conducting the due diligence, pension schemes may allow non-statutory transfers even when risk indicators are flagged when the assessment shows the transfer is in the member's interests and does not pose a risk. Non-statutory transfers should not be used to avoid carrying out due diligence.

First Condition

The first condition covers transfers to three different types of schemes. If the receiving scheme is one of the following schemes, the statutory right exists and can proceed with no further due diligence checks:

- public sector scheme
- authorised master trust, or
- authorised collective defined contribution (CDC) scheme.

Second Condition

The second condition applies to all other transfers, such as to occupational and qualifying recognised overseas pension schemes (QROPS). Members should provide evidence that they are employed by the scheme's employer by providing payslips for the past three months, or to prove they are resident in the same jurisdiction as the QROPS or have an employment link to the scheme by providing evidence such as utility bills, local tax payments or bank statements.

For these, and all other transfers, the second condition to the statutory right is met where the due diligence checks show no red or amber flags.

Red Flags

Transfers must be assessed using a risk-based decision-making approach, and if a red flag is raised then the statutory right falls away and schemes could prevent the transfer going ahead.

Red flags are raised when the transferring scheme encounters one of the following examples:

- the member fails to provide the required information
- an amber flag (see below) has been raised, and the member has not provided evidence of receiving MoneyHelper guidance
- an unregulated person has carried out a regulated activity relating to the transfer
- the member requested the transfer after unsolicited contact
- the member has been offered an incentive to make the transfer, or
- the member has been pressured to make the transfer

Amber Flags

If a single amber flag is raised during the due diligence process, the member must be asked to attend a MoneyHelper guidance session on pension transfer scams.

An amber flag is raised when:

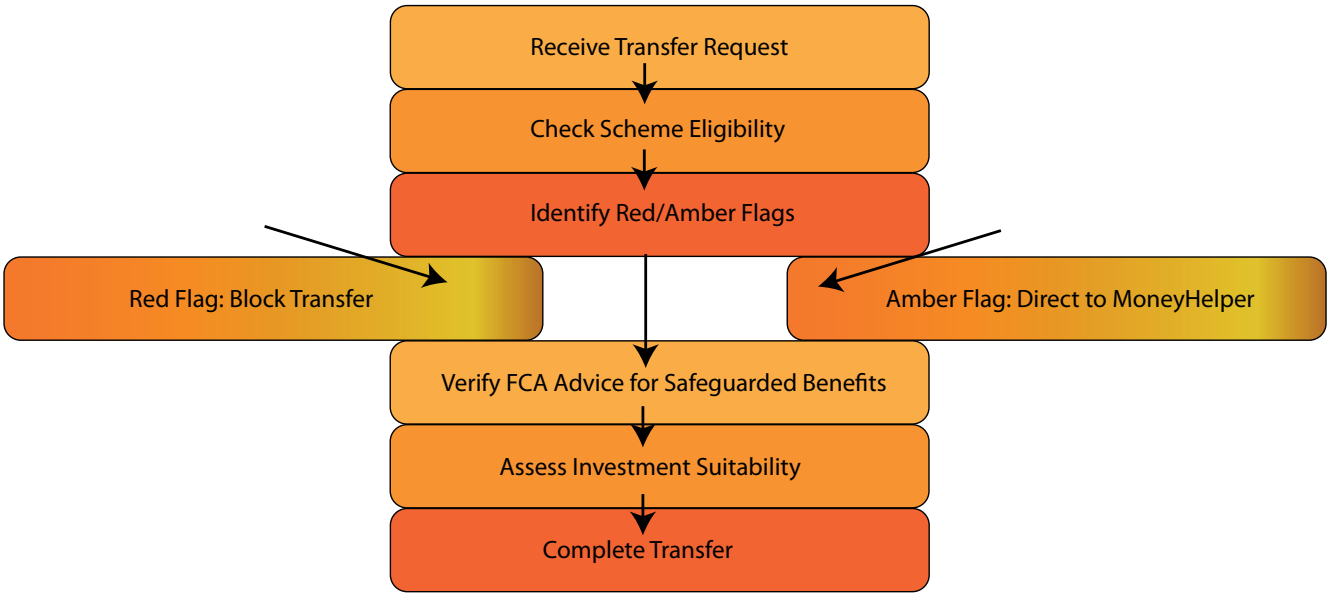
- The member has not shown an employment link or overseas residency.
- The member cannot show an employment link or overseas residency.
- High risk or unregulated investments are included in the receiving scheme.
- The receiving scheme charges are unclear or high.
- Overseas investments are included in the receiving scheme.
- There is a sharp, or unusual rise in transfers involving the same receiving scheme or adviser.

As mentioned, if the due diligence checks raise any amber flags, they must ask the member to attend a MoneyHelper guidance session. They must provide the information on how to set up the scheme, but the member must set up and attend the session on their own. The sessions are conducted by telephone and last around forty minutes to an hour where MoneyHelper will ask the member questions about why they want to transfer their pension. Upon completion, MoneyHelper will issue the member with a unique identifier number to evidence attendance.

Upon conclusion of the due diligence, a decision must be made based on a reasonable foundation, on all the information available. If a red flag is present, the transfer should be refused. An opinion that the transfer is not in the member's interest is not relevant to stop the transfer. If a decision cannot be reached, a formal request can be made to the member for further information.

The decision must be clearly communicated to the member within seven days of the decision being reached, and state that their transfer has been refused as there are circumstances present which remove the statutory right and that the member is at risk of a scam. The member should also be informed of the internal dispute resolution process should they wish to appeal the decision.

Statutory transfer process decision tree



5.3.2 FCA Requirement for Advice

An area which must be considered when assessing transfer requests is if the transfer is a straight transfer between two of the same product types, (eg, defined contribution (DC) to DC), or if the transfer is between different types (eg, defined benefit (DB) to DC).

Deciding whether or not to transfer between DB and DC schemes is a significant decision as it involves giving up guaranteed benefits for potentially greater flexibility and investment control, but at a higher risk.

For a transfer from a DB scheme over £30,000, the FCA requires that members must receive advice from an FCA authorised adviser as per COBS 19.1. A transfer value comparator (CVT) tool is used to calculate the value of the DB scheme, providing a clear comparison of the benefits of the scheme versus the costs of replicating those benefits in a DC scheme. It compares the cash equivalent transfer value (CETV), which is the lump sum offered by the DB scheme for transferring out, and the annuity purchase cost, which is the estimated cost of buying an equivalent level of guaranteed income for life from an annuity provider in the market.

The member must be able to provide written confirmation from the adviser to the transfer agency, a copy of which should be retained. Once received, a check must be carried out that the adviser has the correct permission to carry on the regulated activity by verifying details on the Financial Services Register maintained by the FCA.

The FCA requires that transfer agents must retain records relating to pension transfer activity indefinitely (COBS 9.5) unless the transfer is not proceeded with, where records are then not required to be retained.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **What are the forms of the most common types of investment in the UK?**
   Answer reference: Section 1.1

2. **What are the tax benefits of an authorised contractual scheme (ACS)?**
   Answer reference: Section 1.4.2

3. **What are the three levels of regulation in respect of collective investment schemes (CIS)?**
   Answer reference: Section 1.5

4. **What are the primary methods for implementing a soft closure of a CIS?**
   Answer reference: Section 1.9

5. **What is a unit trust manager responsible for?**
   Answer reference: Section 2

6. **What are the implications of an open-ended investment company (OEIC) being a corporate body with its own legal personality?**
   Answer reference: Section 3

7. **What are the features and roles of the board of an investment trust company?**
   Answer reference: Section 4

8. **What are the benefits of an individual savings account (ISA) to an investor?**
   Answer reference: Section 5.1

9. **List three possible ISA products.**
   Answer reference: Section 5.1.4

10. **What do investment trust savings schemes provide investors?**
    Answer reference: Section 5.2

Chapter Four

Managing the Risk of Financial Crime

1. **Financial Crime** 77
2. **Financial Crime Controls** 79
3. **Cyber Risk Management** 88
4. **Practical Implications for Transfer Agencies (TAs)** 94

This syllabus area will provide approximately 9 of the 100 examination questions



1. Financial Crime

1.1 Legislation

Financial crime is covered by legislation, regulation and guidance from various local and global bodies and is often updated to keep up with any criminal activities or to mitigate any risk of criminal activities. Legislation applicable to UK transfer agencies (TAs) includes:

- Proceeds of Crimes Act 2002 (POCA)
- Money Laundering, Terrorist Financing and Transfer of Funds Regulations 2017 (MLR)
- Terrorism Act
- Office of Financial Sanctions Implementation (OFSI)
- Joint Money Laundering Steering Group (JMLSG)
- Bribery Act 2010.

1.2 Money Laundering

Learning Objective

4.1.1 Know the stages of the money laundering process: placement; layering; integration

Money laundering is the process by which criminal proceeds are 'washed' to disguise the origin from which they came. The organisation/criminal will aim to distance themselves by adopting money laundering schemes of placement, layering and integration in an attempt to make the proceeds of any illegal activity appear legitimate. Once completed, funds from illicit gains can be used without further question by the authorities.

The following actions are considered acts of money laundering:

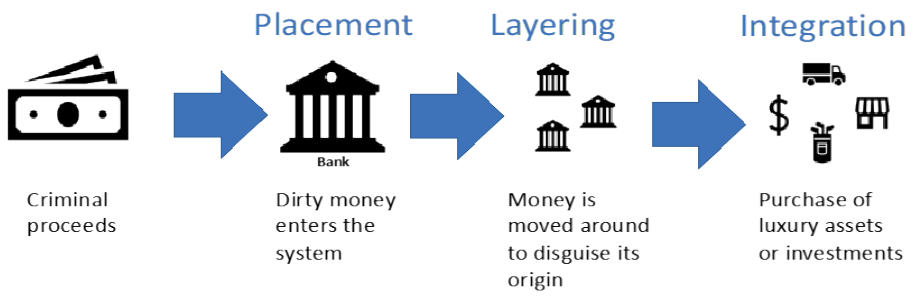
- concealing, disguising, converting or transferring the proceeds of crime
- removing illegally gained funds from the jurisdiction they originated from, and
- entering into, facilitating, using or being a concern within an arrangement that will assist in the acquisition, retention, use or control of criminal property.

It is also an offence to:

- fail to report your suspicions or knowledge where you believe that another person is engaged in money laundering, or
- tip off or prejudice any investigation.

As noted above, to complete the money laundering cycle, there are three processes to complete the washing of funds:

1. **Placement** – to commence the process, cash derived from criminal activities, 'dirty money' needs to be integrated (placed) somehow into the financial system. To do this, the criminal element will find a financial institution, such as a bank/building society or bureau de change that would be willing to accept large sums with little or no validation, or other type of businesses that find it simpler to accept large cash transactions such as a casino. This of course is not restricted to the locality where the crime took place and can just as easily be placed abroad.
   The rise of electronic currencies such as Bitcoin and the ability for large sums to be purchased should be considered as this would form part of the placement process, and could make the following stages easier to adopt until the tracking technology evolves.
2. **Layering** – at this point in the process, the need is to make it more difficult for any authority to detect money laundering activity and ultimately the beneficial owner of the fund. The process involves the movement of money between material assets that can be bought for cash and sold, or in the cash of the financial industry the buying and selling of foreign currencies, shares/bonds or collective investment schemes. If possible, the launderer will also move these assets between countries to further cloud the trail.
   This stage represents the biggest risk to financial services firms as any movement of funds could be designed to disguise the original source of the money and the end beneficiary. Firms need to ensure that they have appropriate procedures and systems in place enabling the user to identify potential criminal activity.
3. **Integration** – once successfully laundered, the funds will then need to be integrated back into the economy where the ultimate beneficiary can be seen to have legitimate earnings or claims to funds. This differs from layering, as the funds are now identifiable, allowing the beneficiary to utilise them as per any legally gained income. This money is now deemed 'clean'.



While the three-stage model of money laundering outlined above is a convenient way of describing the activity, it is rare for a single institution or bank to be able to identify all three stages related to a single case. It is not even necessary for criminals to use all three stages of the model in order to legitimise criminal gains. In addition, criminals will often try to use a number of institutions, often in different jurisdictions, to disguise their activity. Each institution will see only pieces of a larger jigsaw, which is why the suspicious activity reporting process is critical to the success of attempts to seize the assets derived from criminal activity.

2. Financial Crime Controls

Learning Objective

4.2.2 Understand the controls a firm should have in place to minimise its risk to fraud, money laundering and terrorist financing including a training programme

Firms are exposed to the risk that their business will become a victim of fraud and must therefore be fully committed and implement controls that assess where such risks primarily reside to mitigate both the impact of financial crime and reduce the risk of the financial services sector being used to launder money or finance terrorism. Having assessed this risk, senior management must then ensure that they design and develop a control framework that meets the regulatory requirements of the business.

Fraudulent activity can be undertaken by external and internal parties. Internal fraud, for example, occurs when an employee abuses their position for their own gain at the expense of investors, the company or its employees. To mitigate this risk, quality control checks to ensure the validity of processing together with segregation of duties to ensure that work must pass through separate departments or individuals before processing is authorised. Dealing and registration additions and releasing payments are examples of processes where segregated controls can reduce the risk of internal fraud.

In respect of money laundering and terrorist financing, firms must consider international standards, eg, those of the Financial Action Task Force (FATF), and at a minimum, comply with the UK Money Laundering Regulations 2017 (as amended 2022) by implementing due diligence policies and a control framework that covers:

- verification of the customer's identity
- collection of additional information about the customer, and
- ongoing due diligence to monitor transactions and activity for reasonableness to ensure that money laundering or terrorist financing is not taking place.

To decide on the most appropriate due diligence levels and relevant controls for the firm, senior management will be guided on the measures that can be adopted, and to what extent, to manage and mitigate these threats/risks most cost-effectively, and in line with the firm's risk appetite.

As well as assessing at the outset of a relationship, risk management is also an ongoing process. A risk assessment is not a one-off exercise and continuous monitoring ensures that due diligence is continually relevant.

The processes to manage the risks of money laundering and terrorist financing need to be reviewed at least annually, and more frequently if required. Any changes and decisions need to be highlighted in the money laundering reporting officer's annual reporting.

2.1 Trigger Events

Learning Objective

4.2.1 Know examples of trigger events

In addition to the process of pre-determined regular time-driven reviews, monitoring may also be prompted by a trigger event (an event driven review) that may require referral to compliance, a request for further documentation or the raising of a suspicious activity report (SAR). It should not only be single triggers prompting these reviews, but also the cumulative effects of multiple events over a period of time that prompt further investigation. These trigger events can include standard transactions such as:

- Junior ISA trigger event – account beneficiary becoming 18
- investor taking out a new product or service
- when a certain transaction threshold is reached
- top up to investment
- death claim
- stock transfer
- returned mail
- change of bank details, especially to a bank in a different jurisdiction or to an account with a different currency
- change of agent (especially if overseas)
- change of beneficial owners
- change of corporate structure
- change of telephone number (especially if overseas/different country to address on file)
- change of name
- adding a power of attorney (PoA), and
- providing authority to a third party (to whatever extent) where the reason for doing so is not clear.

Trigger events also include suspicious activities such as:

- change of address followed by a redemption
- insistence on funds being paid to an account other than the funding account
- sale followed by a quick redemption
- early redemption of a long-term product, and
- significant increase in savings amount.

Within a firm's procedures there is a need to include the definition of a trigger event and the action that will be taken when a trigger event occurs. This could be achieved by using checklists for staff to follow or flow diagrams. For example, an investor who is currently a UK resident who moves to another address in the UK, with no other trigger events, would not be regarded as suspicious or higher risk. Standard procedures would apply with regards to verification of the new address.

Procedures will already be in place for the identification of fraud such as verifying the new address and mailing the old and new address with confirmation of the change.

However, should a UK investor move to a country deemed by the firm to be high risk, or a change of name occurs at the same time as a substantial investment, enhanced due diligence measures should be applied.

2.2 Suspicious Activity Reporting (SAR)

Learning Objective

4.2.3 Know the criteria for an effective suspicious transaction reporting system

As highlighted, a trigger event may identify a suspicious activity. In the event that this occurs, the member of staff who has identified the suspicious trigger event must raise an internal report as per the firm's internal procedures. This report should include full details of the customer under suspicion and full details of the reason for the suspicion.

Once an SAR has been made, the relevant team along with the MLRO will determine whether there is enough evidence to take the suspicion further. If this is determined to be the case the MLRO or deputy must make a report to the National Crime Agency (NCA) as soon as is practicable. Consent must be sought from the NCA before proceeding with a suspicious transaction or entering into arrangements.

All decisions and communications regarding suspicious activity reports must be clearly documented and maintained on file. Policies and procedures should be in place to guard against the risk of 'tipping off' the customer while these activities take place.

Companies will normally have both manual and automated monitoring processes in place based on the size of their business and the volume of transactions being processed. The key factor of both methods is:

- the quality of scenarios and parameters being used to detect and derive the alerts or exceptions to be reviewed or interrogated
- the competency of staff to assess and act appropriately when performing these duties.

The use of artificial intelligence (AI) is growing within the financial sector, and several FinTech companies offer automated monitoring solutions that use analytics to draw forward alerts or exceptions that match the designated parameters set by businesses thus, enabling companies to review large volumes of investor static and transactional data in a timely manner. These outcomes identify the likelihood of specific transactions being unusual or suspicious when viewed against the profile of the investor. There is still a requirement for staff members' involvement or oversight to make decisions based around the facts presented. Technology will continue to advance, and companies should remain vigilant to the opportunities available as they present themselves.

2.3 Anti-Money Laundering (AML)

Learning Objective

4.2.6 Understand the implications of using a risk-based approach to identify money laundering

Firms that apply a risk-based approach to anti-money laundering (AML) can focus AML resources where they will have the biggest impact.

Firms must have in place policies and procedures in relation to customer due diligence and monitoring, among others, but neither the law nor the regulator prescribe in detail how firms are to do this. Firms' practices will vary depending on the nature of the money-laundering risks they face and the type of products they sell. For example, a large investment bank with many customers is more likely to need to develop or purchase customer-monitoring software, whereas a smaller outfit may be able to monitor its customers using a low-tech or manual solution.

When firms apply a risk-based approach they need to be proactive in seeking out information about money laundering trends and threats from external sources, such as law enforcement, and similar companies, as well as relying on their own experiences and observations. This allows firms to effectively review and revise their use of resources and technology tools to fit the specific risks that they face.

As per the UK Money Laundering Regulations 2017 (as amended 2022), a risk-based assessment is carried out by firms during their customer due diligence (CDD) activities, and prior to applying due diligence classifications such as simplified due diligence, standard due diligence or enhanced due diligence. The requirement is to capture details of the considerations made during the CDD activity and will include the risk classification of the investor and the justification of the approach undertaken.

Simplified due diligence will only be applied in circumstances where risks are low. Investors who would naturally fall into this category would be UK-regulated firms, based in a low-risk country group. A firm increases their due diligence and applies enhanced measures on a risk-sensitive basis in any situation which, by its nature, can present a higher risk of money laundering or terrorist financing. As part of this, a firm may conclude, under its risk-based approach, that the standard evidence of identity is insufficient in relation to the money laundering or terrorist financing risk, and that it must obtain additional information about a particular customer.

As part of a risk-based approach, therefore, firms may need to hold sufficient information about the circumstances and business of their customers for the following two reasons to:

- inform their risk assessment process, and thus manage their money laundering/terrorist financing risks effectively, and
- provide a basis for monitoring customer activity and transactions, thus increasing the likelihood that they will detect the use of their products and services for money laundering and terrorist financing.

2.4 Training

One of the most important controls in the identification of fraudulent/criminal activities is the implementation of an effective training plan. Employees must be alert to the risk of suspicious events and know how to report or escalate their concerns.

While it is desirable to put all staff through training, the content and delivery will be tailored appropriately and the expectation it will be delivered/taken annually. At a minimum it should include:

- understanding the internal controls established, and the risks intended to be mitigated
- staff responsibilities in recognising and to being able to report suspicions and breaches
- staff have relevant knowledge
- internal arrangements for obtaining sufficient evidence of identity
- the identity and responsibilities of the nominated officer and the MLRO
- the effect on the firm, its employees personally and on its investors in the event of legal breaches, and
- appropriate assessment at the end of a training session to ensure it has been effective.

In addition, selected or relevant employees should be given regular appropriate training in order to be aware of:

- criminal law relating to money laundering and terrorist financing
- money laundering regulations
- industry standards or guidance issued by the regulator, and
- policies and procedures.

Within the training programmes, it will also be beneficial, but not compulsory to include:

- examples of fraudulent activity – whether previously identified within the firm itself, or relevant cases from similar firms
- the nature of terrorism funding and terrorist activity, in order that staff are alert to customer transactions or activities that might be terrorist-related, and
- trends and the changing behaviour and practices among those involved in money laundering and financing terrorism.

2.5 Roles and Responsibilities

Learning Objective

4.2.4 Know the responsibilities of directors and senior management in relation to anti-money laundering (AML), combating financial crime (CFC) and anti-corruption (AC) initiatives

4.2.5 Know the role of the Money Laundering Reporting Officer (MLRO) (or equivalent) in relation to financial crime

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The directors and senior management of an authorised financial firm are expected to:

- identify, and manage effectively the risks in their business and this will include ensuring appropriate action is taken in relation to combating the financing of terrorism (CTF), AML, combating financial crime (CFC) and anti-corruption (AC)
- appoint a nominated officer to process disclosures
- appoint an MLRO with certain responsibilities
- ensure the MLRO has adequate resources devoted to AML/CFT, and
- understand the potential personal liability if legal obligations are not met.

Accordingly, the directors and senior management will ensure the policies and procedures established include systems and controls that:

1. enable the firm to identify, assess, monitor and manage money laundering risk, and
2. are comprehensive and proportionate to the nature, scale and complexity of its activities.

2.5.1 The Money Laundering Reporting Officer (MLRO)

The MLRO or nominated officer provides and is responsible for the oversight of compliance with AML systems and controls. They are to have sufficient authority and independence within a firm including access to resources and information to be able to carry out that responsibility. It is a senior role within the firm and should, therefore, report at a senior level taking precedence over operating business lines, enabling them to design, implement and enforce the firm's compliance systems and procedures.

Responsibilities include:

- receiving and reporting of suspicious activity from employees and the business
- reviewing and analysing reporting to determine concerns of money laundering or terrorist financing
- filing and agreeing SAR reporting
- the independent decision to report, or not to report, outside of any consent
- that information in respect of the suspicion of money laundering is properly disclosed to the relevant authority, and
- requesting consent to continue with transactions that have been reported and making sure no transactions are continued illegally.

The size of some businesses may require the MLRO to delegate certain activities, or appoint permanent deputies to fulfil tasks, however, this does not relieve the MLRO of responsibility.

In this case, reporting channels should be well known to all relevant employees via appropriate training. Without exception, firms must ensure cover is in place should the MLRO be absent.

MLROs may also take responsibility for:

- training staff within the business
- advising on SAR procedures to safeguard against tipping off or prejudicing an investigation
- the design and implementation of internal AML systems and procedures.

If the above tasks are not undertaken by the MLRO, these responsibilities should be taken on by another sufficiently senior and skilled person within the business, or team, and work closely with the MLRO.

2.5.2 Combating Financial Crime (CFC)

International efforts to combat financial crime have focused on several objectives to:

- reduce financial crime and deter the use of financial systems in the facilitation of crime
- ensure that firms have in place policies and procedures designed to minimise the risk that the firms' businesses may be used as a vehicle for money laundering and other financial crime
- raise consumer awareness of financial crime issues
- contribute to an effective wider fight against crime through international cooperation
- encourage a balanced, joined-up approach to AML and fraud through standards and guidance
- improve the effective use of regulator resources through risk assessment processes
- improve coordination with partner agencies.

The expectation is that businesses are aware of the risk, have appropriate measures to prevent, detect and monitor financial crime, and provide adequate resources to do so, and that:

- trade associations work together closely and provide leadership over fraud management
- senior managers accept that fraud is a significant threat that needs managing strategically and effectively, and more work is done on the risks and scale of fraud and better ways of tackling it, and
- improved organisational cultures and information sharing are developed.

This means that, using a risk-based approach, regulators will be looking for evidence of:

- a strong anti-fraud culture, with the lead being given from the top
- a clear allocation of responsibility for the day-to-day management of the risk
- satisfactory staff training
- robust know your customer procedures, and how the firm identifies potential criminal behaviour, and
- what management information on fraud is captured and how it is used.

Regulators will be looking for 'reasonable steps' to be taken to ensure awareness of, and tackle, fraud risks by being able to identify and report on the following:

- Who is responsible for managing fraud risks?
- How many frauds has the firm suffered recently?
- What are fraud losses?
- What whistleblowing arrangements are in place and how successful are they?
- How much is spent on preventing and detecting fraud?
- How does the firm monitor the effectiveness of fraud systems and controls?
- What information on fraud goes to the board or senior management?

Regulators have an important role as gatekeepers of those working in regulated businesses (granting authorisation to firms and those individuals seeking to perform controlled functions), and another role ensuring that the expected standards of behaviour and practice are met. Regulators, therefore, monitor firms and individuals to ensure risks are appropriately managed and fraudulent activity reported, confirming that businesses have in place the systems and controls to meet various legislative requirements. This will include looking at IT and manual systems, separation of duties within a firm, the role of internal audit, risk assessment, mitigation and monitoring programmes, documented policies and procedures, organisational cultures, collection and use of internal information, and reforms following frauds.

2.6 Sanctions Screening and Screening Individuals

Learning Objective

4.2.7 Know the rationale behind: sanctions screening; screening individuals

At times, individuals, companies and even countries are considered to have acted illegally, and it is the responsibility of the global community to take action. In this case, one option open to them is the use of financial sanctions.

Financial sanctions prevent the use of monies relating to certain individuals or organisations considered by the international community to be unfit (due to crime and/or terrorism). Being unfit and linked in this way ensures that there is no financial benefit from these activities.

Sanctions lists are maintained by organisations such as the United Nations (UN) and financial services firms will seek to minimise the risk of servicing customers on these lists. In addition, countries (the UK being one) impose legal sanctions on firms or individuals that have breached financial sanctions. Aside from penalties that can be imposed, reputational damage for those firms transacting with sanctioned investors is a considerable risk.

There is only guidance to suggest how firms should have processes to manage the risk of conducting business with, or on behalf of, individuals or entities whether on or off the sanctions list. These interactions and screening expectations, including periodic screening will be fully detailed within the firm's policies.

Sanction lists are provided by either the government, directly from the UN and will be combined with other appropriate sanctions lists. For simplicity of processing, some provide a consolidated list (which includes all the names of sanctioned persons and entities under UN and, for example, EU sanctions regimes which have effect in the country concerned).

As highlighted above, the scope, complexity and frequency of the screening process will be influenced by the firm's business activities and risk appetite of the firm which will be detailed in their policies. An effective screening process will include the following elements:

- the ability to identify matches against the consolidated list
- matches should highlight which measures have been issued, for example, the Counter-Terrorism Act
- reporting of matches should be reviewed by appropriately trained staff and actions recorded
- where matches are confirmed as true, appropriate action should be taken
- true matches should be reported as soon as is practicable to the relevant law enforcement agency (LEA) or government department, and
- the firm should retain reports, including actions taken on both potential and true matches for audit purposes.

Commercially available matching software will be utilised, depending on the size and risk appetite of the business. Any screening system should clearly identify potential matches detailing all of the above criteria. The choice of screening tool may be decided by the TA or the firm may choose to operate a global screening tool and, therefore, arrange for the appropriate procedures to be implemented. As with all software, the continued review of its effectiveness, capabilities and limits should be reviewed by the MLRO to ensure that it fulfils the needs of the firm.

Due to the global nature of the lists, there is of course a chance that data is misspelled, partial or missing. Considering local linguistic differences, spellings, or data formats for dates, any system utilised will need to have the ability to operate 'fuzzy matching' (matching on possibilities). In this case, the user should be able to determine the level of mismatch prior to reporting, again, in line with the risk profile of the business. Greater fuzzy logic use increases 'hits' of false positives and therefore will require manual interaction to finalise the reporting.

Screening happens at the commencement of a business relationship, or shortly after. Those that screen after will need to consider the possibility that business will have been transacted with investors who are on the list and therefore run the risk of doing business with a sanctioned entity. Again, a risk-based approach when transacting is an acceptable practice. Firms must be aware of the absolute restrictions embedded in the financial sanction's regime. Where there is any delay in screening, firms risk breaching the legislation.

3. Cyber Risk Management

Learning Objective

4.3.1 Know the concept of good online practice

4.3.2 Know the additional measures financial services firms can take to manage the risk of cybercrime originated or enabled by an employee: training; improving the management of privileges for joiners, movers and leavers; classifying and segmenting data; embedding ethical practice in relation to data security; implementing whistleblowing procedures

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Cyber security is the application of processes, techniques and controls designed to protect a firm's digital data stored, transmitted or used within systems. The value of data is high and therefore desirable to criminals. Effective cyber security restricts the unauthorised access to systems, data and networks, therefore protecting the data, organisations and individuals.

The implementation of a robust framework of cyber security is based on three main attributes:

- people
- process, and
- the technology employed.

However, regardless of the quality of processes and technology, the human element is often the weak link and, therefore, firms will have to focus on and highlight the responsibilities of the individual user.

3.1 Embedding Ethical Data Security in Practice

To help the end user, there are a series of points that should be considered as part of training and continually reminders firms should embed in their culture for all employees when interacting and utilising data:

1. Ensure that a user is forced to have a strong password (a mixture of symbols, letters and numbers).
2. Remind users of phishing scams and potential malicious links to unfamiliar web pages.
3. Do not to enter personal information online unless confident with the webpage security and connection.
4. Secure data in the work areas including devices (both in the office and at home).
5. Secure laptop, tablet and other mobile devices at all times when they are not in use.
6. Always shut down or log off from devices before leaving them unattended.
7. Update all software on the computer and any other devices with reputable anti-malware.
8. Encrypt any data kept on mobile devices or removable drives.
9. Do not install unsolicited software applications on any device.
10. Make regular backups of all important files or data either manually or automatically.

3.2 Training

Given the constant changing landscape within the technology environment and ever-increasing complexities utilised by criminals, a single training session for employees is not sufficient. Firms will therefore employ an ongoing programme of training (usually annual) to ensure the end user is fully aware of the current security policies and practices.

As per all training with the TA environment, the content should be tailored to the user's role. It is considered best practice to ensure employees are aware of techniques used by criminals to elicit information and log in credentials such as:

- phishing (the fraudulent practice of sending emails purporting to be from reputable companies in order to induce individuals to reveal sensitive information)
- pharming (a cyberattack intended to redirect a website's traffic to another fake site)
- vishing (similar to phishing, but using the phone instead of email)
- smishing (similar to phishing but using SMS instead of email).

3.3 User Profiles

Privilege management involves the assignment, recording and review of specific user rights to individual users. A single user, on a PC or laptop will be subject to some level of privilege management; they will either log on as an administrator, a user, a child user or a guest user. Each type of account has variable admin rights (such as installing new software or creating new user accounts) but only an administrator can do everything.

Within firms, controlling larger networks, managing privileges across a wide range of users, devices and applications is more challenging and, therefore, purpose-built privilege management software is used to add joiners, assign them to groups, define their specific roles and related privileges and deactivate, edit or remove movers and leavers.

Increasingly, larger organisations use centralised systems for privilege management. These involve the use of a single server and application to cover all users across all devices (hosts), network access points and applications.

The types of user group, role and privileges available will differ across organisations. They are a function of the regulatory environment, size, complexity, sensitivity of data, numbers of systems, applications and users, maturity of information security and the level and nature of perceived threats.

Regular reviews of privilege management (also known as privilege auditing) is essential, from both your internal users and with investors accessing systems. As most organisations are in a constant state of flux due to changes in personnel, systems, data and the regulatory and cyber-security environment. A reviewer should focus on the following:

- All users have the privileges necessary to perform their roles.
- No user has greater privilege levels than they legitimately require.
- Privileges are signed off by the managers responsible for the data being viewed or manipulated and/or by the application owner, before they are granted. For data classified as sensitive, additional signoffs by security and senior management may be appropriate.

- Movers have their privileges reviewed and adjusted as soon as they enter a new role.
- Changes in operating procedures trigger reviews of all affected users and their privileges.
- Leavers have their privileges revoked, in accordance with the organisation's HR and information security policies, and those policies are in tune with each other.
- Any lapsed accounts (eg, belonging to contractors who are no longer active) are deactivated.

3.4 Security Classification of Information

Information security and risk management requires information to be classified by the creator/owner, based on defined rules in respect of its perceived value or sensitivity. As not all information is equal, degrees of classification and security will vary. When information is processed, created, stored and transported by any organisation, it must be assigned a security classification to ensure any end recipient is aware of the sensitivity

To define a classification scheme, a firm must consider:

- the rules underpinning the information classification criteria (such as sensitivity, criticality to the business, regulatory stipulations and fraud risk)
- the description of a process for classifying data
- the assignment of ownership and accountability for various types of data at different stages of processing and handling
- the development and promotion of a set of security guidelines relating to the storage and handling of each data class
- the construction of inventories of data held by the organisation, broken down by class and location which allows for the conduct of vulnerability and business impact assessments.

As seen on many documents, the selection of information security classification labels depends on the nature of the organisation and within the TA environment you are likely to see documents and digital images labelled as:

- **public** – can be shared
- **sensitive** – shared internally
- **private and confidential** – not to be shared outside of the recipient group.

The three points above can be added to or defined in a number of ways. The firm must ensure, through appropriate training, that the end user is aware of the categories and their usage/restrictions.

3.5 Data Segmentation and Encryption

To appropriately store data with different classifications, principles need to be defined around data segmentation. This ensures that:

- sensitive data is captured securely
- controls are established for the legitimate needs only of the user or system accessing, editing, deleting or viewing data
- sensitive data and non-sensitive data is not combined and is held separately, and
- data can be protected in different ways, depending on its classification.

The classification and inventory are essential building blocks for data segmentation to be effective; a firm cannot segment data if it is unaware of the type or sensitivity of the data it holds. Once segmented, firms can concentrate on delivering systems that focus on securing sensitive data which offers cost-savings.

The use of cryptography (technique of encryption utilising complex mathematical encoding for encryption) is used as an effective method of securing the data as it renders it unreadable from any attempt to view it by unauthorised users without the 'key'. Only once the key (solution to the mathematical encoding) is known can a system or user convert the data back – this is known as decryption.

Encryption of data to protect sensitive information should be used when data is:

- **transmitted electronically** – via a Virtual Private Network (VPN)
- **moved physically** – laptops, hard drives, removeable media or mobile phones.
- **in storage** – within a corporate database or data security warehouse.

Cryptography also assists applications that require security when utilising sensitive data:

- improvements to authentication methods
- digital signatures
- secure WiFi
- email encryption.

If implemented correctly, encryption can be an incredibly powerful tool, however it also can present security risks. Criminals (hackers) have been known to use the exact same applications on a firm's systems to lock out legitimate users; breaking a weak encryption key either by digital means or through the accidental exposure or loss will allow access to apply with their own key. A security step to be taken is, therefore, to remove or secure access to the encryption applications.

3.6 Access Control

Information and data must not only be limited either to those that are authorised or to those that have a genuine business need to fulfil a role within the firm, but these restrictions must also apply to applications and systems.

To ensure compliance with the above point, firms need mechanisms and techniques from access controls, and logs, to protect that data. The same principles need to be applied that the more sensitive the data, the stronger control mechanisms/techniques need to be deployed.

Access control is built upon three requirements being in place:

- **Identification** – the confirmation of what someone or something professes to be or actually is. For human users, this would be the form of a username, and devices a MAC or IP address.
- **Authentication** – this is the process verifying the claim of identification. There are at least four types of information that the user or system can be relied upon to authenticate:
  - **knows** – a PIN, password, personal security question
  - **has** – a dongle, a security pass, a passport
  - **is** – biometrics, fingerprints, retina scans
  - **location** – IP address, a specific place in the office or world.

  Multi-factor authentication is increasingly becoming more the norm whereby access to systems or data is restricted until two or even three of the above points are proven. A username and password is one of the most common, but is becoming less effective with firms relying on more sophisticated methods.
- **Authorisation** – after being successfully identified and authenticated, systems or processes will need to provide appropriate access to specific tools, programs or data. If data is being accessed controls depending on the authorisation can focus on the ability to view, create, edit or delete, for example.

A firm's policies will determine the level of access dependent on the requirement of whom and for what reason and procedures will back up these policies.

There are multiple access control mechanisms that can be utilised. The mechanism offered will be based on one or a combination of the following:

- **Non-discretionary** – the consolidation of all access under a central administration. Access is granted based on the function or role within the organisation or the tasks that are needed to be complete.
- **Discretionary** – this relies on the creator or owner of the data/system to provide access to the resources.
- **Mandatory** – access is granted solely on the security classification assigned to the information/data.

To be effective, firms must have policies and security controls in place that are enforceable and upheld, bringing users to account for their actions and decisions. To ensure appropriate ongoing monitoring and analysis, failed authentication attempts must be logged and recorded.

3.7 The Legal and Regulatory Basis for Whistleblowing

The legal and regulatory basis for whistleblowing in the UK financial services market is primarily set out in the Financial Services and Markets Act 2000 (FSMA) and the rules and guidance of the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA).

Under FSMA, regulated firms are required to establish effective mechanisms for their employees and contractors to report potential breaches of regulatory requirements, including a protected route for whistleblowers.

The FCA and PRA have also issued rules and guidance on whistleblowing, including the requirement for firms to appoint a senior manager as their whistleblower's champion, and to ensure that whistleblowers are protected from retaliation.

In addition, the Public Interest Disclosure Act 1998 (PIDA) provides protection for whistleblowers in the UK, including those working in the financial services sector, against dismissal or detrimental treatment by their employer in certain circumstances.

Overall, the legal and regulatory framework for whistleblowing in the UK financial services market aims to encourage employees to speak up about wrongdoing and promote a culture of accountability and transparency within regulated firms.

3.8 The Role of the Whistleblowing Champion

The role of the whistleblowing champion within a Financial Conduct Authority (FCA) regulated firm is to ensure that the firm has effective arrangements in place to handle whistleblowing disclosures, and to provide support and protection to whistleblowers.

Specifically, the whistleblowing champion is responsible for the following:

1. Ensuring that the firm's whistleblowing policy and procedures are up to date, effective and fully embedded within the firm's culture.
2. Acting as a central point of contact for whistleblowers, ensuring that they can raise concerns and that their disclosures are handled effectively and confidentially.
3. Ensuring that all employees and contractors are aware of the firm's whistleblowing policy and procedures and understand how to use them.
4. Providing training to employees on how to handle whistleblowing disclosures and raising awareness of the protections available to whistleblowers.
5. Reporting to the firm's senior management and board on the effectiveness of the whistleblowing arrangements, including the number and nature of whistleblowing disclosures received and the actions taken in response.
6. Monitoring the firm's culture and identifying any potential issues or areas of concern that may impact whistleblowing arrangements.
7. Liaising with the FCA as required on whistleblowing matters.

Overall, the whistleblowing champion plays a crucial role in promoting a culture of openness and transparency within the firm and ensuring that whistleblowers are supported and protected.

4. Practical Implications for Transfer Agencies (TAs)

Learning Objective

4.4.1 Know the FCA definition of conduct risk and how it is addressed within transfer agencies

4.4.2 Understand how service level agreements (SLAs) play an important role in transfer agency business with respect to managing regulatory and other risks

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As part of achieving its overall objectives, while adhering to timescales and attitude to risk, the FCA promotes the good management of conduct risk. In April 2017 the FCA published some observations following discussions with a range of firms. The FCA emphasised that conduct risk relates to actions or conduct of a firm that may:

- harm investors
- cause reputational damage to the firm, or
- risk undermining the integrity of financial markets.

The FCA noted that most firms used a combination of two approaches to identifying conduct risk. One approach was to define a central list of key risks, which was then mapped to individual funds' track records, growth projections, investment policies and business processes. The second approach took each business process in turn and determined what risks could arise to then aggregate that risk data. The FCA noted a third approach, which was only used by a small number of firms, which is a reverse-engineering method by which firms would identify the threats within each of their processes and review the design of relevant controls to ensure those underlying threats were properly mitigated.

This theme of conduct risk follows and expands upon an earlier regulatory focus of 'Treating Customers Fairly' (TCF). TCF remains central to the FCA's expectations of firms' conduct, ie, that firms put the well-being of customers at the heart of how they run their businesses. The FCA identified six TCF outcomes, covered in chapter 2, section 2.4, that it expects regulated firms to achieve.

Service level agreements (SLAs) and key performance indicators (KPIs) play an important role in ensuring that TAs meet the standards required by the fund managers that they support. As the regulatory responsibility remains with the fund manager, it is essential that they can hold the TA to account for any service or regulatory failings that may occur from time-to-time from a contractual perspective. SLAs must be designed to ensure that the fund manager can evidence that the service being provided by the TA on their behalf meets all regulatory standards and meets the outcomes expected by the FCA.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **Describe the process of 'integration' when money laundering.**
   Answer reference: Section 1.2

2. **How would a firm mitigate the risk of internal fraud?**
   Answer reference: Section 2

3. **List three possible trigger events due to suspicious activity.**
   Answer reference: Section 2.1

4. **List four of the responsibilities of the Money Laundering Reporting Officer (MLRO)**
   Answer reference: Section 2.5.1

5. **Why are firms expected to perform sanctions screening?**
   Answer reference: Section 2.6

6. **What are the three main attributes for the implementation of a robust framework of cyber security?**
   Answer reference: Section 3

7. **When should data be encrypted to protect sensitive information?**
   Answer reference: Section 3.5

8. **Describe the requirement of 'identification' in regards to the access control of information and data.**
   Answer reference: Section 3.6

9. **List three of the responsibilities of a whistleblowing champion.**
   Answer reference: Section 3.8

10. **What actions does the Financial Conduct Authority (FCA) emphasise that conduct risk relates to?**
    Answer reference: Section 4

11. **With whom do the regulatory obligations lie with when a firm outsources its TA activities?**
    Answer reference: Section 6

Chapter Five

Managing TA Operations

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This syllabus area will provide approximately 42 of the 100 examination questions



1. Anti-Money Laundering (AML) and Know Your Customer (KYC)

Learning Objective

5.1.1 Know the TA Forum's guidance with respect to risk rating investors

5.1.2 Know the obligations of transfer agencies in relation to money laundering directives

5.1.3 Know operational best practice and regulatory requirements for: investor bank validation checks; AML due diligence assessment; ongoing monitoring and enhanced monitoring; third party payees

5.1.4 Know operational best practice and regulatory requirements for: electronic identification standards for opening online accounts; electronic verification techniques

5.1.5 Know operational best practice and regulatory requirements for bank verification checks

5.1.7 Know regulatory requirements relating to: sanctions; politically exposed persons (PEPs)

The TA Forum offers advice and guidance as to the risk rating of investors which is shown in the table below. Although there is no common standard across all transfer agencies (TAs) as the risk-rating process is dependent on each firm's risk appetite, the TA Forum proposes a typical high-level methodology for working out what level of due diligence should be used for each investor dependent on the factors shown in the table.

Risk	Customer Type	Channel	Risk-rating jurisdiction (location/ incorporation) as determined by each firm	CDD/KYC
High	• Retail • Charity/club/ society • Foundations • Offshore trust • Offshore vehicles • State-owned entity (outside of EU) • Sovereign wealth fund (outside of EU)	• **High** – face-to-face, non face-to-face customer (direct or via unregulated third-party introducer) • **Medium** – face-to-face, non face-to-face customer (direct or via regulated third party introducer) • **Low** – face-to-face, non face-to-face customer (direct or via regulated third party introducer)	• High risk countries • FATF non-compliant • Low score on transparency corruption index	EDD/KYC
Medium	• Retail • Limited company (operating & non-operating companies) • Trusts • Family offices • Pension scheme (unregulated or regulated outside EU) • State owned entity (EU) • Sovereign Wealth Fund (EU)	• Face-to-face • Non-face-to-face via regulated third party introducer	• Medium risk countries	CDD/KYC

Risk	Customer Type	Channel	Risk-rating jurisdiction (location/ incorporation) as determined by each firm	CDD/KYC
Low	• Retail • FCA (or equivalent) regulated firm • Listed company on recognised exchange • UK local authority • Pension scheme (UK/EU-regulated) • State owned entity (UK) • Sovereign Wealth Fund (UK)	• Face-to-face • Non-face-to-face via regulated third party introducer	• Low risk countries • UK • EU • US • Australia • Canada • Singapore	SDD/KYC

1.1 The Anti-Money Laundering Directive

The 6th Money Laundering Directive (6AMLD) was the latest directive, passed in the EU in December 2020. Although the UK left the EU in January 2020, it has adopted many of the provisions into its own Anti Money Laundering framework, overseen by the FCA.

6AMLD builds upon the previous directives by providing a clear standardised definition of money laundering across EU member states, expanding the list of predicate offences to include crimes like cybercrime, serious tax offences and environmental crimes, and increasing criminal liability for individuals and legal entities involved in money laundering. It also aimed to strengthen cross-border cooperation in prosecuting money laundering cases.

The 5th Money Laundering Directive (5AMLD) was passed in the UK as the Money Laundering Regulations 2017, which required firms to employ policies and procedures such as introducing a risk-based approach and removing automatic exemptions from due diligence.

5AMLD aimed at strengthening anti-money laundering and counter terrorist financing measures, and it came into effect in January 2020. In respect of effects on the TA process, it did not have the same impact as the 4th Directive and can been seen as more of a series of amendments as it was implemented as a direct response to terrorist attacks across the EU. While a number of the amendments do not impact the funds world, such as the controls and access to data on virtual currencies or pre-paid cards, enhanced due diligence (EDD) in high-risk countries will now have to be completed more strictly.

This includes the following measures:

- obtaining additional information regarding the transaction as well as the natural and legal persons involved, obtaining the approval of senior management for establishing or continuing the business relationship, and conducting enhanced monitoring of the business relationship, and
- the application of elements of EDD, introducing systematic reporting mechanisms and limiting business relationships or transactions with high-risk third countries, the refusal of establishment of subsidiaries or branches or representative offices in high-risk countries, imposing increased supervisory examination and external audit requirements on any of these branches or subsidiaries, as well as requiring credit and financial institutions to review, amend and possibly terminate relationships with respondent institutions in high-risk third countries.

In addition to the above:

- member states are required to issue and keep an up-to-date list indicating prominent public functions for identification purposes; the Commission will compile a single list of all prominent public functions (based on the information received from the member states and also including the prominent public functions at EU level) and make this list public
- the methods of carrying out CDD have been widened to include electronic identification means or any other secure, remote or electronic identification process that is regulated, recognised, approved or accepted by the relevant national authorities
- 5AMLD obliges member states to establish centralised national bank account registries or electronic data retrieval systems, which allow for identification of every natural or legal person holding or controlling payment and bank accounts or safe-deposit boxes held by a credit institution within their territory. National competent authorities should have unrestricted access to this information in order to perform their duties under the AML Directive, and
- 6AMLD targets enhancing transparency of beneficial ownership information, both providing definitions, and identifying different methods, of beneficial ownership. Organisations need to implement enhanced reporting methods and ensure they have access to the latest beneficial ownership information available.

1.2 Investor Onboarding

To mitigate the risk of fraud, the Anti-Money Laundering Directive expects that the firm obtains the appropriate bank details from the outset as part of the onboarding/application process. With appropriate controls and periodic reviews of these details, a fraudulent attempt, ending with a successful fraud, is severely hampered.

Obviously the above is only relevant from the outset of the relationship with the client, and with the case of legacy business where bank details are not held, firms should look to gain details from their clients as part of any process that requires direct contact, such as further dealing, distributions and statement runs. By following these processes, the population of accounts will reduce and, in turn, the level of risk.

1.3 Investor Bank Account Validation

The financial services sector experiences significant volumes of fraud activity where a third party has obtained knowledge of an investor's holding (eg, through postal interception) and will attempt to impersonate the investor, with the expectation that they will ultimately benefit by successfully placing a redemption and requesting payment to be made to the criminal's bank account.

Such attempts commonly (but not exclusively) involve investors based in countries where the risks of postal interception are heightened despite the prevalence of PO boxes, with the recipient bank account being placed in another country.

1.3.1 Validating Bank Account Information

There are two potential methods of validating investor bank accounts which are deemed to offer the best outcome when used in conjunction with each other:

- **Data providers** – while data providers offer services which permit firms to verify whether a bank account matches to the investor name and address, the services are currently limited to some UK bank accounts only. However, firms using these services have a success rate in the region of 60%. To offer a viable ongoing solution, further increases in success rates are dependent on the banks changing their data consent processes, making more data available to the electronic providers to support this process.
- **Proof provided by investors** – investors can alternatively provide proof of their bank account to evidence the link between them and the account. Firms will have appropriate checks in place to identify any evidence of tampering or forgery. Such proof could be provided in one of the following forms:
  - a subscription cheque (eg, accompanying a paper application)
  - an original voided cheque
  - an original/photocopy of a postal bank statement, or
  - a copy of an internet bank statement*.

* The trend towards internet-operated bank accounts increasingly limits investors to providing internet or downloaded PDF Bank statements which are more easily tampered with to support fraudulent activity. Unlike previous guidance, the 2017 JMLSG Part 1 Guidance (5.3.76) permits the acceptance of such documents on the basis that they may be more reliable in some cases, subject to integrity checks being performed (5.3.45).

1.4 Recommended Best Practice

Where online application/dealing processes are supported, this should include the mandatory capture and verification of standard photographic identity documents like passports or driving licenses and may involve biometric verification.

The online account opening process often uses a smartphone or tablet with a camera to capture images of the required documents and the applicant. The documents and images are then securely uploaded to the firm's system for verification. Firms may then use real time verification systems to confirm the identity of the applicant and the authenticity of the documents.

Specialised software should be used to verify the authenticity of the digital documents, checking watermarks and security features and comparing them to a database of known images. Some may also use facial or voice recognition or fingerprint scanning to match the digital images with the applicants' live image. Address verification can be performed using digital copies of recent utility bills in the applicant's name.

Firms are recommended to engage with a registered digital identity service to independently validate data for the opening of online accounts. In the UK there is a register of digital identity and attribute service, which provides a list of organisations currently certified against the trust framework. The trust framework is a set of government backed rules which draws on existing guidance, standards and best practice for trustworthy and secure digital identity services.

If the applicant is unable to provide the digital data, they should be prompted to provide hard copy documentation.

Where dealing/register change instructions can be provided via verbal methods, firms should seek to verify bank details at point of receipt, prompting investors to provide documents if unsuccessful.

Where instructions need to be provided in writing, firms should create dedicated templates for all processes that involve investor bank accounts (eg, applications, renunciation and distribution mandates) and make those readily available to investors to prompt the receipt of evidence with the register change/instruction.

Supplied paper evidence should always be reviewed for evidence of tampering, but reliance should only be considered on such documents for UK bank accounts where the electronic check was unsuccessful.

Firms should not make any payments to investor bank accounts unless:

1. those details were provided at account opening, or
2. have been appropriately validated.

Where bank account changes are requested in respect of ongoing account activity (eg, distribution or regular withdrawal payments), firms should issue confirmation letters (without quoting the full account number) to the investors' registered address to alert them to the change.

Firms should consider whether additional checks (eg, call backs) are appropriate for accounts in jurisdictions deemed higher risk or with other high-risk factors (eg, value), to mitigate the heightened fraud risk.

Firms may decide to waive some or all of the above requirements where the security protocols of their online capabilities are deemed to robustly defend against any attempted account takeover by a third party.

There are a number of industry bodies that work together to help TAs ensure that the AML rules are followed correctly, and the TA Forum provides substantial guidance and best practice information on its website. The TA Forum information has been created by TAs collaborating to define best practice.

1.5 Ongoing Monitoring

A firm must determine based on risk sensitivity, how to conduct ongoing monitoring of entities they have relationships with. This means scrutinising transactions to ensure that they are consistent on how the firm expects the entity to act and ensuring that the firm's knowledge about the relationship with the entity remains current.

Where the risk associated with the business relationship is increased, firms must carry out enhanced ongoing monitoring of the business relationship.

The extent of this monitoring can vary by the perceived risk of a relationship, though the following applies for all clients:

- At client approval level, the operations team should have a process, based on AML compliance direction, for approving the creation and continuation of all standard risk relationships. All higher risk relationships should be collectively approved by senior management.
- Transactions must be scrutinised on an ongoing basis, including source of funds and source of wealth where applicable, to ensure that transactions are consistent with the investment/fund manager's understanding of the relationship. The level of scrutiny will be defined in an individual firm's policies but should be based on factors such as the client risk profile and amount of funds credited.
- For the purposes of ongoing monitoring, information should include an understanding of where the funds were transferred from, as well as understanding the activities which gave rise to the funds, ie, the source of funds.
- All clients will need to be screened against sanctions lists on a regular basis defined by the firm's risk-based approach, as well as politically exposed person (PEP) and adverse media hits via online checks or a screening system (eg, a reputable data set provider).
- Information or documents relative to applying customer due diligence must be kept up to date. This can include annual updates to KYC information to ensure it remains valid, as well as including verification of changes to the client's static data such as a change of name. This should be applied on a risk-sensitive basis. Trigger events within a relationship should be used to refresh information if relevant.

1.6 Enhanced Monitoring

All clients identified as higher risk are subject to enhanced ongoing monitoring by the firm. The firm's risk-based approach should confirm the overall level of risk from a client and the necessary frequency of monitoring. Those clients posing the highest risk are normally reviewed at least annually. It is important to note the frequency of review will depend on the risk appetite of the firm.

Escalation to senior management responsible for AML is required should a client or entity be identified as requiring enhanced due diligence.

In high risk situations, it is necessary to fully understand the purpose and intent of the transactions or client, this will vary the level of enhanced due diligence. Clients which are considered as higher risk will be subject to enhanced monitoring measures which need to be included in a client review to assist in the monitoring of the account:

- PEP and sanctions screening using a reputable data set provider.
- Adverse/negative media screening (internet search, or, more typically, reputable data set provider data suites).
- Total sum of funds introduced by client.
- Changes in client static data and/or changes of parties/structure and whether this raises concerns and/or requires additional information and/or documentation.
- Nature of trades in portfolio – only applies to non-discretionary and execution-only clients.
- Is transaction history in line and consistent with expected investor behaviour or investor profile?
- Clients' documentation, including any updates; for example, confirming new addresses through online verification.

All changes within an account must be checked against the client file to ensure that they have been verified in line with the firm's anti-fraud and AML procedures.

A client identified as high risk and therefore subject to enhanced due diligence should be reviewed, at the very least, on an annual basis.

Transactions which have unusual elements either due to size or involvement of higher-risk jurisdictions should also be considered trigger events which require a review to be performed. Staff should be provided with guidance on what would be considered unusual activity.

The review should include details of any changes made within an account as well as any checks which have been performed. An example of the information which could be used is provided below.

A TA will typically utilise a third-party provider for electronic verification of their client base. Prior to entering into any agreement with an electronic verification provider, the solution should be validated as being sufficiently extensive, reliable and accurate, and independent of the customer to support robust verification.

The standards are set out in Joint Money Laundering Steering Group (JMLSG) rules and should ensure coverage as follows:

- the provider is recognised through registration with the Information Commissioner's Office (ICO)
- if the provider is not on the ICO's list of credit reference agencies, it is accredited/certified to offer an identity verification service that involves meeting minimum published standards
- the service uses a range of multiple, positive information sources
- the service accesses negative information sources such as sanctions and PEP data or mortality records
- through its published standards, the provider undertakes to keep data up-to-date, or maintained within defined periods of re-verification
- the provider's standards are assessed/audited
- transparent processes are used to enable firms to understand the checks carried out, the results returned and the certainty that such results provide evidence to 'living as stated'.

To ensure the solution continues to be appropriate, the operator (TA) should ensure that the provider is capable of providing an annual attestation to support the requirements of the TA and the JMLSG rules. This should be acknowledged either as an annual contractual requirement or a confirmed service level agreement standard.

Best practice suggests firms should take a risk-based approach to electronic identification (e-ID) failures:

- If a potential client is name matched to a sanctions target or PEP, this would be considered high risk and the application process should hit a 'hard-stop'. The client would then be considered only having provided further evidence to the AFM/firm.
- If there is insufficient electronic evidence to create a meaningful footprint, firms should capture the failure and conclude the deal/account opening process or reject the instruction requesting documentation depending on the circumstances. If the deal is placed or an account is opened, a chasing process will then commence to gather the appropriate deal documentation.

Key points, therefore, are:

- subject to periodic review for appropriateness
- an appropriate e-ID tool to the requisite JMLSG standard
- integrated system functionality, informing processes, including hard-stop
- firms are to retain the right to gather paper-based evidences where required, and
- firms' ability to gather annual attestations.

1.7 Due Diligence Checks

Learning Objective

5.1.6 Know required due diligence and AML checks for: corporate clients; trusts; charities; third party payers

During any institutional investor account opening stage, it is advisable to ensure that the contracting party's name is entered as the investor name on the register to support ongoing monitoring and screening requirements. Systems should capture all associated parties that are required to be identified and recorded against the account.

1.7.1 Charity Account Opening Due Diligence Requirements

When completing account-opening requirements for charities, the Charity Commission holds a central register of charities in England and Wales and allocates a registered number to each. The Office of the Scottish Charity Regulator carries out a similar function for Scottish charities.

The Companies House website will also provide supportive information on incorporated charities. These sites can only be used to validate the documentation provided by the charity, but not to satisfy the verification requirements directly.

Unincorporated charities do not have their own legal identity whereas an incorporated charity does have a legal identity.

Information required for due diligence checks:

- charity name and address
- confirmation of charities' activities and objectives
- certification of registration, inclusive of registration number, can be sourced via the UK Charity Commission website, and any documentation not available will be sourced directly from the investor
- list of authorised signatories if not evident on the application form
- list of trustees/directors if not evident on the application form
- record names of any named beneficiaries with at least a 25% interest, and settlor(s) if relevant
- copies of confirmation of legal form and set up of charity
- resolution confirming authority to act on behalf of entity, eg, minutes from board meetings appointing the signatories
- memorandum and articles of association, and
- bank account information used for subscriptions and redemptions.

ID and verification (ID&V) checks must be performed on all signatories named on the mandate/agreement. If these signatories, whose IDs are verified, are not also trustees, ID&V checks must be performed on a minimum of two trustees.

Documentation required:

- memorandum and articles of association for an incorporated charity
- ID&V* for trustees (risk-based decision required on the number to be verified – minimum of two)
- ID&V* for signatories (if different) ID&V* for beneficiaries >25%
- letter confirming authority to open/operate the account on behalf of the charity, and
- bank account evidence (eg, cheque used for first payment or bank statement).

* (Verification requirements for individuals could be satisfied via electronic KYC methods provided the appropriate disclosures are made and the information required to perform the checks is obtained.)

Checks to be performed:

- validate charity info against the Charity Commission's website
- verify company info with Companies House
- validate ID&V documents for each individual, and
- perform reasonableness test of amount invested versus recorded charity income/assets.

Other actions:

- record any named beneficiaries with at least a 25% interest on the register
- record settlor(s) if any identified
- record names of all identified persons (trustees/signatories) on the register, and
- ongoing surveillance of transactions should be standard practice for all investment accounts of unregistered charities.

As these charities are unregistered, they cannot be verified by reference to registers maintained by independent bodies, such as the Charity Commission.

Information required for due diligence checks:

- charity name and address
- evidence of charity's purpose and objective
- evidence of legal form or charities with His Majesty's Revenue & Customs (HMRC) Section 505 Tax Exemption can be verified via HMRC registration
- authorised signatory list, and
- ID&V of all directors or trustees, and in addition all signatories who have signed the Authorised Signatory List.

If non-UK, seek further guidance from the MLRO providing the below information:

- geographical area served, and
- country of establishment.

Documentation required:

- evidence of legal form or HMRC registration/confirmation of tax status
- ID&V* for trustees (risk-based decision required on the number to be verified – minimum of two)
- ID&V* for signatories (if different)
- ID&V* for beneficiaries >25% (if appropriate)
- authorised signatory list or letter confirming authority to open/operate the account on behalf of the charity, and
- bank account evidence (eg, cheque used for first payment or bank statement).

* (Verification requirements for individuals could be satisfied via electronic Know Your Customer (eKYC) methods provided the appropriate disclosures are made and the information required to perform the checks is obtained.)

Checks to be performed:

- validate charity information provided
- validate ID&V documents for each individual, and
- perform a reasonableness test of the amount invested versus recorded charity income/assets.

Other actions:

- record any named beneficiaries with at least a 25% interest on the register, and
- record names of all identified persons (trustees/signatories) on the register.

Ongoing surveillance of transactions should be standard practice for all investment accounts.

1.7.2 Trust Account Opening Due Diligence Requirements

Trusts are not incorporated and have no legal personality, so accounts may be registered in the name of two or more individuals responsible for the administration of the holding, ie, the trustees, or can also be registered in the name of a corporate trustee, or in the name of the trust itself subject to appropriate controls in place to identify and monitor the controllers acting on the trust's behalf.

Documentation should be sourced directly from the named individuals if not supplied at the account opening stage.

Information required for standard due diligence checks:

- name of trust
- nature and purpose of the trust
- country of establishment
- names, DOB and residential address of all trustees
- names, DOB and residential address of any protector/controller
- name, DOB and residential address of the settlor
- signatories list (if a corporate trustee is a holder), and
- names, DOB and residential address of any individually named beneficiaries with an interest of at least 25% in the trust assets.

Documentation required:

- trust deed
- ID&V* for trustees (risk-based decision required on the number to be verified – minimum of two)
- ID&V* for signatories (if different)
- ID&V* for beneficiaries >25% (if appropriate)
- ID&V* for settlors (if appropriate)
- authorised signatory list or letter confirming authority to open/operate the account on behalf of the trust, and
- bank account evidence (eg, cheque used for first payment or bank statement).

* Verification requirements for individuals could be satisfied via eKYC methods provided the appropriate disclosures are made and the information required to perform the checks is obtained.

Checks to be performed:

- validate trust information provided
- validate ID&V documents for each individual, and
- perform a reasonableness test of the amount invested versus recorded trust income/assets.

Other actions:

- record any named beneficiaries with at least a 25% interest on the register, and
- record the names of all identified persons (trustees/signatories) on the register.

Surveillance of transactions should be standard practice for all investment accounts.

Additional measures are required where higher risk features are present (eg, non-UK trust or involvement, particularly offshore jurisdictions, non-UK trusts where there is no equivalent country regulated trustee, proposed payments to beneficiaries, complex structure).

Further information requirements when enhanced due diligence checks are required:

- request further information about the purpose and funding of the trust, the domicile, nature and location of business/activities.

Ongoing surveillance of transactions should be standard practice for all investment accounts.

1.7.3 Corporate Account Opening Due Diligence Requirements

Corporates – Listed on Regulated Markets

Simplified due diligence can be applied so information can be sourced online using Companies House and be matched back to the details provided on the application, or correspondence can be issued to the individuals named on the application to source the required documentation directly if not supplied at account opening stage.

- full name of the company (and parent company if applicant is a subsidiary)
- address
- signatories list
- evidence of listing on regulated market.

Corporates – Regulated in Acceptable Jurisdictions

- full name of the company (and parent company if applicant is a subsidiary)
- evidence of FCA (or equivalent) registration
- address
- authorised signatory list.

Corporates – Excluding Companies Listed on Regulated Markets and Regulated Firms

Initial information can be sourced online and be matched back to the details provided on the application, or correspondence can be issued to the individuals named on the application to source the required documentation directly if not supplied at account opening stage.

- Full name of the company.
- Registered number.
- Registered office in country of incorporation.
- Business address.
- Names of individual(s) who own more than 25% of its shares or voting rights (which will in turn require CDD if they are not individuals to establish beneficial ownership).
- Names of any individual(s) who otherwise exercise control over the management of the company.
- Certificate of incorporation.

Confirm the identity of all shareholders/limited partners with 25% or more interest in the company with either the company secretary or a person named on the signatory list. If these are not readily available, request ID&V information for those identified as having controlling rights. If shareholders are not individuals, ensure further investigation is undertaken to understand the structure of the ownership and ultimate beneficial owners ensuring that ID and verification checks are completed.

Additional high risk checks may include:

- additional information – eg, names of all shareholders/limited partners/other controllers
- certification of information and entity verification provided by the customer
- additional corporate documents beyond those required to confirm existence such as certified copies of reports and all directors' and/or shareholders' information
- full verification of directors/other signatories
- full verification of shareholders (possibly including those with <25% interest) rather than confirmation of identity, or
- general due diligence, eg, internet searches for adverse media, additional screening of all interested parties, if applicable local enquiries about reputation and standing.

All corporate account payments should come from a bank account in the name of the company and ongoing surveillance of transactions and screening should be performed.

1.8 Politically Exposed Persons (PEPs)

Politically exposed persons (PEPs) are individuals who have, or have had, a high political profile, hold, or held, public office, or is, or was, entrusted with a prominent public function. They may also be referred to as a 'Senior Foreign Political Figure'.

The 5th Money Laundering Directive (5MLD) has imposed obligations on member states to keep an up-to-date list of the exact functions that qualify as prominent public functions. In addition, prominent functions of any international organisation hosted by the member state must be included.

Owing to the nature of their role, they are deemed to pose an inherently higher risk of financial crime. This risk also extends to members of their immediate families and known close associates. Having a PEP status in itself does not incriminate individuals or entities. It does, however, put the customer, or the beneficial owner, into a higher risk category when completing due diligence. A PEP is defined as:

> *'an individual who is or has, at any time in the preceding year, been entrusted with prominent public functions and an immediate family member, or a known close associate, of such a person'.*

EU Directive 2006/70/EC sets out the implementing measures for defining PEPs and so provides a definition of positions that constitute prominent public functions. That definition includes:

- heads of state, heads of government, ministers and deputy or assistant ministers
- members of parliaments or similar legislative bodies
- members of the governing bodies of political parties
- members of supreme courts, of constitutional courts or of other high-level judicial bodies whose decisions are not generally subject to further appeal, except in exceptional circumstances
- members of courts of auditors or of the boards of central banks

- ambassadors, charges d'affaires and high-ranking officers in the armed forces
- members of the administrative, management or supervisory boards of state-owned enterprises, and
- directors, deputy directors and members of the board or equivalent function of an international organisation.

Public functions exercised at lower levels should normally not be considered prominent and therefore not a PEP. However, when their political exposure is comparable to that of similar positions at national level, for example, a senior official at state level, a risk-based approach is an acceptable practice when making a determination on whether to treat them as a PEP.

Firms are required to take a risk-based approach to PEPs and need to:

- have appropriate risk-based procedures to determine whether a customer is a PEP
- obtain appropriate senior management approval for establishing a business relationship with such a customer and perform ongoing monitoring – usually annual reviews
- take adequate measures to establish the source of wealth and source of funds which are involved in the business relationship or occasional transaction, and
- conduct enhanced ongoing monitoring of the business relationship.

2. The UK CASS Regime

Learning Objective

5.2.1 Know the principles and activities covered within CASS 6, CASS 7, CASS 8 and CASS 9 and their impact upon transfer agencies

5.2.2 Know the relevance of the following CASS features: CASS mandate definitions and purpose; cash models; DvP exemption

5.2.3 Know the relevance of the following CASS features: prudent segregation and record keeping; client money reconciliation methods; client money statements, frequency and content; intraday cleared funds

5.2.4 Know the relevance of the following CASS features: CASS oversight and SMF 18/22; the role of the auditor; Financial Reporting Council (FRC) audit standards; preparing for audits; CASS resolution pack; policy documentation

2.1 Client Money and Assets

Although there has been regulation in place for a number of years, the protection of client money and assets became a focus following a number of high profile firm failures specifically within the banking world. As a result, the Financial Conduct Authority (FCA) has introduced certain standards to govern the conduct of investment firms when handling client money and safe custody assets.

Client money can be defined as money that a firm holds, or receives, on behalf of a client. To expand, in respect of the TA operation, this will usually be in the form of cheques, direct debits or electronic transfers. In addition to the receipt of monies, it will include amounts held by the firm, and which are not immediately due or payable on demand to the firm for its own account.

All client money and custody assets which are held or controlled by an authorised firm on behalf of their customers are client assets.

When operating TA business, it is critical to ensure the appropriate levels of protection are in place when clients transact investments. By absolute adherence to the rules, it creates an assurance within the marketplace providing clients with the confidence that their assets will be protected in the event of an insolvency in the firm holding those assets.

The key purpose of the Client Assets (CASS) Rules is to ensure that if the firm were to become insolvent, investors' money is returned to them in a timely manner, and this is achieved by ensuring that any client **safe custody assets** and client money that the firm may hold on behalf of its clients are clearly distinct from any assets that the firm may hold for its own account – and that when a firm says it holds a given asset (or sum of money) for a particular client that it does indeed hold that asset/money. This is important for overall market confidence, as it protects investors against losses.

Protection of client assets is achieved by ensuring that funds are:

- segregated (ensuring a clear separation between client money and corporate money)
- reconciled (ensuring that the firm does hold the assets it thinks it does), and
- allocated with clear and accurate records to ensure ownership of funds are detailed in full.

CASS regulations are complex, highly technical and, in some cases, open to interpretation. There are four main sections within the rules that we will deal with in the following text:

- **CASS 6** deals with controls of the safe custody of assets.
- **CASS 7** provides the controls around the handling of client money.
- **CASS 8** confirms the handling and control of mandates.
- **CASS 9** sets out the requirement to report to clients via a statement.

2.2 CASS 6

CASS 6 outlines the rules and guidance that should be followed to ensure that any applicable investor assets are segregated from those held by the firm. CASS 6 applies where a firm is safeguarding assets on behalf of its investors by using a custodian and as such the register maintained by the TA is known as the sub-register, while the custodian holds the main register.

An investment trust savings product is a good example of a sub-register and where CASS 6 should apply. The investor contracts with the firm, market dealing is then performed under the firms' **nominee** with the custodian and it is that nominee who will appear as the holder on the main register. The TA will maintain the underlying investor transactions within the books and records of the sub-register.

Safe custody reconciliations must be performed at least monthly by the TA. The books and records are used to support these reconciliations in one of two ways:

- **Internal custody reconciliation** – where a firm's systems are designed so that the investor and nominee records are separately maintained. One focusing on the firm's (nominees) aggregated holding and each investor's entitlement.
- **Internal system evaluation method** – where the completeness and accuracy of the data is evaluated by a process by reviewing the internal systems and controls. This should include whether the controls have identified and resolved any discrepancies.

External custody reconciliation which compares the records maintained by the TA against the holdings provided by the external party must also be performed at least monthly.

2.3 CASS 7

CASS 7 details the rules and guidance that should be followed to ensure that cash held for investors is protected and kept segregated from any cash held by the firm.

There are two approaches to segregating client money:

- **Normal approach** – for any sums that the firm considers would be client money when received, ie, investors' cash, these are paid directly into a client money bank account and not via a corporate account. It should be held there until fiduciary duty has been discharged (eg, the investor has received cleared funds or the monies have become due and payable to the firm as per the settling of a deal).
- **Alternative approach** – in some situations, the application of a normal approach can result in excessive risk and could even result in less protection for the client. In recognition of this, the alternate approach permits investor cash flows via the corporate account where it will need to be reconciled daily and the firm will then decide how much needs to be segregated at the close of business, moving any monies as part of the next day's process.

Firms will arrange to open a client money bank account to segregate the assets from those held by the firm. The bank account must include 'client money' in the title and must have an acknowledgment letter from the bank, detailed as prescribed by the FCA, between the firm and the bank which ensures that the bank has no claim to the funds to settle any debts of the firm. An acknowledgement letter must be in place prior to transacting any business through this account.

All transactions executed across a client money bank account must be recorded within the books and records that the TA maintains. This recording should be completed without any undue delay and must provide sufficient information to identify the underlying investor.

The books and records are used to support the client money reconciliations:

- a daily internal reconciliation of the firm's own records of client money, and
- a regular (at least monthly) external reconciliation between the firm's own records and those of the third parties holding the money (eg, against a bank statement) – this is typically completed after the internal reconciliation.

2.4 CASS 8

CASS 8 covers the requirements of firms that receive and retain authority from an investor and enables firms to control the assets or money of an investor they hold with another party. This is known as a mandate.

CASS 8 is relevant to firms that accept direct debit instructions that permit the firm to collect proceeds direct from the investors bank account to settle deals or pay fees. All CASS 8 mandates should be included in an up-to-date list which outlines:

- the nature of the mandate, eg, direct debit
- the purpose of the mandate, eg, investment
- how the mandate was obtained, eg, post, digitally, telephone
- name of the investor
- the creation date of the mandate.

The TA should ensure that the mandate conditions are executed accurately, recording all transactions that have been entered under each mandate and maintaining a record of any amendments or corrections which should be retained and made available for supporting audits.

2.4.1 CASS Mandate Definition and Purpose

The CASS 8 mandate rules apply in the situation where a firm receives and retains a 'means' by which it can issue instructions that affect assets of a client (or the indebtedness of the client) that the firm itself does not hold.

For example, if the firm directly instructs a collection from a bank account in the name of the client, CASS 8 rules apply to the 'means' that enables that collection (ie, the bank account details retained by the firm) and the control/use of that 'means' by the firm, while CASS 7 would apply as normal once the firm has received that money. Importantly, the CASS 8 rules are not applicable where a firm is making outbound payments, as such activity would be subject to CASS 7. For example, CASS 8 is not applicable where the firm uses the client's bank account details in order to effect payments to the client.

Similarly, if the firm holds an authority that enables it to re-register or transfer some asset held for the client outside of the firm's own accounts, the CASS 8 rules apply to the 'means' by which the firm could issue such instructions – with CASS 6 rules applying as normal from any point at which the asset is received into the firm's safe custody service.

The primary risks that CASS 8 is designed to mitigate are those where the client provides some active operational mandate to one firm, enabling it to instruct the movement and transfer of assets between accounts of the client – effectively enabling the firm to transact on behalf of the client without bringing client assets within the firm's own segregated accounts.

However, firms recognise that the drafting of the rules means that simpler processes – such as the periodic collections of cash sums from the investor's bank account under the direct debit mechanism – can also be subject to the CASS 8 rules.

2.4.2 When Does a CASS 8 Mandate Exist?

CASS 8.2.1R records five conditions that must be satisfied if the 'means' obtained by the firm are to constitute a CASS 8 mandate. Note that if the firm's arrangements are such that any of these five conditions are not met, the 'means' in question will not be defined as a CASS 8 mandate (even if it is sufficient to enable the firm to complete some operational process).

Condition	Implication
1	The 'means' are obtained from the client, and with the client's consent. (Ie, if the client is unaware that the firm has the 'means', those 'means' would not constitute a CASS 8 mandate).
2	If the firm is performing insurance mediation activity, the 'means' must be in written form. Note that for other forms of designated investment business a CASS 8 mandate may be in non-written form. (Ie, even if an insurance mediation firm collects a 'means' in non-written media, those 'means' would not constitute a CASS 8 mandate).
3	The 'means' must be retained by the firm. (Ie, if the firm arranges its affairs and records so that it does not make an enduring record of the 'means' once the relevant instruction has been issued, there would be no CASS 8 mandate created).
4	The 'means' must enable the firm to issue an instruction to another person, the result of which instruction would be to transfer or move an asset held by that person on behalf of the firm's client. (Ie, any 'means' that do not enable any of these types of outcome would not be a CASS 8 mandate).
5	The person receiving the firm's instruction (from condition 4), would act on that instruction without referring to the client. (Ie, if the third party would obtain confirmation from the client of any instructions issued, that 'mean' does not constitute a CASS 8 mandate).

Guidance in CASS 8.2.3G(1) confirms that if the firm performs a transaction immediately upon receiving the 'means' from the client, and having done so deletes or destroys the 'means' (rather than retaining the specific information), Condition 3 is not satisfied and consequently no CASS 8 mandate exists.

2.5 CASS 9

CASS 9 reconfirms to AFMs their obligations on the requirement of reporting to clients that are included in the **Conduct of Business Sourcebook (COBS)**.

Where a firm holds client money for an investor, as is detailed within CASS 7, it must provide a statement under CASS 9. Client money statements should be issued at least annually, and the TA should have the systems and processes in place to either reprint or create an ad hoc version of the statement within five business days from the request of the client. Other regulations may lead to a requirement to issue statements more regularly if those regulations are relevant to the AFM's business model.

The statement must be sent in a durable medium and it is now more common practise for the AFM to include the client money statement as part of the holdings statement, reducing costs and providing a better customer experience. Additionally, an AFM may charge for producing an ad hoc statement, but this charge must correspond to the costs incurred by the firm in producing it.

2.6 Record Retention

Overall, CASS record retention requirements are that records are retained for five years after they were created or last updated. CASS 8 includes a specific record retention obligation (CASS 8.3.2G R), which relates to the records that the firm is required to maintain in respect of its use and control of the CASS 8 mandate held. CASS 8 does not include any specific record retention obligation in respect of the 'means' that constitutes the CASS 8 mandate itself.

In respect of the 'means', the firm must only retain that information for as long as it has a valid business purpose to do so (per data protection rules), ie, at any point the firm may conclude that it is no longer appropriate to retain a given 'means'. Each firm will reach its own decision as to the circumstances in which 'means' data will be deleted – and having deleted the 'means' data, the CASS 8 mandate ceases.

Where the firm was using the CASS 8 mandate in respect of MiFID business, CASS 8.3.2G R requires the firm to retain records of the control and use of that CASS 8 mandate for a minimum of five years after the firm ceases to hold that CASS 8 mandate. For non-MiFID business (such as a firm acting as AFM) this minimum period is one year after the firm ceases to hold that CASS 8 mandate. The firm's documentation of 'other records and internal controls' noted above must be retained for the relevant period after the firm no longer holds a 'means' that satisfies the conditions listed in the table above.

The 'up-to-date list' need no longer include a 'means' that the firm no longer holds (as that 'means' is no longer a CASS 8 mandate). However, CASS does permit the firm to continue to include such items on its 'list' until the expiry of applicable record retention periods – provided the firm clearly distinguishes ceased mandates within 'the list'.

As noted above, the firm might generate and retain its 'list' periodically – in which case the fact that the CASS 8 mandate was previously held would simply be demonstrated with reference to those prior 'list' files. Where this approach is employed the frequency that the list is generated is likely needed to be daily, where the list is derived from underlying records which are maintained independently of the list.

2.7 Delivery versus Payment (DvP) Exemption

As we have seen above, CASS rules require that all money should be received into a **client bank account**; however, some firms may elect to employ an exemption which allows money to be received into their corporate bank account on the condition that it is either due and payable to the firm or placed into a client bank account within one **business day** of receipt. This would require client consent which is typically obtained by noting its use in the fund prospectus and the client signing an application form accepting the terms of the prospectus.

The ability to utilise this exemption is limited to AFMs of collective investment schemes (CISs). However, as it creates an exposure to client loss if the firm was to fail before the settlement was fully completed an incoming insolvency practitioner may not be able to settle the transaction, the investor's consent in writing must be obtained before a firm can use the exemption.

In the case of an investment deal, money will be paid into the firm's corporate bank account. If the payment can be applied to a specific investment this should be done; at which point a decision will be made as to whether the payment for the investment will become due and payable to the firm within one business day of receipt. If the answer is yes, the money may remain in the corporate account. If the answer is no, the money must be moved to a client bank account by close of business on the business day following receipt.

2.8 Prudent Segregation

In some instances, it may be determined that there is an exposure to the risk that in the event of insolvency, the total amount of segregated client money may not be sufficient to pay each client the due amount.

The CASS rules therefore permit a firm to protect their clients against this risk and place corporate money into the client money bank account. This is known as **prudent segregation**. It may only be used when the firm considers this a reasonable means of protecting the client. Prudent segregation may also be used to protect client assets where risks in business as usual processes cannot be mitigated through controls.

For a firm to utilise prudent segregation, it must have a detailed and defined policy stating the risks in which it would determine prudent segregation would become applicable, why the firm believes that prudent segregation is a reasonable means to mitigate these risks and how the amount of segregation is calculated for each identifiable risk and should be individually assessed. Such risks may include the following:

- daily client money calculation/intraday review – physical cash movement into client money bank account is not made/made incorrectly as a result of either the firm's failure or the bank's failure
- incorrect payment, eg, incorrect value/payee details/value date
- an order is contracted on behalf of the wrong client
- system failure results in prolonged **shortfall** in the client money account or the firm is unable to complete the daily client money calculation
- cheque/direct debit receipts failing to clear and are returned unpaid, or
- the client money pool has a **shortfall** due to fraud or theft.

Following the risk assessment, firms should conclude which risks, if any, cannot be mitigated through controls/processes and determine how much of the firm's money would be required to cover these risks and arrange for that money to be held as prudent segregation.

If a new risk is identified, which was not previously been considered, firms will need to reassess the prudent segregation policy and amend it accordingly, with immediate effect.

Once applied, for any increase or decrease in the amount of prudent segregation in place, the prudent segregation record would include:

- the outcome of the calculation of the prudent segregation amount
- the amount paid into or withdrawn from the client money bank account
- why the payment or withdrawal was made
- confirmation that either:
  - the payment was made in accordance with the firm's existing policy, or
  - the firm's policy will be amended considering the circumstances
- confirmation that the payment or withdrawal has been made in accordance with the relevant rules, and
- a current total of prudent segregation money.

The prudent segregation record must be retained for five years after the firm ceases to retain money as client money.

2.9 Client Money Reconciliation Methods

The purpose of the internal client money reconciliation is to check that the firm has segregated the correct amount of client money the previous business day, as per its internal client money records, and is able to promptly determine the total held for each investor.

The daily client money reconciliation is completed by comparing the client money resource value against the client money requirement value. Both the resource and the requirement figures must be derived from an internal record; if the firm is relying on external information (such as bank statements, online access to a banking system, or other third-party confirmations) to source these figures, then this would be deemed to be a non-standard method and would require an auditor approval.

The client money resource is an internal record of what is held in the client money bank account (what the firm believes it has protected) and is often referred to as the cash book. It is typically maintained as part of the general ledger system for the firm's investment trading.

The client money requirement is calculated by using one of two methods:

- **individual client balance (ICB) method**, or
- net negative add-back method.

2.9.1 Individual Client Balance (ICB) Method

The ICB method requires a firm to calculate its client money requirement by reference to how much the firm should be holding in a client bank account for each of its individual clients with a positive balance, across all products and accounts.

A firm may calculate either on ICB for each client, based on the total of the firm's holdings for that client or a number of ICBs for each client, for each product or business line the firm operates for that client. Balances held with a third party should be included when calculating the requirement.

Each individual client balance for a client should be calculated as follows:

The total of:

1. free money (sums held for a client)
2. sale proceeds due to a client, and
3. the cost of purchases.

Less:

4. money owed by the client for unpaid deals, and
5. proceeds remitted to the client for sale transactions.

The calculation of an ICB for each client should include the following:

6. dividends received
7. interest earned and allocated
8. stock lending fees and other payments received and allocated
9. money segregated to cover an unresolved shortfall in safe custody assets
10. prudent segregation
11. cheque payments drawn that have not yet been presented, and
12. any unallocated or unidentified money considered prudent to segregate as client money.

2.9.2 Net Negative Add-Back Method

The requirement figure (ie, what the firm should have protected) used in the net negative add back method is calculated by starting with the resource value which should include the following:

1. unallocated client money.
2. unidentified client money.
3. prudent segregation.
4. cash segregated for the funding of stock shortfalls, and
5. cheque payments drawn that have not yet been presented.

Any investor that reflects as an overall negative position with the account, ie, where a payment has been made which does not match with a prior cash receipt, is then added back to the client money requirement. This is because that investor has effectively been paid from the protected balance in the client money bank account, which is allocated to other investors.

The aim is to ensure that the total requirement amount is fully protected on any given business day. This means that if the resource is higher than the requirement, the excess amount needs to be transferred from the client money account to a corporate account and, if the resource is lower than the requirement; the shortfall must be funded by transferring money from the corporate account to the client money account. All excesses and shortfalls must be fully explained by the TA with supporting detail.

The TA will repeat the daily client money reconciliation, and record the prior funded negative balances within this until such a time as the net negative add-back is no longer needed, eg, a client payment is returned or rectified through permanent funding.

2.10 Intraday Cleared Funds

CASS rules should be understood from two important perspectives:

- the recording of money and allocations within the books and records of the firm, and
- the actual movements of physical money between bank accounts (whether those are both accounts of the firm, or whether the firm is either receiving or paying money between one of its own accounts and the bank account of some other party).

The term 'intraday' simply relates to things taking place during the working day (in contrast to the position being established at 'close of business') and, while it is not technically a CASS term, there are situations in which the phrase gets attached to CASS discussions.

In terms of CASS rules, certain obligations specifically arise in respect of the close of business position (for example, reconciliation rules, the identification and resolution of shortfall and excess positions). There are, however, some obligations under the CASS rules that apply when they occur (such as the obligation under the 'normal approach to segregation' that any client money being received by a firm should be received directly into a client bank account). Receiving such money into a corporate account would be a breach of the normal approach to segregation (unless some other CASS exemption can be applied to that receipt). It is not the case that a CASS rule applies in different ways to an 'intraday' position rather than a 'close of business' position; what matters is the point at which a given rule applies to a given movement and/or internal posting.

The term 'cleared' relates to a different aspect of cash processing – specifically that the firm must recognise the point at which money is declared by its bank as being 'available for use'. Cheques traditionally have the longest clearance period, although the introduction of cheque image clearing is expected to reduce the time. CASS rules highlight that a firm should not permit a payment of client money allocated to a given client if that money is not yet 'available for use' (as doing so would effectively breach the statutory trust noted above, as the physical movement of money would effectively relate to another client's money).

It is, therefore, important that the firm's processes and controls recognise the clearance periods agreed with its bank for each type of payment method supported to prevent money being used for a client before that client's allocated balance is available for use.

2.11 CASS Oversight

There is a requirement for a firm meeting the criteria for a CASS medium or CASS large firm to appoint a SMF18 or SMF22 with appropriate skill, expertise and experience. A CASS small firm must allocate a director or senior manager with responsibility for oversight of CASS activity.

The following highlights the typical oversight arrangements as required of an AFM who has appointed a TA and the services provided to help the AFM meet its ongoing CASS responsibilities:

CASS governance	A firm must have effective governance and oversight over the CASS processes outsourced to the TA. As best practice the firm must establish a specific CASS Oversight Committee and ensure that the firm has sufficient CASS representation on other management committees where business decisions are made which impact on the CASS control environment. Additionally, firms should be able to demonstrate appropriate senior management engagement on CASS matters at board level.
Communication	Due to the CASS requirement to report material breaches promptly to the FCA it is important to have transparent, timely and effective communication/ escalation between the firm and the TA.
CASS oversight committee	A firm should establish a formal CASS oversight committee, which should be attended by the SMF18. The committee should have a term of reference and it is recommended this includes an assessment of key performance indicators (KPI) on CASS functions, including those outsourced to a TA. As a minimum, the KPI data should include the number of CASS breaches, CASS rules breached, client money balances impacted, trends month on month and root cause analysis, together with actions taken to rectify breaches. Any significant CASS issues, including those identified at the TA, should be escalated up to the CASS oversight committee and discussed under a standing agenda item.
CASS documentation	It is recommended that firms have in place appropriate CASS policies. As a minimum these policies should explain: • which CASS functions the firm has outsourced • which TAs are utilised for different business areas • the governance and BAU oversight arrangements. This is to ensure a firm is able to clearly explain a TA's operating model and procedures relevant to its outsourced CASS functions. Additionally, it is recommended that firms have CASS policies for client money diversification, frequency of reconciliations and prudent segregation. It is also important to ensure that the TA understands these policies if it performs the relevant CASS function/control.

Typical TA Service and Oversight

Regular client service review meetings	Regular service review meetings are typically scheduled with a TA provider. The frequency of meetings should be considered in relation to the risks and complexities within the operating model, and participants should include those with influence over the decisions and actions carried out. Terms of reference, agendas, minutes and progressed actions evidence the operation of such meetings. Any aspects of change should be discussed at this meeting and supported via further business change meetings where deemed appropriate
Scheduled onsite visits	A firm should be able to articulate working knowledge of the TA. Regular visits to operating locations are key to ensuring full understanding of CASS controls and processes, flows of client money and governance arrangements.
Process and controls documentation	TA providers develop and share information (such as procedures, record keeping, cash flow diagrams) to support and share knowledge of the outsourced services provided. These documents should cover key aspects of the CASS rules such as method of reconciliation, frequency of reconciliation, shortfall funding, resolution plans and risk/controls framework. TAs are typically willing to share risk and controls self-assessment information, and key audit reports such as the International Standard on Assurance Engagements (ISAE3402).
Management information (MI)	Meaningful MI regarding transaction volumes, investors, breaches, errors, and complaints can be provided to enable the identification of trends, themes, risks and controls. A firm should ensure it analyses this information and demonstrates how the MI is influencing the way the business is run, oversight is applied and where any issues or breaches are deemed material report accordingly to the FCA.
Reconciliations	A firm should expect reconciliations to be completed at the agreed frequency, where applicable, and it is recommended thorough reviews of the reconciliations are performed to identify, for example, issues, themes and risks. As a result of reconciliation oversight, policy-based decisions can be monitored, for example, regarding prudent segregation or client money diversification, and potentially highlight the need for any reconsideration of such policies. A firm should consider the ability to recreate reconciliations from source data and identify/distinguish clients holding client money to ensure effective recovery planning can be implemented in the event of an insolvency or business continuity issue at the TA.
Training	A firm should be able to review and assess the suitability of an outsourced provider's CASS training material and the audience to whom the material is delivered to (operational staff and management/board members). This should be in addition to ensuring its own oversight staff and management/board members are equally trained to understand how CASS impacts their business and the risks mitigated.
Attestations	The use of attestations within the industry is a method of ensuring adherence or accountability within an outsourced provider where shared evidence may not be an option.

There are several industry bodies that work together to help TAs ensure that the CASS rules are followed correctly, and the TA Forum provides substantial guidance and best practice information on its website. The TA Forum information has been created by TAs collaborating to define best practice and liaising with auditors to ensure the recommendations meet audit requirements.

2.12 CASS Audit

The Financial Reporting Council (FRC) is the body responsible for setting the standard for CASS audit reviews. The FRC's mission is to promote transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the competent authority for audit in the UK, the FRC sets auditing and ethical standards and monitors and enforces audit quality.

Every firm that holds client assets is required to have a specific annual audit of the arrangements under which they are held. The auditor reports directly to the FCA on its findings. In order to carry out this audit function effectively, the auditors will need to understand details of the firm's business model, including the nature of the services it provides, what sort of transactions it does and how they are settled, any inter-group relationships and the role played by any third party administrator or custodian.

The Supervision Manual (SUP) determines whether a where the firm holds client assets and should complete a 'reasonable assurance client assets report' or 'limited assurance client assets report' when it is entitled to hold but does not, or if there are no **client asset** provisions

The CASS auditor will also consider:

- any CASS breaches and the risk to client assets
- the impact of any changes to IT or reporting systems, and
- the impact of regulatory changes.

During the audit, the auditor will conduct a risk assessment, having considered the firm's own risk assessment, as to whether the firm has maintained systems adequate to comply with the CASS rules, and has complied with the rules. It will conduct this assessment against each of the CASS rules.

2.12.1 Audit Lifecycle

Testing of controls is required to be performed during the audit lifecycle and there are six specific steps in the audit process that should be followed to ensure a successful audit.

1. Preparing an audit plan with scope of the audit.
2. Scheduling an open meeting to introduce the audit team and ratify scope.
3. Conducting onsite fieldwork with process walkthroughs.
4. Sample requests selected items.
5. Follow up questions on exceptions and drafting the report.
6. Setting up a closing meeting.

There are three main types of internal controls:

1. **Detective internal controls** – detective internal controls are designed to find errors after they have occurred but can also be used to prevent errors having an external impact. They also identify where errors have occurred so that these can be corrected in a timely fashion.
2. **Preventative internal controls** – these can range from system controls such as dual re-key to operational checklists to ensure tasks are completed.
3. **Corrective internal controls** – these operate to ensure that when an error has occurred this is corrected, promptly, accurately and fairly. This may also result in a process or procedural change being implemented.

During the audit, the firm will meet key members of staff in the firm/TA who perform the key CASS controls including detailed presentation in operational processes, procedures and the CASS control framework. This will cover the main cash and asset flows of the CASS firm and all key CASS areas.

2.13 CASS Resolution Pack

At the beginning of the chapter we considered the key CASS operational processes (segregation, allocation, and reconciliation). In the case of a firm's insolvency and to prevent clients being exposed to loss, there is a requirement to maintain a **CASS resolution pack (CRP)**. This provides detail for an incoming insolvency practitioner to return client money and safe custody assets (client assets) more quickly following an investment firm failure.

The CRP must include various elements, such as:

- Confirmation of all bank accounts and custody accounts holding client money and client assets (including the legal agreements for the operation of those accounts).
- The firm's procedures for the management, recording, and transfer of client money and client assets (so that the insolvency practitioner could instigate a collection and distribution of the assets).
- Information regarding the key systems relevant to CASS matters, including any necessary instructions for operating those systems.
- Internal policy materials relevant to the firm's records and how they should be interpreted.
- Information on how to retrieve copies of the most recent CASS reconciliations performed (so that the insolvency practitioner can assess the value of claim held by each client).
- Details of the key individuals within the firm who are 'critical or important' to the operational functions relating to the firm's CASS 6 and CASS 7 obligations.
- Key contracts with third parties.
- Client agreements (particularly any specific agreements by which the client acknowledges the use of any CASS exemption).

All firms holding client money or client assets must establish a CRP. Firms are classified into CASS small funds, CASS medium funds, and CASS large funds according to the highest value of client money and client assets held in the prior year. This can be determined by the production of a client money and asset return (CMAR) return which provides the FCA a monthly overview of a company's client money and client asset positions and holdings, enabling the regulator to make regulatory interventions in relation to client assets on a timely, firm-specific or thematic basis.

3. Registration

Learning Objective

5.3.3 Know the registration process with respect to trusts

5.3.4 Understand the entitlement to inspection

Each fund must maintain an up-to-date and accurate record of all unitholders and has a regulatory duty to ensure the records are complete. The register must contain:

- the name and address of each unitholder (for joint unitholders, no more than four need to be registered)
- the number of units of each class held by each unitholder
- the date on which the unitholder was registered for units standing in their name
- the number of units of each class currently in issue.

The fund manager must make the register available for inspection free of charge in the UK, by or on behalf of any unitholder (including the manager or authorised fund manager), during office hours. It should be noted that the register is made up from the data held on the TA system. The system used does not necessarily directly represent the register, but it must be able to produce the data that makes up the register to meet the fund manager's regulatory requirements.

3.1 Power of Attorney (POA)

Learning Objective

5.3.1 Know regulation and best practice in relation to powers of attorney

A power of attorney (POA) is a mechanism which lets the **principal** or donor (giver) give, or delegate, to the donee (the recipient) the power to do certain things on their behalf. POAs are registered with the Office of the Public Guardian (OPG) which is a UK government agency with responsibility for POAs. There is a wealth of information online regarding the OPG.

Typical powers granted by the POA include the power to:

- sign documents on behalf of the donor
- handle their financial affairs – for example, buying and selling investments, signing cheques and making bank transfers
- make purchases on their behalf, and
- dispose of their property, including by making usual gifts to third parties.

A POA will not allow the donee to make very large or unusual gifts, unless the courts specifically approve it. Nor will it empower them, to make non-financial decisions for the donor – for example, about their personal care or medical arrangements.

A POA must be signed as a deed by the donor; or if not signed by them, signed at their direction and in their presence, and in the presence of two witnesses.

- a **specific POA** – this only lets the donee act on specific occasions or in respect of specific property; it is therefore the most limited kind
- a **general POA** – this gives the donee a general power to act on behalf of the donor – the deed may, however, state certain limitations on this, and
- a **lasting POA (LPOA**) – this is a specialist form of POA that replaced the enduring power of attorney (EPOA).

A POA may be executed for a number of reasons. For example:

- someone who expects to be travelling for long periods may execute a POA so that a trusted relative, friend or adviser can handle their financial affairs in their absence
- someone in poor health may delegate powers so that someone else can look after matters while they are recuperating
- someone may delegate power to handle their financial affairs simply because they do not want to be troubled with managing their own bank accounts and other financial affairs.

Once a POA has been put in place, it can be terminated at any time using a Deed of Revocation of POA.

3.1.1 Specific/General POA

An individual can choose to grant their attorney authority to undertake only specific tasks on their behalf, for example, the renewal of a car insurance premium or managing a specific bank account and is most often used by individuals who will be away travelling for a period of time or by those whose mobility is affected and need to appoint someone who can do things on their behalf.

A general POA will become automatically void in the event that an individual loses their mental capabilities. Accordingly, a general POA is often not suitable for managing the affairs of the elderly or mentally ill.

3.1.2 Lasting Power of Attorney (LPOA)

For those individuals who are either elderly or are losing their mental capabilities, an LPOA should be used as this will continue to be valid once a person succumbs to the mental illness, providing that it is registered with the Court of Protection. The LPOA replaced what was an enduring power of attorney (EPOA) in 2007 and is noted here as, while new ones cannot be registered, they can continue to be in force and acted upon.

An LPOA can only be given by someone who has the mental capacity to do so. An LPOA also has no expiry date, however, it will automatically end in the following circumstances:

- the individual or the attorney dies
- the individual or the attorney becomes bankrupt
- a marriage or civil partnership between the individual and the attorney is dissolved or annulled
- the attorney(s) lack the mental capacity to make decisions
- the power is disclaimed (or rejected) by the attorney, or
- the Court of Protections decides the attorney is not carrying out their duties.

The POA does not end in the above circumstances if there is another attorney left to act or there is a replacement attorney. If more than one was originally nominated, the POA to make decisions for an individual is transferred automatically.

3.2 Management of Deceased Investors

Learning Objective

5.3.2 Know the management of deceased investors, including small estates

3.2.1 Registering the Death of an Investor and Notifying the TA

When registering a death, there are differences between firms as to their acceptance as to whether the original or certified copy of a death certificate is acceptable.

For death certificates and grants some firms may require original documents; others may accept original or certified copies. Firms that accept certified copies may also have differing requirements for that certification, ie, who can certify the documents.

When processing a firm must be clear when using terms such as 'original or certified copy' of a death certificate in their communications. The 'original' certificate is the entry in the death register, which is completed in ink and remains in the General Register Office (GRO) as a record, for perpetuity, from which subsequent certified copies can be obtained when required. Accordingly, a death certificate obtained from the GRO is referred to as a certified copy on the document itself.

For most purposes and where the deceased is the only holder on the account it is common practice to accept either an original certified death certificate as provided by the General Register Office or a copy of that document certified by a solicitor or Independent Financial Adviser (IFA).

However, most firms will only accept an original certified death certificate where the deceased owned the account with another person (ie, a joint account) since for a joint account the death certificate is the only documentation required to complete the transfer to the surviving holder(s).

3.2.2 Small Estates Process

Firms should not be seen promoting their small estates process over the alternative of obtaining a grant, but it should be made clear that it may not be necessary to obtain a grant purely for the purposes of accessing a low value account.

A small estates policy defines the circumstances when the firm is prepared to release the proceeds of a deceased investor's account(s) on the instruction received from the personal representatives without sight of a grant. While there is no legal requirement for the personal representatives to obtain a grant, the personal representatives may be unable to perform their role without it.

There are some assets that do not require a grant to affect a transfer because the required transfer happens automatically as a result of the way that the deceased held the assets and not as a result of the instruction from the personal representatives.

There is no common definition of a 'small estate' and the policies operated by firms will differ.

The benefit to a firm of adopting a small estates policy might include making the process:

- more efficient for the firm, and
- as painless and practicable for the personal representatives of the deceased.

A firm is not required to have a small estates policy. In the absence of a small estates policy, the firm would require personal representatives to provide a grant. The use of a small estates policy will expose the firm to the risk that it makes payment of the investor's assets to someone other than the party with the legal entitlement. The potential cost to the firm is the cost of meeting the claims of the legal representatives.

Each firm will determine their policy and documentary evidence requirements having regard to the risks and benefits and their risk appetite.

3.2.3 Providing the Additional Permitted Subscription (APS) Value for an ISA

The APS rules are covered in chapter 3, section 5.1.7 of this workbook. However, it is worth noting that there is no requirement in the ISA rules to provide the value of the APS allowance (or details of its availability and use) other than when requested by the deceased's spouse, civil partner or another ISA provider as part of the transfer of the APS allowance to that provider.

If the firm offers in-specie asset transfers to a beneficiary outside of an ISA, firms are required to advise the personal representatives of that option. Firms may, however, find it difficult to justify notifying the personal representatives of the option of an in-specie transfer outside of an ISA without also advising a spouse or civil partner of the availability of the APS allowance (in-specie or by cash) with the same firm (if accepted) and other ISA providers.

The HMRC ISA guidance for managers' states:

> *'Where the firm decides to provide the APS allowance value as a matter of course this can be achieved at the same time as the value of the account(s) is provided at the date of death and when the value of the account(s) at closure is provided (when the APS allowance value may be different to that provided earlier)'.*

Initially, the value of the APS allowance is always the value at the date of death until the account is closed when the value may change or have changed because:

- it has been transferred to another provider, ie, the APS allowance with the originating provider is now zero
- the APS has been used with the deceased's ISA provider when the value will be reduced to the extent is has been used by that provider
- when neither of the first two bullets are true but not otherwise, and for deaths on or after 6 April 2018, the value of the APS can be increased (but not reduced) to the closing value of the continuing ISA.

3.2.4 Anti-Money Laundering (AML), Sanctions and Adverse Media Screening

Identity checks, PEP, sanction and adverse media screening may be made on:

- personal representatives
- applicants to the small estate procedure, and
- any payee/transferee

In addition, verification of any new bank accounts should be completed prior to transferring any assets or monies, except where a grant is provided. A payment can be made:

- in the form 'executors/administrators of XXXXXXX' or direct to a bank account confirmed to be in that name
- to the client money bank account of a law society registered solicitor or FCA-regulated firm where that firm is acting as executors/administrators for the deceased.

A grant should not be used for any other part of the AML/customer due diligence (CDD) process for any other party or for any reason.

3.2.5 Dealing in the Assets During the Period of Administration

Management companies will also have a policy with regard to whether they will permit:

- dealing in the assets (on the instruction of the personal representatives) in the period of administration of the estate
- paying out the proceeds or transferring assets at any point other than the point of closure.

It is for the firm to decide whether or not to permit the personal representatives to deal in the assets of the estate in the period of administration and in doing so will consider:

- the demand for such a service
- the fact that the firm might struggle to market the service without a detailed explanation of why the service may be beneficial (eg, for tax avoidance)
- the presence of additional options may confuse more personal representatives than the options will benefit
- the revenue opportunity available to the firm

- the potential for asset retention from the activity
- the additional work for the firm since it may extend the period of administration and increase the complexity of the reporting required from the firm. If the volume is low, then the attention that the firm will apply to automation and detailed procedures is likely to be smaller than ideal, increasing the risk of error, and
- a firm is normally motivated by the need to reduce (not extend) the period of administration since for most personal representatives the desire is to finish rather than seek to benefit by extending the period of administration.

3.2.6 Advance Payments

Depending on the circumstances of the representatives of the estate, the TA may receive a request for advance payments, typically to meet the costs of the estate, eg, funeral or an inheritance tax liability. The acceptance of this will be agreed on a need-by-need basis but most importantly, prior to any authority to make that payment.

3.2.7 Sole Holder

Where the deceased investor is the sole account holder, the 'death of an investor' process commences, starting with the 'notification of death' and completing when the deceased's account is closed. The accounts will be closed when the cash proceeds are paid away or the assets in the deceased's accounts are transferred to an account in the name of the beneficiaries.

For a sole holder account, the death of an investor process can be considered in three stages:

- Notification of death until just before the receipt of the original death certificate.
- Receipt of a death certificate until just before the receipt of the grant or small estates.
- The receipt of the grant or small estates form and ending when the deceased's account(s) close.

Sole Holder Process Stage

Stage 1 – Notification of death

Until a death certificate is received, there is no documentary proof of the death of the investor. Firms will not have authority to rescind any authority provided by the 'alleged' deceased and not have any new authority to accept instruction from anyone other than those that the firm held such authority prior to that notification.

The TA process may require either:

- any account that has been flagged to be dealt with any differently. This minimises the potential fraud risk and the risk of administrative error caused by identifying the incorrect investor

or

- process on a more risk-based approach considering:
  - the sending of communications
  - the continued collection of regular subscriptions
  - the payment distributions in accordance with the arrangements made with the investor as they would have prior to being notified of the death
  - other payments in accordance with the arrangements made with the investor as they would have prior to being notified of the death.

Stage 2 – Receipt of a death certificate and ending just before the receipt of the grant or small estates form

- Firms should record the date of receipt of the death certificate as the date of notification of death.
- Firms can release account details to the sender of the death certificate and provide the sender with the account values required for probate/IHT purposes.
- Firms should cease communications to the deceased investor and any third party where the firm received authority from the deceased to provide information or services to that third party. (Note that POAs cease on the death of a donor).
- Firms should cease collecting regular subscriptions.
- Firms should cease making any payments to the deceased investor.
- Firms should not make any payments to anyone (including the sender of the death certificate).
- Reinvestment of distributions can continue but some firms will hold the distributions as cash.

Stage 3 – Receipt of the grant or small estates form and ending with the closure of the deceased's account(s)

- Subject to completion of AML, sanctions and adverse media screening processes firms can dispose of the proceeds of the deceased investor's account in accordance with the instruction provided from those with the authority.
- Firms should provide account details of the account to the personal representatives to meet their information requirements with regard to taxation.

3.2.8 Joint Holder – Process

Where the deceased investor is a joint account owner, and not acting as a trustee, the death of an investor process commences with a notification of death and completes when the assets in the account(s) are registered in the name(s) of the surviving joint holder(s).

There are two main types of joint ownership of property:

- joint tenants
- tenancy in common.

The term 'joint tenants' means that each tenant owns the whole of the asset; whereas a 'tenancy in common' means that each tenant owns a specific share of the asset.

While each type of ownership is treated differently following the death of a tenant, joint accounts held with financial institutions are nearly always held as 'joint tenants'.

As joint tenants, the assets pass automatically (following receipt of acceptable evidence) on death to the surviving joint owner(s). If a will specifies what should happen to an asset that is owned as joint tenants this is ignored as the rules of joint tenancy override the will. Consequently, a grant is not required and if a grant is provided it does not provide any authority to the personal representatives named therein to act for the surviving joint owners. The surviving joint holder(s) are the only one(s) with this authority.

For a joint holder account the firm's death of an investor process can be considered in two stages:

- from notification of death until just before the receipt of the death certificate
- from the receipt of a death certificate until the assets in the account(s) are registered in the name(s) of the surviving joint holder(s).

Joint Holder Process Outcomes

As can be seen from the processing required for a sole holding, it is similar, if not the same for a joint holding until the assets are allocated to the surviving joint holders.

3.2.9 Communication to Personal Representatives

There are three key communication events:

- notification of death without a death certificate
- immediately after the receipt of the original death certificate
- the closure of the deceased sole account(s) or, for a joint account, the transfer of the assets to the surviving joint holder(s).

3.2.10 Notification of Death without a Death Certificate

Firms should limit the information provided to:

- the need for a death certificate
- the effect (if any) that the notification of death (without a death certificate) will have on the services provided by the firm in respect of the 'alleged' deceased investor's account.

For example, if the firm makes no changes to the services provided the firm should state that it will continue to send communications to the investor and collect subscriptions since the firm is obligated to perform these services in accordance with the agreement made with the investor and, at this point in time, no other party is authorised to provide any other instruction to the firm.

The firm should not provide any personal details of the account holder and not provide any details of the accounts.

3.2.11 Following Receipt of a Death Certificate

Where appropriate, firms might consider communicating the following information. For a joint account much of the content listed will not be necessary.

- Confirmation of receipt of the original death certificate and the firm's registration of the death.
- The immediate impact on the firm's service as a result of registering the death:
  - no further correspondence will be issued by the firm to the deceased
  - regular payments by direct debit will stop
  - a statement by the firm with respect to what happens to future income (if any) that is received on the account(s), eg, the income will be held as cash by the firm and distributed at the closure of the account(s) in accordance with the instruction provided by the personal representatives.
- Information about the account(s):
  - general information on the account
  - to transfer to a platform for the beneficiary
  - the value of the account(s) at the date of death
  - for ISA accounts the availability of the APS allowance to a surviving spouse or civil partner of the deceased
  - the options that the firm provides to disperse the proceeds:
    - to sell the investments and make the proceeds available to a designated person by bank transfer and (if offered) by cheque
    - to transfer the assets to a beneficiary.
- A description of what is required of the personal representative:
  - to provide the grant to the firm. Firms might also mention the availability of a small estates process on request
  - to consent to electronic verification and to provide the AML documentation required
  - to provide an instruction from the party who is legally entitled to the proceeds of the account(s) selecting one of the options available and provided by the firm. The firm might include any forms that are required to execute the selected option.
- A statement by the firm about what happens next, ie, when the accounts are closed or assets transferred at closure or transfer.

Where appropriate, firms might consider communicating the following information:

- confirmation of the actions performed by the firm
- for a sole account the value of the account(s) at the date of closure, and
- for ISA accounts the availability of the APS allowance to a surviving spouse or civil partner of the deceased.

3.3 Registering Trusts

To register a trust, the registrar will need to see an original trust deed which must be submitted with the application at the time of subscription.

The trustee will be recorded as the registered shareholder; if there is more than one trustee then they will also be listed (usually up to a maximum of four) shareholders in the same order as they appear in the trust deed.

The way in which trusts are recorded on the register depends on the fund manager's specific requirements. If the investment is to be redeemed then payment can be made to any of the trustees as long as the instruction/renunciation has been signed by all authorised signatures as detailed on the trust deed.

If trustees change then a new trust deed would be required to update the trustee name(s).

4. Settlement

Learning Objective

5.4.2 Understand the different methods of settling investor transactions

5.4.3 Know the causes and implications of late and failed trades

5.4.5 Understand the application of FinTech to settlement and payment processes

5.4.6 Know the correct treatment of dormant assets

4.1 Know the Regulatory Requirements for Settlement

Learning Objective

5.4.1 Know the regulatory requirements for settlement

Once an investor has entered into a contract to buy or sell units/shares, the next stage is for the contract to be settled. This requires the amount of money due under the contract to be paid and the legal title to the units/shares to be transferred.

The authorised fund manager (AFM) must describe the arrangements for the sale and redemption of units/shares in the prospectus. This will normally include the terms on which settlement of transactions takes place.

The regulations require redemptions to be settled on no later than the defined settlement date for the trade; this can be anything from zero to four days, but the UK market is generally moving to three days for typical funds or once the AFM has received all the duly executed instruments and authorisations necessary to transfer the title to the units/shares back to the AFM (for example, a form of renunciation signed by the unit/shareholders).

From May 2024, the Investment Association (IA) recommended that fund managers with funds with a North American focus transition towards a two-day settlement cycle. This followed the US transitioning the settlement of US Securities to a one-day settlement period, which necessitated a change to fund settlement period to mitigate the mismatch between the receipt or payment of cash and the obligation for the fund to trade. The IA further suggested that fund managers consider transitioning all funds to a two-day settlement cycle to future proof against further markets accelerating the settlement periods.

For redemptions, the AFM must ensure that it remits the proceeds to the redeeming investor, as failure to make payment would be a breach. For sale transactions (units/shares purchased by the investor) the period of settlement is not specified by the regulations, though AFMs will commonly require the retail investor to provide a payment method with the deal instruction be that debit card details, cheque or some form of electronic payment to a bank account as notified by the firm. Institutional investors transact on a far more regular basis and will often settle electronically on the settlement date following receipt of the appropriate deal confirmations.

In the case of regular purchases through a **savings plan**, the investor may pay via direct debit claimed by the fund managers, using the Bankers' Automated Clearing Services (BACS). The AFM must at all times comply with CASS rules in respect of money received from its clients.

Depending on the value of the transaction, the transfer agency (TA) (if this service is offered) or the AFM will directly chase the investor for payment for outstanding settlements leading up to the settlement date. Significant sized transactions may be chased earlier. If payment at contractual settlement date remains outstanding, the AFM is entitled to cancel the transaction as the investor has failed to satisfy his obligation under the contract. The units/shares would be removed from the registered holding of the investor and returned to the manager's box on the date the transaction was cancelled. The AFM will then include those units within its normal daily processes to determine whether to instruct the trustee to issue or cancel units in the collective investment scheme (CIS). However, consideration must be given to any loss and investor relationships.

From time to time, there will be a problem with the settlement process and the investor may not pay for purchased units on the appropriate date. Some of the primary causes of this are:

- disagreement as to whether the correct deal has been placed
- communication or operational failure between the entity placing the deal and any agent that entity might use to settle the deal
- payment to the wrong bank account so money cannot be applied to the deal
- bounced cheque or recalled debit card payment (for retail clients).

The consequences of a failed trade can be severe, although this is rare. The failed trade position is usually covered by the fund manager out of their own account or by the use of overdraft facilities with the bank. If the fund manager is unable to cover the position, then this would be a serious breach of the regulations and the units that have not been paid for would be cancelled.

It is rare that the TA (on behalf of the fund manager) is unable to settle repurchases, but in the case of a severe system outage, this could be the case. Once again, this would be a serious breach of the regulations and the consequences could be severe for the investor. In the case of retail investors, they may be relying on the payment for another purchase such as a house and for corporate investors, they may be using the payment to settle a purchase with another fund manager.

4.2 *In Specie* Issues of Units/Shares

Occasionally, an investor may wish to settle their investment by transferring investments (rather than cash) to the scheme. This is termed an '*in specie*' transfer, and the AFM must decide whether to accept those assets in settlement of the unit sale transaction and the corresponding issue of units. Under the regulations, the trustee/depositary may issue units/shares in exchange for assets other than money, provided the assets being received are consistent with the objectives of the scheme (as disposal of inconsistent assets would impose dealing costs on the existing unit/shareholders of the scheme).

4.3 Cheques

Learning Objective

5.4.4 Know the use and management of cheques plus other methods of payment and the pros and cons of each

There is a need to focus on electronic solutions for settlement within the financial services sector. The use of cheques in the UK has been steadily declining for several years. Business use began falling steeply in 1997 and has continued to decline as businesses increasingly move to automated payments with a significant decrease in the volumes of personal and corporate cheque settlements. The volume of cheque payments over a 12 month period until the end of July fell from 1.34% of all payments at the end of July 2022, to 1.07% at the end of July 2023. As a proportion of the total value of payments, the amounts paid using cheques has declined from 0.19% for the year ending July 2022 to 0.16% for the year ending July 2023.

In this landscape, there is an opportunity to leverage the power of technology to make what we have better; for corporates, using it to eliminate operational inefficiencies, and for transfer agents, specifically to provide improved service to their investors.

In this context of growing choice and efficiency of electronic payments – cheques can be seen as an increasingly inefficient means of settlement and enhance the risk of fraud to the extent that the TA industry should now consider moving away from cheques as a strategic goal. TAs should be looking for opportunities to maximise the value of their services to their investors by looking for the most efficient settlement methods.

4.3.1 Inefficiencies of Cheques

There are several areas to consider when reviewing the efficiency and applicability of cheque clearing by comparison to electronic methods.

Regulatory presentation and liquidity considerations:

- CASS regulations show electronic payment mechanisms are significantly more efficient than the current cheque settlement with the industry coming under increasing pressure from the Financial Conduct Authority (FCA) to engage and clear client money balance:
  - continuing to issue cheques will extend the necessity to support a re-issue and repatriation process and add to servicing costs for, eg, investor mailings outwards
  - cheques can go unpresented for a significant period of time necessitating lock in of monies to client money gone away and unclaimed accounts – this problem with uncleared funds requiring protection is less of a consideration with electronic settlement
  - liquidity is more key than ever since the recent CASS implementations – not needing to hold unpresented balances and lock them up in client money bank accounts across several days by clearing with electronic methods gives a cleaner more easily ascertainable picture of available true liquidity. This results in reduced reconciliation and liquidity management effort and oversight to monitor and account for positions.
- The payments journey:
  - certainty of fate is increased with electronic means
  - cheques can become intercepted/lost/delayed more readily and once issued the issuer has no sight of/recourse or audit of the whereabouts
  - this is true to a lesser degree once in clearing, but cheques are not traceable in real time within clearing.
- Interest accrual on funds clearing by cheque will not happen until day two in the 2–4–6 clearing cycle – same day clearing electronically remitted funds will attract interest (if applicable) on the day of settlement.
- Cheques can be bounced unpaid for up to six days – this outcome necessitates amendments to reconciliations, and the costs and inefficiencies associated to that outcome.

4.3.2 Logistical and Clearing Challenges and Associated Cost

There are significant logistics/costs associated to getting cheques into clearing on the inwards side, courier and physical handling costs. For corporates there is a reliance on physical transportation to get cheques to clearing centres as well as the costs of postage. In the retail cheque recipient space there is a requirement to attend a branch to pay cheques inwards.

- **Image clearing system implementation costs** – multi-bank corporates have a particular challenge with banking monies inwards: either send their images to the banks through separate bank hosted solutions or become a direct corporate participant to the new image based clearing switch: there will be costs of implementation for corporates, process changes required and potential increases in bank tariffs for cheque clearing post the change.
- **In a recent development, RBS have closed a clearing receipt centre near London and centralised it to their Midlands Shepshed operation** – part of pre-Future Clearing Model efficiency drives. This centralisation of clearing infrastructure has added cost and timing issues to getting cheques to clearing for corporates and further inconvenience to the logistics of the process.
- Change administration costs of needing to maintain lithographic signatory mandates and change manage them – significant associated overheads and costs.

4.3.3 Security

- Necessity (and risk) of having lithographic indemnities between bank and investor to guard against misuse of lithographical fraud.
- Ease of cheque interception/being lost and falling into the wrong hands.
- Ease of conversion and complete manufacture of fraudulent cheques.

4.3.4 Cheques Inwards Challenges

Cheques remain a popular method for transacting investment business. High daily volumes are experienced during ISA season and realistically no business would want to shut down a potentially lucrative revenue stream.

- The age of customers also impacts their use of cheques with a general trend that some sections of the older population may prefer to use cheques.
- Cheques are an effective method in confirming source of funds.
- They are extensively used in North America.
- Some see cheques as the cheapest and most secure method for large (>£10k) transactions.

4.3.5 Cheques Outwards Challenges

- Replacing cheques with Faster Payments (FP) should be easy for users of the scheme with re-mandating exercises required.
- Cheques are considered an effective method of sending payment where the TA cannot confirm a client's bank account details.
- Cancelling and reissuing cheques and circumstances where both the cancelled and the reissued cheques are cashed can be a real problem.

4.3.6 Descoping Cheques

Due to the inefficiency of using cheques (significant volumes of unbanked cheques, CASS considerations and to modernise processes in line with UCITS operations in other EU locations), the TA Forum recommends that firms look to have in place the following processes and considerations as they look to descope cheques.

Initial analysis to establish scope and impact:

- Identify the number of investors (unitholders) and agents/entities where bank details are not held.
- Analyse cheque volumes of both inbound and outbound, not only including subscriptions and redemptions, but also distributions and commission payments.

Following the completion of any analysis the following will need to be considered:

- client agreement(s)
- communication strategy
- system enhancements
- process to capture missing bank mandate instructions
- any known industry or regulatory initiatives.

Descoping cheques can be completed in two phases, with the initial focus on outgoing cheques. This should then be split into new vs existing investor groups for all investor and entity types (retail, institutional and third parties).

The following recommendations assume a phased approach for all outgoing payments (Phase 1)

New Investors

For new investors, T&Cs and applications forms will need to be revised to make it clear that redemption payments will only be paid in electronic form, eg, direct credit, FP and CHAPS and to stipulate that if income units are selected, a valid bank mandate must accompany the application, if no valid bank mandate is included the automatic default will be to switch to accumulation units or reinvest income until such time a valid mandate is received. T&Cs will also need to stipulate that redemption proceeds cannot be released unless a valid bank mandate is held.

Existing Investors

Use income mandates to pay redemption payments and vice versa. Where a valid bank mandate is on file for a retail investor, consideration should be given for redemption payments and income payments being paid to the same account. Subject to legal input, investors need to be notified that bank mandate instructions will be used across all payment types and any income previously paid but unclaimed will now be paid in accordance with the existing bank mandate instructions.

For distributions, and subject to legal advice and relevant processes being followed, where no valid bank mandate instructions are held, any unclaimed income is to be reinvested and default applied for all future income to be automatically reinvested (or **income shares** converted to accumulation shares).

- **Unclaimed income balances greater than six years old** – subject to legal advice, where the holder is no longer an investor and no bank mandate or current address is held, the recommended process is for unclaimed monies to be paid, in line with the prospectus or relevant regulations including CASS. The current process/requirements for unclaimed income distributions for non-ISA investments is for such monies to be repaid to the fund from where it came. Further consideration needs to be given to this scenario.
- **Unclaimed income balances less than six years old** – where the investor is no longer current, these should be periodically chased until such time they are six years old and the above will apply: the CASS rules currently make provision for this scenario and need to be followed in all instances.

The following recommendations assume a phased approach for all outgoing cheques (Phase 2)

When discontinuing incoming subscription cheques, promotion of alternative payment methods is required and any challenges overcome.

Consideration needs to be given to:

- treatment for applications that are received without bank details, ie, to reject, or communicate to investors the need for bank details
- processes to be implemented
- applicable amendments to a firm's T&Cs
- identification/verification process of account details in the absence of an investor cheque, and
- regulatory requirements and consideration to ISA subscriptions which are currently paid by cheque.

4.4 Electronic Payments

The appetite for digital payment and financial services solutions is clearly increasing in tandem with the evolution of new technology as the public become more conversant with electronic payments and financial services. The payments ecosystem also has more electronic settlement scheme channels and options than ever before: some of them are considered here – and comparison is given in each case against cheque settlement.

There are many FinTech firms introducing new technology initiatives to the market and many of these initiatives cover the banking and settlement processes used by TAs. These initiatives offer opportunities for TAs to provide more secure and efficient solutions to clients and are constantly monitored by TAs to identify cost effective ways of improving processes.

FinTech has introduced advancements such as mobile payment systems, online payment gateways, peer-to-peer apps, cryptocurrencies and blockchain. FinTech has also enhanced areas such as instant payments and transparent payment tracking which ultimately improve the settlement process by increasing efficiency and reducing costs while also incorporating enhanced security measures.

4.4.1 Electronic Payment Benefits Over Cheques

Electronic settlement processes in the main offer a number of significant improvements over the production and issuing of cheques:

Direct costs include:

- printing
- postage
- storing
- certification
- banking of cheques
- BCP cheque production and storage, and
- bank account or stationery.

Improved security:

- potential risk of fraud – UK cheques are open-ended under UK cheque law giving rise to unlimited by value liability exposure/risk
- fraud risk of cheques (interception and conversion cases)
- incorrectly submitted account details are checked and reported on, and
- future proof settlement/receipt models based on using Faster Payments via its real time, irrevocable methodology which is available 24/7.

Improved processing and timescales (including CASS benefits):

- manual matching/generation of letters/correspondence to cheques
- stop and re-issue
- low value uncashed cheque payments are no longer classed as an outstanding balance
- maintenance of stale cheque accounts
- cheque payments are classed as client money until they are cleared
- investor experience is improved as monies are deposited into their account for immediate access.

4.4.2 BACS

The BACS suite of automated payments including standing orders, direct debit and direct credit have long been stalwarts of the UK settlement system (the first direct debit was in 1970).

The scheme uptake continues to grow across all products, with 6.6 billion direct debits and credits processed in 2022 totalling over £5.3 trillion. An obvious advantage by comparison to cheques or one-off electronic payments for retail funds inwards is that the direct debit process – once set up – is repeated periodically in an automated way. Irregular (ad hoc) direct debit is also available to allow one-off investment payments.

Key Features

BACS is the company which runs BACS direct debit and direct credit schemes in the UK. According to BACS, over 150,000 organisations use direct credits for a wide range of payments.

In order to make payments or collections using electronic schemes, the firm will need a relationship with the bank or building society which sponsors the use of the services, possibly with a software supplier or a third-party bureau – a combination of one or more of these organisations is needed to enable vendors to use the schemes.

There are rules which all organisations using the schemes – both BACS direct credit and direct debit – must adhere to, including the need to confirm collection amounts and dates.

Strengths

- The cost to send a payment by BACS is relatively cheap in comparison to other electronic methods and cheques.
- If the systems are in place then it is relatively straightforward to send high volume, low value payments.
- Change of bank details via Advice of Wrong Account for Credit reports (AWACs) depending on debit or credit.
- Secure and reliable (proven track record).
- Simple to use.

Weaknesses

- The requirement to submit files several days prior to the payment date reduces the processing times for any corrections.
- Software requirements and having to test new files (time taken).
- Set-up time for the service user number (SUN), sometimes known as an originator ID. The SUN is a unique six-digit number used to identify a business paying or receiving money through a direct debit BACS transaction. SUN details are kept in a database managed by BACS.
- Where client money is involved, the BACS account must be funded as the money can be debited at any time.

4.4.3 Clearing House Automated Payment System (CHAPS)

CHAPS is a long established channel for both business to business (B2B) and the retail sector for same-day payment processing. Similar to BACS, it can be utilised for the push of funds in preference to cheques, with fund clearance on pay date.

Key Features

On 9 February 1984, the CHAPS sterling system commenced operations. CHAPS transactions total over 48 million payments accounting for £83 trillion pa.

CHAPS is the UK's real-time, high-value sterling interbank payment system, where payments are settled over the bank's real time gross settlement (RTGS) infrastructure and uses SWIFT for messaging. Once made, the settlement is irrevocable.

The key difference to using CHAPS is that it can process international payments in any currency without an upper payment limit.

Faster Payments Service

The Association for Payment Clearing Services (APACS) is the UK payments association. In May 2008, it introduced the Faster Payments (FP) system for institutions to deliver payment services to customers.

The system enables payments to be made and cleared within a couple of hours (quicker than the traditional three days BACS cycle), providing that it is a bank working day and that the payment does not exceed £250,000 (though it must be noted that each bank may set a lower operational limit). The service operates 24 hours a day, seven days a week.

For AFMs it means they can receive and pay out cleared funds from/to investors much quicker. However, the cost per transaction compared to BACS for example, can be considerably more.

Strengths

- Real or near real-time settlement, improving reconciliations.
- Can be sent using existing BACS technology and protocols.
- Better client experience (faster) than cheques and BACS.
- Business limits mean that a large majority of payments can be made.
- Sequenced release of funds to improve CASS compliance.
- Ease of access to payment initiation via bank front-end payment platforms.
- No overheads for TAs to start using/transitioning from other channels to FP as it is already an open enabled channel via banking platforms.
- Enhanced settlement processes for distributions and direct to consumer (D2C). Reduce cheques and associated costs.
- Multiple corporate access options in line with Payment Services Directive 2 (PSD2) objective to open up payments infrastructure access channels.
- Direct membership – enables a payment services provider (PSP) to connect directly into the FP central infrastructure to send and receive payments. Directly connected participants also perform their own settlement with the Bank of England. Each direct participant has to be a PSP and a credit institution.
- Enhanced experience for the end investor: no need to attend a branch to bank cheques, and funds clear faster.

Weaknesses

- More expensive by comparison to both CHAPS, BACS and cheques. Increased uptake. FPs charge 3.5p per transaction (direct member).
- Likely to require a change to have the system route payments over a certain value via CHAPS as unable to make payment via FP due to the limit.
- Reliance on external bank systems to transact FPs.
- GBP only.
- At times there are issues with returning the money to the sender as these are not transacted through the SWIFT messaging system and this has a knock-on impact for CASS (holding balances and unallocated monies).
- Issues with returning unidentified balances. Could be unwitting participants in the layering stage of money laundering.

4.4.4 CREST/SWIFT

Another method of making payment, particularly for institutions, is to settle via use of the CREST system. CREST settlement of CIS investments follows a different process to settlement of securities through CREST's central settlement system. CIS investment deals are described within CREST as 'residual'.

With residual securities, the unit/share certificate and stock transfer form are passed from the seller to the buyer (normally via their brokers), either inter-office or through the CREST Courier and Sorting Services (CCSS).

Residual settlement of CIS investment differs from residual settlement of corporate securities because in the normal course one of the parties to a residual CIS transaction will always be the AFM. This means that settlement risk can be reduced, since the AFM can ensure that transfer of title is coordinated with payment.

There are a number of benefits to be gained by CREST members and AFMs:

- The system complements the electronic trading system, Electronic Message Exchange (EMX), introduced in 2000.
- The CIS industry is able to use infrastructure that is already proven and very firmly established.
- CREST settlement reduces the elements of settlement risk present in other methods (ie, it speeds up delivery of cleared funds for purchases and redemptions).
- CREST members are already significant investors in collective schemes and have indicated that their transaction volumes will increase as a consequence of the efficiencies described above. As an example, the cost of settlement of unit trust transactions is expected to reduce.

Calastone ltd currently offers similar order routing and settlement based on International Standards Organisation (ISO) standard messaging using the SWIFT infrastructure. SWIFT is the Society for Worldwide Interbank Financial Communication. Although not a payment method per se, SWIFT solutions have long been central to the payments disbursement of corporates offering a payment messaging channel utilising the other schemes.

4.4.5 Debit Cards

In the digital payments market, the growth and increasing ubiquity of payment cards is considerable. Within the TA sector there is an increasing number of investors wanting to utilise cards collection as a key service, however, fraud rates are an important factor that need to be considered in any increased usage.

Debit card settlement for mutual fund deals is a commonly accepted form of settlement, particularly when deals are taken over the phone or placed online.

Strengths

- Well understood by the client as it is typically used for smaller retail transactions.
- Can provide guaranteed cleared monies to the provider where 'Verified by Visa' or 'MasterCard SecureCode' are used allowing clients to deal immediately on those monies.
- Transactions can be made for any amount provided there are sufficient funds in the cardholder's bank account. In practice, some banks impose limits, but these are now £100,000 and therefore are sufficient for the majority of retail investors.
- There are many payment providers with 'white label' solutions which mean that it is relatively straightforward to implement a debit card payment solution.

Weaknesses

- Any debit card payment system needs to be integrated into a firm's back-office solution.
- Any mail order/telephone order (MOTO) transactions that do not use Verified by Visa or MasterCard SecureCode, could be dishonoured leaving the company to pay the bill for any related fraud.

- Linked to the above, the risk of fraud on debit cards has increased significantly in recent years.
- Monies take 48 hours to clear, which is generally better than a cheque, but not as fast as an electronic funds transfer.
- Charges can be significantly higher on larger transactions (eg, a full ISA subscription).

4.4.6 Dormant Assets

From time-to-time, fund managers can lose contact with investors; this is more common for retail investors. The assets owned by the investor remain on the register and continue to be paid distributions and be priced each day. Financial institutions such as banks and building societies have a process in place for handling accounts where the owner of the account can no longer be contacted and the money in the account is declared as 'dormant'.

In August 2024, the Dormant Assets Act (DAA 2022) expanded the Dormant Asset Scheme (DAS) to include investments and client money. The DAS allows for dormant assets to be moved to an authorised reclaim fund. The FCA incorporated the requirement for firms to retain records of any dormant assets transferred for six years into COLL rule 6.6.6R.

4.5 Post-Settlement

Learning Objective

5.4.7 Understand the components of the post-settlement phase: reconciliation; inventory management; margin/collateral monitoring

5.4.8 Know key controls associated with the post-settlement phase

Post-settlement refers to the stage immediately after the trade has settled. This stage will typically include reconciliation and inventory management, along with margin and collateral management. It also includes financial, management and regulatory reporting.

The firm has a duty of care to ensure that its customers' trades are carried out in accordance with their instructions and it is the firm's responsibility to make sure that the customer is treated fairly by the firm at all times. This requirement extends into the post-settlement phase as well.

4.5.1 Reconciliation and Inventory Management

Firms will reconcile their records and positions of the trades after the trades have settled to make sure that the correct amounts of cash and assets were exchanged and that there is no shortfall. Firms will reconcile as often as they need to with respect to customer assets held in custody to demonstrate to the regulator that they have treated their customers fairly.

Inventory management involves how a firm keeps records of its customers' cash and stock movements. For example, if it uses an electronic system to record these details, then the firm must ensure that the system is sufficient for this purpose.

Reconciliation is an accounting/control function which ensures that the firm's record of cash and stock movements (the 'internal world') is accurate and, furthermore, agrees with its statement of balance and holdings (the 'external world'). It is a key detective control that ensures that the differences are identified and resolved in a timely manner. It forms part of the post-settlement phase in the lifecycle of a trade.

Reconciliation controls are typically applied to provide checks against a wide range of records, such as cash, stock or (depot) accounts, collateral, margin, dealing positions, client money and custody accounts.

4.5.2 Margin and Collateral Management

Margin or collateral is an asset held by a lender on behalf of an obligor, under certain agreed conditions, as a form of security for a loan perhaps. It can be in the form of cash, securities or a physical asset. It is a form of insurance to reduce the amount of credit exposure (or credit risk) to a particular counterparty. The lender may retain the margin or collateral if the obligor defaults. The management of margin and collateral forms part of the pre- and post-settlement phases of the lifecycle of a trade.

The value of any margin or collateral held during the transaction instruction and settlement phases will need to be closely monitored to ensure that it remains sufficient to cover the potential exposure should one party default on their obligations. The value of any margin or collateral held will be marked to market, ie, compared against the current price of the asset in the relevant market. The value of margin or collateral held will, in practice, be monitored daily, either on an end-of-day basis or an intra-day basis and any shortfall in the value will need to be notified to the obligor so that additional margin or collateral may be requested and supplied.

A margin call is the request for additional funds when a margin account falls below the minimum requirement to be deposited. The need for a margin call will typically arise as a result of an adverse change in the value of the asset or contract.

Whenever the firm has less cover for margin or collateral than it requires, it is exposed to potential risk.

New trades may be processed without a problem and may settle on their intended settlement date. However, sometimes the trade may not settle in accordance with the market practice applicable, leading to possible brokers' claims, payment of interest or compensation along with decreases in the level of customer satisfaction. These results of poor post-settlement processes can be used by firms as KRIs to assist them in monitoring the level of operational risk that they are exposed to.

The volume of unreconciled events (or breaks) is commonly used as a risk indicator to assess the quality of the transaction capture and processing activity. The more errors a firm detects when reconciling its many positions after the settlement date has passed, the higher the level of risk the firm may be exposed to.

Other risks associated with reconciliation errors will involve:

- increased staff effort in trying to resolve the issues, often leading to lower levels of productivity
- increased overtime being worked by the appropriate teams
- financial impact from overtime
- fines imposed by regulators when failing to follow regulatory requirements
- the payment of interest or compensation claims to parties that have been disadvantaged.

5. Corporate Actions

Learning Objective

5.5.1 Know: the types of corporate actions and events; the process required to execute corporate actions; the role of various parties involved; client communications and proxy voting; the risks and regulatory requirements associated with corporate actions

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A corporate action is initiated by the authorised corporate director (ACD) or AFM and can be categorised into one of the following three types:

- voluntary
- mandatory, or
- mandatory with choice.

Voluntary corporate actions are rare in the TA world as they tend to be used more for listed securities, with a tender offer being an example. Mandatory corporate actions are far more common with the most common being a distribution, with some funds distributing monthly. Distributions also give the investor a choice as to whether to have the distribution reinvested directly into the fund. Distributions are so common that they are often not treated as corporate actions as they happen on a scheduled basis and are seen as usual business activity and are, therefore, covered separately in this training material.

Other mandatory corporate actions that are often seen in the TA world are:

- **Fund closures**
  - Funds can close for several reasons and the AFM will work with the trustees to plan the closure and ensure all regulatory requirements are met before the fund closes. The primary reasons for fund closure are:
    - the fund has become too small to be viable
    - the fund may have liquidity problems with the underlying investments, making it impossible to manage on an ongoing basis as underlying assets cannot be bought or sold in a timely manner.
  - A fund may be suspended before it is closed, especially when it is closed due to liquidity issues.
  - Before a fund closes a fund manager will typically offer a switch into another of its funds in an attempt to retain the investors' business.
  - A final distribution is typically run directly before fund closure to ensure all income is handled correctly.

- The TA's role in a fund closure may include sending client communication to let them know the closure timescale.
- The fund account will continue to price the fund until closure and provide a closing distribution rate and price to the TA.
- When the closing price is received from the fund accountant, the TA will ensure that it is applied correctly, and all units are repurchased.
- The TA will issue contract notes to all clients impacted.

- **Share class closures**
  - A single share class for a fund can be closed, with investors being moved to an alternative share class. This is permitted if there is no detriment to the investor and that this can be evidenced.
  - The TA's role in a fund closure may include sending client communication to let them know the closure timescale.
  - The fund accountant will provide a conversion rate to use to transfer units between share classes.
  - The TA will use the conversion rate to calculate the correct number of units in the new share class and update the clients' accounts accordingly.
  - Contract notes will be issued to inform clients of the transactions.

Although these corporate actions may give the investor some form of choice, the choice is usually to move out of the fund before the corporate action takes place as the action has to be applied to all holders on the corporate action date.

There may be times when a shareholder vote is necessary before a corporate action can take place. This is often the case with fund mergers. Fund mergers occur when one fund is merged into another often due to fund manager organisations merging. The TA may be involved in the communication regarding the vote, depending on the services offered. Shareholder votes are typically completed using an online portal and the result is typically driven by large, institutional shareholders, rather than retail investors. Once the vote has been held, assuming it gives the go ahead for the fund merger, one fund will typically be merged into another, using a factor provided by the fund accountant, which will ensure that the investors are not disadvantaged in any way. Again, the TA will issue contract notes following the merger.

There are often complexities involved in corporate actions which lead to decisions needing to be made as to how to handle non-standard situations. These situations include:

- investors where death has been notified, but the bereavement process to handle the estate is not yet complete
- 'gone away' clients with whom the fund manager has lost contact
- suspicious accounts that may be under investigation for some reason.

In these cases, if the client is due a payment, agreement is needed as to whether to make the payment or hold the proceeds in client money until a later date.

5.1 Risk and Regulations Associated with Corporate Actions

There are several risks associated with the processing of corporate actions. These include:

- **Operational risk** – corporate actions involve complex processes and extensive data management. Transfer agents face operational risks related to accurate and timely processing of corporate actions, ensuring proper record-keeping and managing large volumes of transactions.
- **Data integrity and security** – transfer agents handle sensitive and confidential shareholder data during corporate actions. Risks associated with data breaches, unauthorised access or data manipulation can have serious implications for the integrity and security of the corporate action process.
- **Regulatory compliance** – transfer agents are subject to regulatory requirements aimed at ensuring investor protection, transparency and fair treatment. Failure to comply with these regulations can result in penalties, reputational damage and legal consequences.
- **Legal and regulatory changes** – the regulatory landscape regarding corporate actions can change, necessitating ongoing monitoring and adaptation by transfer agents. Keeping up with evolving regulations and ensuring compliance with the latest requirements is critical for transfer agents.

From a regulatory standpoint, there are a number of areas that must be considered by the transfer agent and other parties involved in the process. These include:

- **Investor protection** – transfer agents are required to act in the best interests of investors, ensuring fair treatment and accurate communication regarding corporate actions. They must provide clear and timely information to investors, facilitating their decision-making process.
- **Record-keeping and reporting** – transfer agents must maintain accurate records of shareholders and transactions, ensuring the integrity and auditability of the corporate action process. Regulatory requirements may also mandate regular reporting on corporate actions to regulatory authorities and other relevant stakeholders.
- **Risk management and internal controls** – transfer agents are expected to establish robust risk management frameworks and internal controls to identify, assess and mitigate risks associated with corporate actions. This includes operational risk management, data security measures and compliance monitoring.
- **Compliance with market standards** – transfer agents adhere to industry best practices, market standards and professional codes of conduct to ensure consistency and high-quality service delivery in the corporate action process.

6. Order Management

Learning Objective

5.6.1 Know the methods for direct and intermediary dealing

5.6.2 Understand the operational risks associated with: direct dealing; intermediary dealing

5.6.7 Understand the difference between single- and dual-price dealing

6.1 How an Investor Deals

There are several dealing channels by which a client may transact directly with an AFM. In addition, they also have the option to place deals via an intermediary or adviser.

Whether an investor wishes to buy or sell his units, they will be either bought from, or sold back to, the authorised fund manager. There is no active secondary market in AUTs or OEICs, except between the investors (or their advisers/intermediaries) and the fund manager. The key point to note therefore, are that units in AUTs and shares in OEICs are bought from the AFM themselves and not via a stock market.

Investors of course have the option to trade through a fund supermarket or platform. An organisation that specialises in offering investors easy access to a range of unit trusts and OEICs from different providers. They are typically based around an internet platform which takes the investor's order and processes it on their behalf usually at reduced, or nil, commission rates.

Offering online dealing, valuations, portfolio planning tools and access to key features documents and illustrations, investors can look at their various holdings in different funds in one place, analyse their performance and easily make switches from one fund to another.

When an order to buy or sell units is undertaken by an organisation that provides dealing services, such as a platform, it is likely to use a systems platform to place those orders with the fund management group.

An investor wishing to purchase units/shares might use any of the following options (providing that the specific AFM enables dealing by these channels). The investor may:

- complete an application form
- send a fax for a top up, switch or redemption (this is typically for non-retail investors)
- deal directly with the AFM (or the TA if the AFM has outsourced this work) by telephone
- use an intermediary to place the deal on their behalf
- deal via a platform (who will, in turn, often utilise straight through processes)
- make regular investments using direct debit or direct credit, or
- subscribe to a monthly investment scheme.

Terms for the purchase of units/shares by investors may require that the AFM receives settlement proceeds at the same time as receiving the order (this could be a regulatory requirement if the investor is dealing into an ISA), or the AFM will require settlement to be in line with the fund settlement cycle which typically occurs three or four business days from the transaction being placed.

There are risks associated with trading directly or through an intermediary which can cause misalignment in the settlement process and required timeframe. Operational errors in processing the transactions, incorrect NAVs or failures in the trading, settlement or valuations systems can result in financial losses, cause regulatory breaches, and potentially cause reputational damage.

Deals placed with an application will sometimes include a cheque; this is sometimes required for the first investment to provide appropriate anti-money laundering (AML) and fraud prevention information. While many AFMs also accept payment by debit card, technology challenges when storing details, together with bounced payments, has resulted in this settlement process being slow to take-up. In either of these cases, the AFM will already be in the process of collecting the investor's payment, but the units/shares are not considered to be owned by the investor until payment has been received by the AFM.

To encourage investors, AFMs may from time-to-time offer discounts. The discount may be applied for lump sums and might have a closing date. In all cases the discount will be applied to the AFM's initial charge and not to the unit/share issue (creation) price. For dual-priced funds the discount will be reflected in the offer price while for single-priced funds a reduced initial charge will be shown separately.

6.2 Redemption Arrangements

For redemptions, investors may give instructions in the same way as a subscription (ie, by post or telephone, or via an intermediary). Whatever channel is used, investors must often complete a form of renunciation (depending on value and the risk appetite of the AFM), renouncing their interest in the units/shares being repurchased by the AFM. The completed form is effectively a transfer of units/shares back to the AFM, used by the AFM to ensure that it has received a genuine instruction from the holder of the units/shares. These forms may be issued with the contract note at the time of purchase or sale or found online. The use of forms of renunciation is reducing in the UK market and the industry is actively working to find ways to remove the need for them.

Undertaking for Collective Investment in Transferable Securities (UCITS) schemes have to give investors the right to redeem at all reasonable times and valuation points and should support dealing at least twice each month.

For non-UCITS retail scheme (NURS), COLL allows schemes which invest substantially in approved immovables, or whose investment objective is to provide a specified level of return (ie, guaranteed or protected funds), to provide limited redemption arrangements that are appropriate to the schemes, objectives and aims. In these cases, the period of redemption must be no longer than six months apart.

6.2.1 Deferred and Limited Redemptions

Generally, the Collective Investment Schemes (COLL) Sourcebook requires a UK-authorised collective investment scheme (CIS) to act on investor redemption instructions at the next dealing valuation point. This will usually be daily, though some funds are established with less frequent dealing days.

As identified above, at some point, given the illiquid nature of assets such as a property fund and following specific market conditions, a fund manager may not be able to satisfy the needs of investor redemptions on any given day, and in extreme cases this may last for many months.

While a fund may hold cash reserves and can utilise this to satisfy small manageable requests, investors looking to leave in larger numbers (or large institutional investors looking to pull large sums) may force a fund manager to act upon their right as defined in the fund's prospectus to suspend or restrict dealing in some way. This was seen in 2016 with property funds at the time of the UK referendum for a number of managers and more recently, the Woodford Equity Income Fund.

The effect of a suspension in dealing is to bar investors from removing assets from the fund for a time that will allow the investment manager to appropriately dispose of the assets with the hope of securing a suitable valuation so as to not detrimentally affect those remaining within the fund, or for the fund to receive enough subscriptions to enable these to bolster cash reserves and cover the future redemptions. It is, however, unlikely that a fund that is subject to a suspension will have clients looking to invest and therefore the fund will manage the suspension with the disposal of assets.

Within COLL, the application to apply a restriction to the fund requires the agreement from the trustee or depositary and, once granted, the manager has a number of options open to them.

6.2.2 Limited Redemption

COLL rules allow NURS that invest substantially in physical property to apply 'limited redemption' arrangements. Such arrangements must be recorded in the fund's constituting documentation, and the scheme must enable redemptions at least once in any six-month period. Different classes within a scheme can adopt different redemption arrangements.

To give the AFM time to realise the cash needed to fulfil redemption instructions, the AFM can use a limited redemption process to allow the redemption proceeds to be paid out over a longer period of time. For example, they could choose to pay 10% of redemption proceeds on the original settlement date and pay the remaining 90% on a later settlement date. This approach must be documented in the scheme documentation and must treat all investors equally.

This limited redemption process is rarely used in the UK market primarily due to the complexities in administering the process and the difficulties it brings to platforms and other aggregators who need an equivalent process to manager their investors.

6.2.3 Deferred Redemption

Deferred redemption (also known as queued redemption) arrangements must also be documented in the fund's constituting documentation, and allows the AFM to delay payments across all redemptions for a deal valuation point to a later settlement date. This gives the AFM the opportunity to offset redemptions against future purchases as well as giving more time to redeem underlying assets in the market. Although more common than limited redemptions, deferred redemption is still rarely used in the UK market, with most AFMs using a fund suspension process to manage liquidity difficulties.

6.3 Dealing Communication

Learning Objective

5.6.3 Know different methods of dealing communication and associated benefits and risks: straight-through processing (STP); telephone dealing; fax

6.3.1 Straight-Through Processing (STP)

STP is an automated solution used by the TA to capture and process instructions from any number of third parties in which they have regular interactions. STP, as it suggests, should allow for an entire process to be completed without human intervention, however, technological constraints often result in some form of manual input.

While STP can be implemented throughout a TA's services provided to an AFM – from an investor's interaction and input through a website portal amending their address, a reconciliation process with the bank and automated price upload – the significant number of transactions with the potential of a high financial risk impact within dealing is often the focus.

Within the UK financial services sector, there are two main dealing solutions that are typically utilised where systems are configured to process straight through:

- The EMX Message System is an electronic message exchange providing a means through which distributors and fund providers communicate purchases, sales and valuations for investment funds, including retail, institutional and **hedge funds**. It is run by Euroclear plc and is based on the FIX messaging protocol.
- Calastone ltd offers a similar system for order routing and settlement supporting the ISO standard and SWIFT infrastructure but also allowing bespoke message formats.

Both the above dealing solutions offer a fast, paperless, efficient service to IFAs, distributors, institutions and stockbrokers.

Users of these systems can place buy or sell instructions via electronic messages. When issuing a buy or sell instruction, information about the IFA, the client, the trade transaction, and settlement instructions are required and are provided in a single agreed format. All products available via the system are required to be in this agreed format. It is a requirement that full registration information is provided by the IFA within the trading instruction sent via the system.

Such systems can handle requests for valuations at either an individual, account or agency level. They may also have the facility to run regular reconciliations to aid those FCA-regulated intermediaries who have a requirement to reconcile their nominee account holdings on a regular basis. This reconciliation will take the form of a register enquiry against individual providers (such as AFMs).

There are significant benefits in dealing via STP, including:

- use of common standards both for the sender and recipient
- increased dealing capacity with no extra staff
- lower costs for transactions and payment processing
- high service standards for transactions, statements and valuations
- a reduction of duplicated effort/rework through automation
- significant increase in accuracy with less time spent sorting out errors
- immediate responses confirming transaction receipt and pricing
- improved cash flow, with the ability to settle transactions electronically, and
- access to both nominee and own account information held on the register to facilitate reconciliations.

However, as with all technological solutions, while the risk of a human element is significantly reduced, reliance is placed on the technology. The risk of failure at any point of the process can affect both the end customer, or the TA, and many of the benefits noted above can also be seen as significant risks if, and when, a failure occurs when manual processing must be implemented. Errors are not always attributable to the TA system as distributors may also revert their systems to produce manual fax-based deals during an business continuity event.

The TA will often not have the resource to manually place the deals that are generally received within the usual timeframes, with knock-on impacts to book processing, fund pricing and settlement.

Risks during an STP business continuity event:

- skilled resource not available to cope with the spike in transactions
- increased errors with manually input transactions
- communications breakdown with distributors
- re-submitting deals leading to duplicate trades
- late closure of dealing impacting downstream processes (fund pricing, fund of funds, settlements), and
- loss of reputation and impact on financial penalties or more significant fines.

6.3.2 Telephone Dealing

AFMs may offer existing investors the ability to deal via the telephone. Assuming access to one of the STP platforms above, this will primarily be utilised by smaller institutions, corporate or retail clients. While a slower process than STP, telephone dealing allows the TA and investor to have immediate interactions to ensure the regulatory requirements of the deal is captured without undue delay.

While a manually input transaction, telephone deals are typically read back to the caller with caveats regarding errors being identified after the call may result in the investor suffering a loss and are, therefore, often error free. During a significant financial event a TA may experience high volume calls within a short timeframe with the investors unable to place their deals. The TA will have agreed

a resource plan and call volume expectation with the AFM to mitigate any risk or claim from a client should they escalate or complain.

6.3.3 Fax Dealing

For the UK market, while smaller corporate clients may utilise this as their primary channel, dealing via fax is often only resorted to by distributors as a back-up mechanism event when neither of the two STP platforms are available and the distributor has to place numerous trades that would be impractical to do so via the telephone.

Out of the three channels, fax has the highest risks associated to it for both the sender and the recipient for several reasons, such as:

- there is often no automated solution to confirm receipt of the fax
- faxes can be easily duplicated or resent by the distributor (often including further information) resulting in duplicate trades
- faxes can be unclear in their instruction due to corrupted transmissions, increasing the risk of a mis-key, and
- numerous deals can be placed on a single instruction, increasing the risk of dealers missing trades.

6.3.4 Email Dealing

The use of email to accept dealing instructions has become more prevalent over recent times, although primarily as a back-up option when STP dealing is unavailable. There are several risks involved with accepting email instructions, including:

- emails can be easily duplicated or resent by the distributor (often including further information) resulting in duplicate trades
- emails can be unclear in their instruction due to corrupted transmissions, increasing the risk of a mis-key
- numerous deals can be placed on a single instruction, increasing the risk of dealers missing trades, and
- there is a risk of fraud due to the lack of security around the sending and receiving of emails.

6.4 Switches, Conversions and *In-Specie* Transfers

Learning Objective

5.6.4 Know the application of switches and *in-specie* transfers

6.4.1 Switches

A switch is a two-sided transaction processed when an investor chooses to rebalance their portfolio either by moving a percentage or a specific amount between funds in the same account. This type of transaction will typically be detailed on the register and any communications as a 'switch in' and 'switch

out'. Switches must be between separate funds and not between different share classes of the same fund when a conversion transaction must be used. Using a switch transaction to move from one share class to another has tax and accounting implications for the existing investors of the fund.

A switch is similar to the processing of a sale and repurchase transaction, however the investor will only have to provide a single instruction to the TA, and the process (depending on the valuation point (VP) of the funds) will be completed in a single day (or by the next available VP for each fund). As the instruction is singular, the TA systems must have the ability to link both sides of the transactions together. It will perform an estimated dealing process on the switch-in element as the value of the switch-out will not be known prior to pricing and therefore the value which can be applied to the switch is not known.

Complications within the process can arise if the fund's VP are not aligned, including funds that have a cut off. Systems will either be designed to cope with this level of complexity, or the TA will create a manual procedure which does bring risk unless appropriately controlled.

A switch can be instructed at a number of levels:

- **One to one** – where either the entire holding in a single fund is moved to a different fund.
- **One to many** – the investor wishes to switch out, and move the proceeds to two or more funds.

When completing a switch, the TA must consider other aspects of account management and define processes where investors could have regular savings into the 'ceasing' fund or if there are future dated transactions such as a reinvestment of income that will need to be moved.

The process of a switch will be seen as a disruption and, therefore, commission will not be paid on those shares' units going forward (please see the Retail Distribution Review (RDR) in chapter 2, section 2.1). Similarly, the process will be seen as a disposal of assets and unless held within an ISA, the process will be subject to capital gains tax (CGT). It is worth noting that a switch will not affect a client's ISA allowance for that year and the value is not seen as a subscription.

6.4.2 Conversions

A conversion transaction takes place between share classes of the same fund, for example, moving between income and accumulation versions of a fund. Conversions are on a one-to-one basis, where a defined number of units are converted from one share class to another. The fund accountant will provide a **conversion factor** which will define what rate to use to calculate the number of shares to allocate in the new share class. Conversions do not have any associated money movements and are technically not deals as they do not go through the manager's box.

Investors are often not aware of the difference between a switch and a conversion and may request a switch transaction when a conversion transaction is the correct transaction to use. The TA will ensure that the transaction is processed correctly so that investors are not negatively impacted.

6.4.3 *In-Specie* Transfers

An in-specie transfer is the process where an investor (either directly or due to an IFA instruction) wishes to move holdings in the form of stock without initiating a cash exchange. Within TA administration, this is often seen when ISA transfers are made between accounts on the main register to a platform (ie, a nominee holding on the main register) or platform to platform.

A transfer will be initiated following the client instruction by an acquiring party either via an automated process (ie, Altus gateway) or paper channel. Upon validating the instruction, the transfer is processed and a specified number of units moved between accounts. As the process is moving stock (units or shares) and not a value, there is no need for the transaction to be processed through a VP, there is no box movement at the AFM and the transaction (from an AFM perspective) does not carry any initial charge (the AFM or TA, however, may have the right to charge to process the transaction depending on the product).

Regardless of the controls and procedures that are put in place when transacting deals, any process that has an element of manual input or the risk of a technology failure may result in a dealing error. The impact if volumes are small (ie, the number of deals affected) and if captured quickly may not be significant, however should dealing errors be linked to incorrect clients/agents, have a systemic issue, are created on large deals (value wise) or have not been captured by the TA or other controls over a long period, the impact can be substantial. The impact must not always be linked to a direct financial loss.

We will consider a dealing error to be a transaction that has been processed by the administrator and for some reason has been deemed to be an error once it has been priced and acknowledged to the underlying customer – therefore, discovered after the dealing date. The error need not be one caused by the TA alone, as instructions can be received by the AFM. Dealing errors could be the result of transactions being placed for an incorrect fund, an incorrect value, missed completely or incorrectly capturing key data. They can affect all transaction types (such as sales, repurchases and switches).

We are unlikely to consider an error by the client or IFA as a dealing error as the impact and correction will often follow a different path.

6.5 Dealing Errors Caused by the TA and their Impact

Learning Objective

5.6.5 Understand the consequences of dealing errors and their impact upon profit/loss

6.5.1 Financial Impact

Errors will often lead to a profit or loss when processing a correction. When a fund is not dealt in correctly, there is a requirement to correct the register and ensure the client has not been disadvantaged.

Missed deals will need to consider the price at which the fund should have been dealt with and compare that to the current price. This will be compounded if the transaction was carried out in an incorrect fund as the value of this will need to be considered as part of any calculation.

6.5.2 Regulatory Impact

Deals placed with an incorrect agent could lead to regulatory breaches such as data protection where significant information regarding the investors account, their investment decisions and holdings are exposed.

6.5.3 Reputational Impact

Incorrectly executing client instructions could lead to losing a firm's client base and/or adverse marketing/brand defamation. This is especially prevalent within the institutional client base where multiple incorrect transactions have an impact on the operation of mandated accounts or those that rely on a nominee sub account structure. The reputational impact is not only felt by the TA, but also the AFM who often has direct relationships and contracts with these clients.

6.5.4 Operational Impact

While we have discussed the direct financial impact of correcting errors above, there are significant indirect costs to dealing errors. Each issue requires significant operational effort in correcting a client's position, recording the errors, reporting to regulatory bodies and the AFM. In addition, the TA will need to consider processes and procedures if the errors are systemic and implement mitigating actions to correct and ensure future issues are minimised.

Dealing errors not only require correction in themselves, but an error can also impact a number of other processes such as the processing of distributions and the impact to client money.

If a transaction is missed, due to an error, the TA will need to consider a number of methods of pricing when looking to put the client's position 'right'.

6.6 Using Original/Right Price

Learning Objective

5.6.6 Understand the difference between right and best price

This process puts the client's position right by utilising the price that should have been allocated to a deal regardless of whether it is in favour of the client or not.

While the deal is carried out at the 'right price' and this will be reflected on the contract note, the transaction with the market, and through the book will be carried at the current price, creating a profit or loss.

The expectation and requirements of the underlying client will need to be considered when determining the process to correct deals. While initially a better pricing policy provides the client with a fair and clear outcome, this result will not be acceptable to clients running nominee positions. In this case, the nominee will have applied the correct pricing and deal date to their own systems and allocated units/settlement to the underlying investors and confirmed/reconciled on that basis. A change to the deal, however insignificant, could result in significant work and corrections for the platform and therefore they will often expect the original/right price.

6.6.1 Best Price

The transaction is corrected and placed at the current price. However, once this is known it is compared to the original price and if there is a deficit of units/value, the client is compensated. Client compensation could be in the form of a payment to the client or an increase in their share/unit holding.

If the client is better off or in an advantageous position with the current price, no further action is required and the TA or AFM making the error will not have a profit or loss to cover.

6.6.2 Best Pricing

This is less used, however, all prices from all valuation points are compared between the date of the error and the date of correction with the best price being applied to the client. This will always result in a loss to the book that will need to be covered.

7. Transfer of Title

Learning Objective

5.7.1 Understand the processes and information requirements relating to transfers by the holder, in favour of the AFM, and by the operation of law

5.7.2 Know the requirements for transfers: by the holder; to the AFM; to third parties; by operation of law; by electronic transfer; via TISA exchange (TeX)

7.1 Are Units/Shares Transferable?

Units and shares within a fund are a registered security and therefore title to those units/shares is transferable either by the holder or by what is called 'operation of law' (such as following the death of the holder).

In the transfer process, there is a requirement to perform KYC checks on the transferor as well as the transferee prior to effecting the transfer, which includes ensuring that the transfer has a genuine purpose and is not being used to sidestep third-party payment policies or effect fraud.

7.2 Stock Transfer Form for AUTs and OEICs

Historically, the common stock transfer form used to affect a transfer of company shares or stock has also been used for UK unit trusts and OEICs. From December 2007, however, money laundering regulations imposed a requirement on fund managers to verify the identity of all registered holders of their funds and any underlying beneficial owners or controllers. For this reason, the Investment Association (IA) developed a standard form for UK funds. Other provisions relating to the transfer of legal title between registered unit holders continue to be as set out in the Stock Transfer Act 1963.

7.3 Transfers by the Holder

The first common type reflects a transfer from one holder to another. Units/shares may be transferred by the current holder completing a stock transfer form which is sent to the fund manager. Providing that the transfer form is completed correctly, and any appropriate stamp duty is paid, the register will be updated. The TA will send confirmation to the transferee of their holding, upon completion.

7.4 Transfers to the AFM (Transfers to the Manager's Box)

The second common type of transfer occurs when the unit/shareholder sells their units/shares back to the AFM. As we have mentioned above, there is no secondary market for unit trusts or OEICs and all sales of units must be with the AFM. For significant value dealing, an AFM will often require some manner of confirmation from the investor which could be written or electronic.

For this transfer, the name of the transferor is removed from the register, however the AFM is not added. Instead the units/shares are reflected in the manager's box for reselling or cancelling.

7.5 Transfers by Operation of Law

Upon the death of a holder within a joint holding of units/shares, the surviving holder(s) will be recognised as having automatic title to the units/shares. Following the process of the AFM the death certificate will be reviewed in line with their requirements and the register updated.

If either a sole holder or the last surviving holder dies, authority to deal with the holding rests with the executors or administrators of the deceased holder. The Grant of Probate or Letters of Administration will be required in such cases to establish title. The executors or administrators can complete a simple Letter of Request form to have the holding placed in their names as unitholders, without reference to the deceased. Alternatively, they may transfer the units/shares to beneficiaries by means of the usual stock transfer form, or sell the units/shares back to the AFM.

This type of transfer may also take place in the event of bankruptcy or, in the case of corporate holders, liquidation. It will be necessary to provide satisfactory evidence of the appointment of the person claiming title to the units/shares (such as a receiver) before any transfer is registered.

Until the units/shares have been transferred to the new holder(s), the legal representatives, such as executors, are not entitled to receive notices or attend or vote at any meetings of unit/shareholders.

7.6 Re-registration

Following the introduction of the RDR initiative, the regulator raised concern that not all platforms support investor instructions to re-register assets either on or off the platform. Without such an option, an investor would be required to sell their assets and withdraw the proceeds – an approach that could incur tax consequences and additional costs. Having identified this barrier to investor flexibility the regulator required all platform providers to facilitate re-registration.

The Tax Incentivised Savings Association (TISA), established the TISA Exchange ltd (TeX). This is an industry 'contract club' to facilitate the electronic transfer and re-registration of unit trusts and OEICs. The electronic transfer process is facilitated by the use of:

- a **standard legal contract** that manages the risks and liabilities associated with electronic asset transfer and re-registration, and
- an **industry-agreed service legal agreement (SLA)** agreeing the standards and service levels for the electronic re-registration of assets.

The TeX process achieved a quick and compliant platform-to-platform re-registration through ISO 20022 messages, achieving the FCA's requirement that all platforms offer *in-specie* re-registration.

8. Sub-Registers for Savings Plans, Pension Plans and ISAs

Learning Objective

5.8.1 Know the requirements governing the sub-registers for savings plans, ISAs, and pension plans

5.8.2 Know the rights of holders on sub-registers

5.8.3 Know who has responsibility for sub-registers

When an investor places money in a savings plan or ISA, the plan manager generally places an aggregated deal with a third party administrator in the underlying CIS. The scheme's register does not, therefore, record units/shares as being held by the various individual investors – it shows a single position for the plan manager (usually using a corporate nominee as the registered holder).

If the plan manager is independent of the AFM (for example, if it is a platform), such investor records are simply the records of that firm. However, if the AFM is acting as the plan manager, the investor-level records may be referred to as a sub-register. The register confirms how many shares are held by the nominee company in respect of the savings plans, and the sub-register records how many of those units/shares are held on behalf of each plan investor.

The costs of maintaining savings plans/sub-registers operated by the AFM can be paid out of the property of the scheme, though 60 days' notice must be given to holders of any proposal to establish such a sub-register (due to the increase in chargeable costs that may arise). Where the cost of maintaining the sub-registers is charged to the CIS fund, the plan holders must be afforded the same rights as those holders who hold units/shares directly on the register (ie, not through a plan). This includes receipt of the fund manager's reports and the right to attend and vote at unit/shareholder meetings.

Similarly, sub-registers are subject to oversight by the trustee/depositary (as the AFM is running the savings/pension plan) and will be included in the trustee's monitoring programme (including monitoring of any third-party administrator retained). Consequently, the trustee/depositary will require that periodic reconciliations are performed, matching the units/shares on the sub-registers against the nominee's holding(s) on the main register, and will generally review such items during regular monitoring visits.

9. Box Management

Learning Objective

5.9.1 Understand the concept of box management

5.9.2 Know the differences between sub-register dealing and business as usual (BAU) investor dealing

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As we have seen in the products chapter 3 of this workbook, unlike investment trusts, OEICs or unit trusts do not have a finite number of units. Instead, the number of units for an OEIC or unit trust can increase or decrease daily dependent depending upon the net sales/repurchase. Share/units are managed at a share class/fund level within the manager's box which controls and reconciles the register and the holding with the trustee/depositary. The manager's box should never have a negative number of units as this would imply that there are not enough units in issue to cover all investor positions which would be a serious breach of the regulations and need to be reported as such.

The book process allows the AFM to see the net movement of all deals placed on a daily basis and make the appropriate decision with the trustee/depositary to ensure that the fund either has the correct amount of cash to make investments, or sells underlying holdings to pay for client repurchases:

- sale deals (clients buying funds) will result in a creation of the net position
- clients repurchasing (clients selling their holdings) will result in a liquidation.

All shares/units are to be created/liquidated via a trustee decision made through the manager's book.

Often a fund manager will hold a buffer of shares – a small holding that can cover either small price movements between making decisions or if dealing volume is low. Historically, fund managers used the box position to make money on fund movements; this is now not allowed under the regulations. However, box positions are still held normally at nominal amounts to act as a buffer to ensure the funds always have enough units/shares in issue.

On a dealing day if, the AFM finds that the box does not hold sufficient units/shares to meet the need of the investors, they will instruct the trustee to create more units/shares and have them added to the manager's box. Clients who have made purchases may receive either units/shares that have just been created, or ones that have previously been issued and bought back by the AFM. However, this has no impact on the investor, as the AFM normally deals as principal, and the shares are kept until they are either sold to another investor or cancelled with the trustee.

The AFM uses its own capital for any holding in the manager's box. If the AFM considers it has an excessive amount it will instruct the trustee/depositary to liquidate and the proceeds will be paid to the AFM on the settlement date.

The regulations are clear in relation to the size of the box:

- At each valuation point, having established the net investment and redemption deals performed, the AFM must ensure they hold sufficient units/shares to meet all outstanding orders.
- This can include any units/shares already held in the box, plus any additional units/shares being issued by the trustee.
- Where the AFM does not hold sufficient units/shares in their box, they are said to have a negative box position, and it is a serious breach if an AFM does not instruct the creation of sufficient units/shares to cover this.

There are two main parts to the process which are listed in the following points.

Form A – Estimated Decision

- Once the valuation point has been reached and all trades are processed, the box manager will 'freeze' the box. This process results in no further movement for that day's decisions. The AFM/TA will then enter the decision to liquidate or create units to meet the underlying requirements of the investor trades for that valuation point.
- The trustee will require either cash trades to be advised as a value or estimated at the previous VP's price to advise units/shares.
- Once completed, a Form A will be produced and sent, detailing the decision per International Securities Identification Number (ISIN) or can be rounded up and reported per fund.
- The initial form is typically expected to be produced within two hours of the VP.
- The form is used by the trustee/depositary and contains only those funds that are relevant to them and for a single VP (AFMs can employ more than one trustee/depositary).

Form B – Final Decision

- Once the actual prices have been provided by the fund accountant and the pricing jobs run, transactions within the systems are updated and the cash decisions converted to actual shares/units.
- Box decisions can then be recalculated to meet the specific underlying requirements of the investor trades for that valuation point.
- These decisions are sent to the trustee and depositary (normally within four hours) advising the net movement payable and settlement date due. There is a regulatory requirement to send them within 24 hours of the valuation point.
- This report also details the number of shares/units that are in issue (ie, all of the fund's holdings in total) which allows for a trustee reconciliation.

- As each share class is listed separately, there may be multiple creations/liquidations on the single instruction. In most cases, the trustee will then only require the net amount to be moved between the AFM bank account and trustee bank account.

The reason this process is referred to as 'box management' is before dematerialisation each time units were either purchased or redeemed by an investor, the investor would be issued with a revised certificate to prove ownership. These certificates were left in a 'box' for the trustee and depositary to update and issue a new certificate. The trustee was normally based in the fund manager's office.

9.1 Errors

As we have seen above there are times when errors will happen within the dealing process. If the error is significant, the AFM or TA may not wish to accept any potential loss. In these cases, the trustee will be contacted and, if within the settlement period, a re-work will be requested.

It is worth noting that the trustee may not grant this request as there are several factors that have to be taken into consideration in respect of whether underlying stock was sold, if the fund's cash reserves were being used or even if there have been a number of failures/errors and the operational costs are too high.

9.2 Issue and Cancellation

Issues (creations) and cancellations are instructed by the AFM to the trustee/depositary to ensure that sufficient units/shares are available so that the AFM can meet all outstanding unit/share transactions, with the desired number of units/shares remaining in the manager's box.

When the AFM holds insufficient units/shares in the box to meet all orders received at the valuation point, they must give instructions for the creation of at least the relevant number of units/shares to meet this shortfall. Under the FCA COLL Sourcebook regulations it is left for the AFM and trustee/depositary to agree an appropriate period for this to be affected. FCA guidance suggests that if the AFM operates a box with the principal aim of making a profit, this period will be short (eg, two hours), otherwise, a longer period (eg, up to the next valuation point but in all cases within 24 hours) may be acceptable, providing that controls to manage any conflict of interest and treat customers fairly are established.

The purpose of these regulations is to try to ensure that the AFM never has a short position or negative box, ie, there are enough units in issue to cover all investor positions. The reason for this is to prevent an AFM from manipulating share orders and making hidden profits from selling more shares at one price in the expectation that they will be able to buy back sufficient shares before the next valuation point.

As the unit/share price of a **forward pricing** fund is unknown during this period, the AFM is unable to provide a full instruction to the trustee/depositary (recording the number of units/shares, the price and cash concerned). The notification will generally allow an estimate of the total net issue/cancellation to be performed, with the trustee/depositary ensuring that the finalised figure does not differ significantly.

Once the pricing process is completed, the issue and cancellation prices will be known, and the AFM can send a final notification to the trustee/depositary. The AFM is obliged to pay for units/shares issued by the trustee/depositary by the close of business on the fourth business day following their instruction.

Similarly, if a cancellation is instructed, the trustee/depositary must pay the proceeds to the AFM on the fourth business day, subject to the trustee/depositary receiving such evidence of transfer of legal title as they may require.

Thus, an AFM may decide to arrange for the CIS to cancel units/shares if there are more sellers than buyers, taking into account all orders received before the relevant valuation point. The AFM is prevented from cancelling units/shares if to do so would leave him an insufficient number to fulfil all the orders they had received for the purchase of units/shares. While this may seem to be simple common sense, the regulations are framed in such a way as to prevent the AFM from manipulating the buying and selling of units/shares and taking a short position in expectation of a fall in the market.

An exception to the four-day settlement requirement is if the unit/shareholder requires payment in a currency for which the scheme holds insufficient cash or has insufficient facility to borrow in that currency to meet the redemption. In such circumstances the settlement period is extended until the shortage of currency is rectified.

9.3 Sub-register Dealing

Deals placed by investors directly with a platform are held on a sub-register. The investor's details allowing them to place that trade, together with a full record of their transactions, will be held on the platform's system as it would be if dealing directly with a fund manager.

When dealing, the platform will enforce a pseudo-VP prior to, or a dealing cut off in advance of, the fund manager's valuation. This allows the sub-register to amalgamate the trades and transmit them to the AFM prior to the 'real' VP. This amalgamated trade is placed in the name of the platform (or a nominated custodian/nominee). The fund manager will only have the name of the nominee on their register and will be unaware of the underlying investors held on the platform's sub-register.

Once the trades are priced, confirmation will be sent back to the platform and pricing/deal allocation will take place on the sub-register. It is the responsibility of the platform/sub-register to ensure that the nominee position (shares or units held) reconciles with the fund manager.

9.4 Business as Usual Dealing

As highlighted in this chapter, under section 6.1, depending on internal processes, deals can be received by post, email, telephone, fax and STP.

The TA, on behalf of the fund manager will process all deals received before the VP (assuming they are in good order). Investors placing deals directly with the fund manager will be placed directly onto the register.

10. Cash Management

Learning Objective

5.10.1 Know intraday cash management

5.10.2 Know the difference between creation and liquidation versus subscriptions and redemptions

5.10.3 Know what is meant by the term 'cash matching'

5.10.4 Understand the significance of electronic receipts versus cheque receipts with respect to various account types including distribution accounts

5.10.5 Understand the procedures for treasury reporting and liquidity management

10.1 Intraday Cash Management

TAs typically administer many bank accounts on behalf of fund managers. These bank accounts fall into three main categories:

- client money accounts
- dealing (or firm) accounts, or
- distribution accounts.

In order to administer these accounts, the TA will have an agreement in place with the fund manager, depositary and the bank to allow them to administer the account, moving money as necessary to ensure cash management activities can be completed successfully. These accounts will be used solely for TA business to ensure that the TA's records match precisely what is in the accounts at all times. There are two types of payments made by TA, firstly payments to and from investors (perhaps via a client money account) and payments to and from the fund via the trustees for creation and cancellation (liquidation) of units.

10.1.1 Client Money Accounts

Depending on the systems and processes in place, there may be one or many client money accounts that the TA administers for the fund manager. As these accounts belong to the fund manager they will be in the name of the fund manager rather than the TA. All the money held in these accounts belongs to the clients of the fund manager and the accounts will have the phrase 'client money' in their name. Client money accounts are pooled accounts holding money for many clients.

Although not specifically documented in the regulations, it is typical that processes will be in place to avoid client money accounts from becoming overdrawn as the concept of an overdrawn client money account suggests that there are no clients whose money is being held by the fund manager, which is an extremely unlikely scenario.

As already discussed in the CASS section 2, client money accounts are managed very carefully, and meticulous record keeping is required to ensure the TA has the correct records of which clients are entitled to which money in the account. One client's money is not allowed to be used to offset money owned by another client.

Any money arriving into the client money account must be receipted to record its arrival and the type of payment method that the client used will also be recorded as this can deem when the money is cleared. Cheques will take longer to clear than electronic payments, although some fund managers have agreements with their bank to give cleared funds for cheques on receipt.

Payments made out to clients from the client money account must also be recorded, and if the payment is made by cheque, money must be held by the fund manager in a client money account until the cheque is cashed. Ensuring there is enough money in the client money account to pay clients is an important part of the cash management process and may involve moving money from the dealing account to the client money account to cover positions. These movements might be reversed at some point in the future when payments are received into the client money account to cover these positions. BACS payments to clients are one area where fund managers must pre-fund the client money account as the payment will go out very early in the morning, before money has been received into the client money account from the trustees to pay out to clients. This pre-funding will effectively be reversed once money is received from the trustees.

10.1.2 Dealing Accounts

Dealing or firm accounts hold money belonging to the fund manager. As it is the fund manager that the client buys and sells funds through, all cash from the fund to clients flows via the dealing account. This money may move from the dealing account to the client money account before being paid out to the client. Typically, the dealing account will have an intraday overdraft limit to allow payment to be made before money is received from the fund or from investors (such as any BACS pre-funding) as well as an overdraft limit to allow for an overnight overdrawn position if necessary to help the fund manager manage cash flows.

The dealing account is used to make payments to (for creations) and from (for cancellations) the trustee on fund settlement date. Creation payments are funded by investors paying for the units or shares they have bought, and any late payments by investors must be funded by the fund manager to ensure the fund is paid on time (via the trustee).

10.1.3 Distribution Accounts

Distribution accounts are held in the name of the trustee and are used solely for the handling of distribution payments to investors. A single payment will be paid into the account by the trustee on the distribution payment date and the TA will then allocate the distribution across all investors who are due a payment.

10.2 Subscriptions and Redemptions

Subscriptions and redemptions are payments made between the investor and the AFM.

10.2.1 Subscription Payments

A subscription payment is made by the investor to the AFM; this is payment for units/shares purchased by the investor and the payment is required by the close of business on the fourth business day following the instruction. Should an investor be late in making the payment, it is the AFM's responsibility to fund the shortfall until the payment is made.

10.2.2 Redemption Payments

A redemption payment is made by the AFM to the investor; this is payment for units/shares cancelled by the investor and payment must be made by close of business on the fourth business day following the instruction.

10.2.3 Creation and Liquidation Payments

Creation and liquidation payments are those made between the trustee/depositary and the AFM. A creation payment is administered by the AFM with a liquidation payment administered by the trustee/depositary.

Creation Payments

The AFM is obliged to pay for any new units/shares issued by the trustee/depositary by the close of business on the fourth business day following the instruction, this payment is known as a creation payment. The funding of the creation payment is derived from the subscription monies received from investors. On a day when there is a creation payment, the subscription monies expected will be higher than that of the redemption monies to be paid out, with the net cash balance of the two being the amount required to meet the creation payment.

Liquidation Payments

The trustee/depositary is obliged to pay the proceeds of any cancellation of units/shares (liquidation) to the AFM by the close of business on the fourth business day following the instruction. The AFM then uses these proceeds to pay the investors that had requested to cancel their units/shares four days prior. On a day when there is a liquidation payment, the subscription monies expected will be less than that required to meet the payment of redemptions to investors, with the liquidation payment making up the difference.

10.3 Cash Matching

Cash received into the client money or firm accounts, for the settlement of subscription deals, is matched to the corresponding unsettled deal(s) in a process known as 'cash matching'. This procedure may be performed on the same day as the cash is received into the bank account or, where the delivery versus payment (DvP) exemption for CISs is applied, then it may be carried out on the following working day. It should be noted that investors may pay for subscription deals on a one-to-one or one-to-many basis.

10.4 Electronic Receipts vs Cheque Receipts

A cheque is a legal banking document that orders a bank to pay a specific amount of money from a person's account to the person in whose name the cheque has been issued known as the payee. Cheques that are received by transfer agents need to be deposited into the appropriate bank account. Cheques paid in on a business day will clear on the next business day by 23:59.

10.4.1 Out-Clearing

Out-clearing is the part of the clearing process where customers pay cheques which could be drawn from various banks into a branch of their own bank and the cheques are sent out for clearing at a regional centre. The cheques drawn on other banks are sent to the central exchange where they are then couriered onto the other banks for 'in-clearing'. For a TA, this is the process of receiving/paying in cheques inwards to the TA-managed accounts.

Cheques drawn by the TA are sent via post to the investor together with associated correspondence. A record of the cheque issued is retained within the TA for clearance monitoring and reconciliation purposes.

10.4.2 In-Clearing

In-clearing is the part of the clearing process where a bank receives the physical cheques paid into other banks that have been drawn on their bank, from the central exchange, and make a pay/no pay decision. For a TA, this is the process of issuing outgoing cheques from the TA-managed accounts.

Although cheques are still widely used in the UK market and the clearing cycles have reduced, electronic payments are much more efficient as it reduces costs, fraud attempts and provides immediate cleared funds.

Electronic payments eliminate the need for paper to move money from one account to another. It is a way of making transactions through an electronic medium without the use of cash or cheque. There are several electronic payment mechanisms that can be used for electronic payments in the UK.

BACS facilitate payments (direct credits) and collections (direct debits) in GBP. These need to be prepared three days in advance of the required payment date as this is the period they take to complete.

Direct credits facilitate payments from the TA to the investor, with BACS offering reporting that advises the sender of any payments that have been unsuccessful and enables the TA to update the register:

- **Automated Return of Unapplied Credits Service (ARUCS)** provides details of any payment that cannot be executed, eg, where the account has transferred or the investor is deceased.
- **Advice of Wrong Account for Automated Credits (AWACS)** provides details of incorrect bank accounts for amendments to be made.

Direct debits are instructions provided by the investor to the firm for a value to be debited from their bank account on a pre-determined date and frequency. The investor instruction is also sent to the customers bank which can be completed via BACS using the Automated Direct Debit Instruction Service (AUDDIS).

- **Automated Return of Unpaid Direct Debits Service (ARUDD)** provides details of any direct debits that have failed to collect and the reason for the rejection.

Where BACS transactions are executed across a client money bank account, consideration is given to prefunding the account the previous day as the BACS debits will occur at the first available opportunity which can result in an intraday shortfall.

Faster payments Service (FP) offer near real time payments and operate on a 24/7 basis. Transactions are executed in GBP and within two hours of submission, but often this is within minutes. The maximum value that can be transacted using FP is £1,000,000, and not all sort codes can accept FP which can lead to failures and additional steps to remediate. To complete a FP, there has to be available cleared funds in the originating account which can introduce challenges where payments are being made from a bank account that has sufficient credit limits but insufficient cleared balance.

Clearing house automated payment system (CHAPS) are used for high-value payments and those being sent overseas using the SWIFT infrastructure. CHAPS payments are completed with same day value provided the instruction has been submitted prior to the cut-off time, currently 18:00 for GBP (other currencies may have earlier deadlines). There is no upper limit for transacting across CHAPS.

All transaction types and methods above can be used for all account types including dealing, distribution and client money accounts. However, TAs and asset managers must use the tools available to them based on accessible banking and payment infrastructures.

Money movements instructed to banks cannot be guaranteed to be made in the order in which they are sent to the bank as some movements may need manual approval by the bank. This can cause challenges for the TA as money movements may need to occur in a prescribed order to ensure that CASS regulations are met. Therefore, checks will need to be made after an instruction is made to a bank to ensure the instruction has been completed before the next instruction can be sent. There are times when investors will have placed large deals to purchase units and the money to pay for these deals is expected to be received by fund settlement date. The TA may have to go through a cash-matching process to monitor the client money or dealing account for the arrival of this payment so that enough funds are available to make payments out to other clients. If the payment does not arrive before the cut off for making payments out to other clients, the fund manager would have to provide the funds from their own corporate account to cover the position. The investor who has failed to provide funds would then be tracked and chased as a debtor.

Ensuring the dealing account is correctly funded, including monitoring intraday and overnight overdraft positions is an important part of the cash-management process. To help with this, TAs will typically provide some expected positions via a treasury report which looks forward to expected payments and receipts to give the fund manager pre-warning of any extra cash it may need to pay into the dealing account from other corporate accounts.

10.5 Treasury Reporting and Liquidity Management

Treasury reporting and liquidity management is the responsibility of the fund manager where they manage both cash flows in the fund and the resultant liquidity to meet investor redemptions.

Transfer agents support this activity by providing cash flow reporting (net trading reporting) at multiple points throughout the working day together with bank balance reporting and debtor/creditor positions. Additional information may be requested to enable fund managers to fulfil their responsibilities in the area.

10.5.1 Managing Risk Liquidity

When investors redeem their investments they expect the proceeds to be paid in line with the contractual settlement date stated within the fund prospectus, typically the settlement date can be anywhere between T (Trade Date) + 1 to T + 4.

It is important for management companies to have good liquidity risk management (also known as funding in place). This enables them to meet the contractual redemption settlement date(s) so that proceeds are paid on due date to their investor(s), this also needs to include when there are varied market conditions.

10.5.2 Process Followed for Funding

If the counterparty (trustee/custodian/depositary) has not released the payment(s) from the fund(s) on the day of settlement and/or settlement has not been received for subscription(s) with the same settlement date, for the contractual settlement obligation to be met, there would be a requirement from the management company to fund this shortfall position, normally from their corporate account (this account would normally hold a surplus amount for this type of funding).

There are occasions where the fund manager may need to arrange additional internal funding to the corporate account for large redemption(s). The management company can give authority to the TA to arrange funding as and when required from their corporate account, to avoid slowing down the process, as most corporate accounts are reconciled by the TA and/or by the management company.

If funding is not available and/or additional funding has not been arranged to cover settlement obligation(s) this will then result in a late settlement breach.

To avoid late settlement from the trustee/custodian/depositary, figures are confirmed by the TA on behalf of the management company to the trustee/custodian/depositary before settlement date. Also subscription(s) due to be settled by the investor(s) on the same settlement date as the redemption(s) will be monitored and chased during the trade date to settlement date to ensure receipt of payment on settlement date. This then limits/reduces the risk of the value and frequency that funding will need to be arranged by the management company. As for most trustees/custodians/depositaries, they settle net with the management company daily. This means if the value of redemptions settling is greater than subscriptions, the trustee/custodian/depositary will pay the fund manager. If the value of subscriptions settling is greater than redemptions, they will pay the management company.

Any funding that has been arranged should be returned to the corporate account as soon as settlement has been made by the trustee/custodian/depositary or investor(s) for subscriptions to avoid a CASS risk event as this is the firm's money. Most TAs will have an automated banking operation/sweep whereby their system, at a certain time in the day, calculates the level of borrowing required from outstanding debtors (trustee/custodian/depositary/investors) and initiates a process to automatically fund the amount from a corporate/float account into a payments account in order to settle and pay out the investors and/or trustee/custodian/depositary on a net basis. Then, later time in the day, another sweep will run which will return any funding back to the corporate/float account where payments have since been received as funding is no longer required. This is to avoid any CASS risk event.

11. Income and Distributions

Learning Objective

5.11.1 Know the sources of income

5.11.2 Understand the different treatment of income for income and accumulation shares/units

5.11.3 Understand the reinvestment and distribution process including equalisation, rebate processing and bank account structure

5.11.4 Be able to apply the timetable for distribution of income

5.11.7 Know the difference between dividend, interest and property income distributions and the relevant criteria

5.11.8 Know the customary payment processes and their associated requirements for the following: tax vouchers; BACS/Faster Payments; distribution warrants

5.11.9 Know the treatment of unclaimed distributions

Generally, the income of a collective investment scheme (CIS) comes from the dividends and/or interest from the underlying assets held, underwriting fees, interest on cash deposits, and sale of assets. This total income, less expenses, is effectively earned by the investors within the fund. Furthermore, if the fund received portfolio assets in lieu of income (eg, as part of a scrip dividend), a corresponding transfer from the fund's capital account to its income account may be made. This income earned inside the fund is not generally subject to corporation tax.

Under the Financial Conduct Authority (FCA) regulations, every fund must have, at a minimum, an annual and half-yearly accounting period. Income will be allocated to unit/shareholders as at the annual income allocation date, though the authorised fund manager (AFM) may identify other accounting periods as having income allocation dates attached.

For each period (or income allocation date), the AFM or fund accountant calculates the amount of income received during the associated accounting period(s). As we have seen in previous chapters, it is the responsibility of the trustee/depositary to ensure that income is allocated to each unit/shareholder appropriately and in relation to their holding.

Distributions may be made as a payment of income (removing the income from the fund price to enable a payment to the unit/shareholder), a reinvestment to purchase additional units, or it may form part of an accumulation share class/fund (where income is moved to the fund's capital cash balance maintaining the unit price).

Responsibilities/high level steps:

- The AFM calculates the total income and that due to each holder.
- The trustee/depositary transfers the distribution sum from the fund's income account to:
  - a distribution account (income funds)
  - the capital account (accumulation funds).
- The transfer agency (TA) will process payments and arrange for tax vouchers/distribution advices to be issued to each investor.

Income is calculated on the last day of each annual accounting period; this is referred to as the accounting end date (or accounting reference date).

Once the income per unit/share has been determined, the unit/share price is quoted ex-distribution until the payment date. This means that the value of income to be distributed is removed from the ongoing calculation of the fund price even though it will operationally still be held (or receivable) in the fund's income account. Entitlement to the income remains with the registered holders as at the accounting reference date, so subsequent unit dealing does not include entitlement to that income. A CIS may also have one or more interim income allocation dates and interim accounting periods.

Funds must distribute income within four months from the accounting end date (both interim and final). If a fund makes one or more interim distributions, eg, monthly, quarterly or half-yearly within each annual accounting period, the prospectus must specify the payment dates (referred to as the interim allocation dates). Income will be calculated on the last day of the interim accounting period and generally treated in the same way as if it were an annual income allocation. However, unlike a final distribution date, interim distributions do not necessarily have to allocate/distribute all the income.

All sub-funds of an umbrella-type CIS will have the same annual accounting reference date and, in the normal course, the same annual income allocation date.

11.1 Action Taken if the Income Available is Small

Specific funds, such as those focusing on growth, will generate very little income from their underlying assets. In these cases, the income generated may not even cover the expenses the fund may incur to process the income payment including the preparation and mailing of vouchers and **warrants**.

In this situation, the AFM may apply to the trustee to defer payment or simply credit the income to the capital account. COLL rules enable the AFM to agree with the trustee/depositary, the figure (known as **de minimis**) below which the distribution, will not be paid. The scheme prospectus would confirm the policy in respect of any *de minimis*.

11.2 Dividend and Interest Distributions

CISs can pay the following types of distributions:

- **Dividend distribution** – resulting from investment by the fund in shares.
- **Interest distribution** – for funds that are invested in 60% or more **gilts**, UK or overseas bonds and/or money market deposits throughout the accounting period (ie, a fund with predominately interest-bearing assets).

11.3 Property Income Distributions (PIDs)

In addition to the two types of distribution above, a property authorised investment fund (PAIF) (where the underlying assets are predominantly real property or shares in UK real estate investment trusts (UK REITs) and certain other similar entities) will pay a third type of income – property income. Under PAIF regulations, this income must be ring-fenced and will be documented separately. The fund will then make a distinct property income distribution (PID), in addition to a dividend and interest distribution.

11.4 Calculating the Available Income

Learning Objective

5.11.5 Be able to calculate the available income

Generally, the income of a CIS comes from the dividends or interest from the underlying assets held. The calculation is completed as in the following example:

Example: Income Available for Distribution: 1 May 20XX to 30 April 20XX

	£000
Income brought forward (note 3)	200
Gross income (received or receivable during the period) – including franked investment income (eg, dividends received and stock dividends) and unfranked income (such as interest on debt securities, bank deposit interest, and underwriting commission)	3,800
Equalisation: add the amount received on shares issued during the period (note 1)	100
Subtotal	4,100
Deduct:	
Charges and expenses of the company paid or payable out of income (note 2). This may include, for example, the AFM's **periodic charge**, registrar's and depositary's fees and safe custody fees	(1,000)
Equalisation: deduct the amount paid on shares cancelled during the period (note 1)	(10)
Taxation (tax credits, corporation tax, withholding tax)	(600)
Income carried forward: any income it is agreed should be carried forward to a subsequent accounting period (note 3)	(300)
Amount available for distribution (note 4)	2,190

1. Equalisation is the proportion of the price received or paid for units/shares that are related to income. It is included only if provision for equalisation is included in the trust deed/instrument of incorporation.
2. The charges and expenses must also be covered in the prospectus if they are to be taken out of the income or capital property of the trust/company. Certain charges and expenses may be charged to the fund's capital account. If the objectives of the fund are to provide income or a balance between income and growth, the AFM's periodic charge can be treated as a charge against capital. Taking this charge from income to capital increases the amount available for distribution but could have an adverse impact on capital. The prospectus must state which charges are taken from income or capital and, if capital, it must include appropriate risk warnings on the effect of this on capital.
3. This may include income that is unlikely to be received until 12 months after the income allocation date.
4. This includes any amount to be transferred to the capital account in respect of accumulation units/shares.

The underlying assets of a CIS will provide income throughout the accounting period, and the price quoted will reflect this accrued income until the next accounting date. The ex-distribution (XD) date is the first valuation following the accounting end date. At this point, the accrued income within the fund is stripped out of the price. Investors buying shares on this date will not be included within the next distribution accounting period and will receive a lower price due to the lack of income. At this point, the fund's income cycle starts again, and income begins to accrue as before.

Given the above, the price allocated to most purchases of units/shares will include some element of income. Assuming the fund's income receipts exceed its expenses, those units/shares purchased at the beginning of the period will have less income included in the price than those purchased towards the end of the period. Equalisation is the element of income included in the price of units/shares purchased by investors during the accounting period, and is paid out to these investors as a return of capital at the end of the accounting period.

11.5 Equalisation

- If an investor buys shares within a fund since the last XD date, those new shares will not have been held for the full period over which income was received by the fund.
- Shares bought at this time are known as Group 2, those bought prior to the XD are Group 1.
- As a distribution is processed and payment calculated these Group 2 shares will be entitled to the same distribution rate (pence per share) as the Group 1 shares.
- His Majesty's Revenue & Customs (HMRC) has deemed that this portion of the distribution payment (ie, those Group 2 shares) will be treated as income for tax purposes and therefore as a return of capital (see below). This means that in an ISA, for example, the **tax credit**/reclaim amount on the first distribution will be considerably lower than on subsequent payments.
- This is known as an 'equalisation' payment, because it equalises the per share amount that is paid on Group 2 shares with that paid on Group 1.

Once Group 2 shares have passed their first XD date, they automatically become Group 1 shares.

- **Group 1** – those who purchased their units prior to the previous XD date and still hold their units.
- **Group 2** – those who purchased units after the previous XD date and prior to the next XD date.

The amount of income equalisation may be the actual amount of income included in the price of units/shares purchased or as is the case more commonly, it is an average amount, calculated as follows:

$$\frac{\text{The aggregate of the amounts of income included in the issue (creation) price of the unit/shares issued or re-issued in the accounting period}}{\text{The total number of unit/shares purchased by investors during the period}}$$

The resultant average rate is applied to each of the units/shares purchased in question – hence the term equalisation. The average rate is referred to as the equalisation rate. Units/shares purchased during the distribution period are referred to as **Group 2 units/shares**, whereas units held at the beginning of the period are referred to as **Group 1 units/shares**. Any distribution statement/voucher shows the breakdown between Group 1 and 2 units held and, usually, in the case of Group 2 units/shares, the amount of equalisation applicable to those units/shares.

It is possible, however, in the case of a fund of funds, that Group 1 units may be allocated an equalisation rate. This is because the underlying investments include the purchase of new investments, and either the unit trust fund or the fund of funds is required to pass on the equalisation to all its holders.

In the case of a unit trust, in order to apply equalisation, the manager's policy and a provision for grouping must be included in the trust deed. It is optional for managers to apply equalisation. If they do not wish to do so, reference in the trust deed will be omitted.

A Simplified Example

Existing investors have 100,000 units/shares at 50p invested in a fund holding fixed interest securities earning 12% pa (1% each month). No capital appreciation is assumed. A new investor purchases 10,000 shares on the last day of month two, and a second new investor purchases 10,000 shares on the last day of month four. Equalisation would be calculated as follows:

End of Month	Group 1 Shares	Group 2 Shares	Income		Price (p)	Equalisation	Capital (£)
			Group 1	Group 2			
0	100,000				0.500		**50,000**
1	100,000		500		0.505		
Purchase		10,000			0.510	100	**5,000**
2	100,000	10,000	500		0.510		
3	100,000	10,000	500	50	0.515		
Purchase		10,000			0.520	200	**5,000**
4	100,000	20,000	500	50	0.520		
5	100,000	20,000	500	100	0.525		
6	100,000	20,000	500	100	0.530		
Distribution			3,000	300	0.530	300	**60,000**
			–3,000	–300	–0.030	–300	**0**
			0	0	0.500	0	**60,000**

The distribution is payable to 120,000 units/shares at a rate of 3p per unit/share (ie, 6% in the first half of the year and 6% in the second half of the year). This equals £3,600 as shown:

Group 1 income:	3,000
Group 2 income:	300
Equalisation:	300
Total:	**3,600**

For Group 1 units/shares the whole distribution of 3p is income.

For Group 2 units/shares:

- In theory:
  - **1st investor** – 2p is income and 1p is equalisation
  - **2nd investor** – 1p is income and 2p is equalisation.
- In practice:
  - due to averaging, for both investors half the distribution is income and half is equalisation.

11.6 Calculation of Effective Yield

Learning Objective

5.11.6 Know the requirements for calculation of the effective yield

Generally, the income of a CIS comes from the dividends or interest from the underlying assets held. During 2007, changes were made to the way in which bond income is accounted for and distributed from authorised funds (unit trusts and open-ended investment companies (OEICs)) requiring funds to choose to distribute on a 'coupon basis' or an 'effective yield basis'. In practice, only those funds whose investment objective is to provide high income continue to distribute on a coupon basis.

Effective yield takes account of all expected cash flows from a bond over its lifetime. This differs from the coupon basis because expected cash flows include, in addition to coupons, any differences which exist between the purchase cost of a bond and its final redemption amount.

In light of this change in accounting rules, and in order to allow high income funds to continue to distribute coupon income notwithstanding the change in accounting, the regulator clarified its rules. The rules allow managers of authorised funds to choose to distribute income from bonds on the effective yield basis (as shown in the fund's accounts) or on a coupon basis. Coupon distributions are permitted only if these are at least equal to the amount of the income calculated on an effective yield basis.

Many funds choose to keep distributions in line with accounting income, and distribute effective yield income. Some funds, particularly those whose objective is to produce regular income for investors (such as high income bond funds), continue to distribute coupons. Funds that distribute on a coupon basis may have a higher risk of capital erosion or constrained future growth. However, it is important to note that other factors, such as changes in interest rates, may impact the value of bonds held by a fund, no matter what its distribution policy.

11.7 Effective Yield and Coupon Bases Compared

In order to illustrate the differences between effective yield and coupon-based accounting and distribution, two simple examples are set out below.

In reality, a fund will hold a portfolio of investments and may not hold them to maturity. The distribution which an investor receives will depend on the net income from the entire portfolio. For these examples, however, the impact of a fund's distribution policy is illustrated on the assumption that the fund holds only one bond and that it holds it to maturity.

- In example A, a fund purchases a bond at a premium to its redemption value.
- In example B, a bond is purchased at a discount.

Example A

A fund buys a bond for £102. The bond is due to redeem in one year's time for £100 and pays an annual coupon of £8. The total return on holding this bond over the year is, therefore, £6 (that is, £8 of coupon minus the £2 loss when the bond is redeemed). The coupon and effective yield basis of calculating income (ignoring any investor tax) can be compared as follows:

- The fund's income on a coupon basis for the coming year is £8; if income is accounted for on a coupon basis, the fund in this example will make a capital loss of £2 as the amount receivable on redemption is less than the purchase cost.
- The fund's income on an effective yield basis is £6; if income is accounted for on an effective yield basis, the fund in this example will make no capital loss or gain as the £2 premium paid on purchase of the bond is brought into the income calculation.

The fund may choose either to continue to distribute on a coupon basis or to distribute on an effective yield basis:

- Distribution on a coupon basis will enable investors to receive distributions comprising the £8 of income, with potential impact on the capital value of their investment, (the £2 loss at redemption).
- Where a fund distributes on an effective yield basis, the investor would share a distribution of £6 (the net yield expected at redemption), but the capital value of their investment is not reduced as it is taken into account when the income is calculated.

Example B

A fund buys a bond for £98. The bond is due to redeem in one year's time for £100 and pays an annual coupon of £4. The total return on holding this bond over the year is, therefore, £6 (that is, £4 of coupon plus the £2 gain when the bond is redeemed).

In this example, the fund's income on a coupon basis for the coming year is £4 and the accounting income on an effective yield basis is £6. The fund is not permitted to distribute on a coupon basis as this is less than the amount of the fund's income calculated on an effective yield basis.

The investors would share a distribution of £6, compared with the £4 received in the past as the redemption amount is taken into account when the income is calculated.

It is important to note that these examples relate to only one bond with only one year to maturity; funds will have a mix of bonds in their portfolio, all of which, taken together, will determine an investor's net income. In practice, therefore, for a number of funds effective yield income will be little different from coupon income for the portfolio as a whole. It is only those funds whose portfolios predominantly contain either high coupon bonds or low coupon bonds where the difference may be material. Typically, high income bond funds will be heavily invested in bonds bought at a premium and/or with high coupons. For these funds, coupon income will generally be above effective yield, so they are more likely to choose to distribute on a coupon basis.

11.8 Distribution Warrants

Distribution warrants are normally valid for six months from the payment date. Often the amount outstanding on the distribution account after six months is transferred (following reconciliation against the paid warrants) to an unclaimed distribution account where any interest earned is for the benefit of all unit/shareholders in the fund.

Any distribution payment remaining unclaimed six years after the payment date is transferred to, and becomes part of, the capital property and neither the unit/shareholder nor payee, if different (or their executors), can reclaim the income.

Traditionally, distribution payments were made by crossed cheque or warrant. The warrant is drawn in favour of the sole or first-named holder and sent to that holder's registered address by post, either on or just before the distribution payment date.

In addition, the payment can also be instructed to:

- a third party (ie, someone other than the unit/shareholder, such as a beneficiary), or
- bank, building society or firm (eg, solicitors).

Income due to the AFM (ie, in respect of units/shares held in the manager's box) is paid to the AFM, along with the associated tax credit.

11.9 Direct Payment

Given that there is a possibility that printed warrants can be misplaced or of such a small value the unitholder chooses, forgets or is unable to pay them into their account, the AFM's (and, therefore, the TA's) preference is to pay distribution amounts directly into the investor's bank account.

11.10 Distributions Paid via BACS/Faster Payments

If instructions are given in favour of a direct payment, it is now common for a payment to be made via BACS or the FP service (both of which are explained in more detail within the settlement section in section 4).

As per any electronic method of settlement (a distribution payment being no different), the automatic crediting of the value has multiple benefits, both from an investor servicing and operational aspect.

For the holder:

- no risk of a warrant/payment being delayed or lost in the post
- income is credited as cleared money on the due date, ie, there is no cheque-clearing delay
- there is no need to visit the bank or building society to pay in the warrant, and
- the tax voucher can still be sent direct by post to inform the unit/shareholder of the amount credited to the bank account.

For the AFM/CIS:

- paper handling is reduced
- reconciliation problems are reduced, and
- costs are reduced significantly.

Most firms encourage holders to have payments made direct to their bank account because of the benefits to both parties. The administration required when using distribution warrants is substantial:

- preparing and printing the warrants by specialist print houses
- reconciliation and ongoing monitoring, or
- providing duplicate warrants in the case of those lost or destroyed.

12. Reporting

Learning Objective

5.12.1 Understand specific transfer agency reporting requirements: statistical; AML; regulatory; shareholders and unitholders; HMRC

12.1 Reporting Requirements

12.1.1 Statistical

Dependent on the individual arrangements made by the ACD, there may be statistical obligations that the TA has to carry out on its behalf, these can range from monthly statistical reporting such as the Investment Association (IA), or quarterly product sales data reports submitted to the FCA.

The IA reporting is performed monthly where the transfer agency will report directly to the Investment Association funds under management figures which the IA then uses to compare against **benchmarks** in the sector of those particular funds and also displays the manager in a league table which is available to view publicly. This reporting may be completed by the fund accountant instead of the TA.

There may be other agreements in place to submit pricing information to providers, such as *Morning Star* or the *Financial Express*, who will publicise the share prices which have been provided to them by the delegated fund accountant for the particular fund. Depending on the frequency the fund values, this could be provided daily, weekly, or even monthly.

FCA reporting such as the Client Money and Assets Return (CMAR) reporting is produced monthly and reports the highest balances held in client money over that period.

The product sales data is provided quarterly to the FCA via Gabriel and reports on introduced advised business on behalf of retail clients placed into the delegated fund.

There are other reports provided which again are subject to agreement like TEX, where TAs will report their weekly transfer figures to the transfer exchange for the reporting period.

12.1.2 Anti-Money Laundering (AML)

AML reporting is actioned more frequently. The authorised fund manager (AFM) (or the TA on their behalf) is obliged to risk rate their incumbent investors and apply different levels of investors depending on their risk appetite, which could vary per authorised corporate director (ACD) client. The reporting could be as specific as categorisations, where, as an example, a UK nominee institution could be considered as low risk versus a PEP where they would be considered a higher risk and as such seek specific reports to satisfy their AML requirements.

Market timing reports will be performed daily to identity the timings of when deals have been struck within the TAs.

Transaction monitoring will be performed over the top of register updates/dealing transactions to identify any trends in investor's movements, ie, an investor changes an address then immediately redeems – could be interpreted as fraudulent and the ACD would seek further clarity on these movements.

Sanction checks can be performed weekly on the current register, as well as any new investor purchasing into funds. The sanction check will seek whether the incumbent investor is listed or has been sanctioned on a recognised exchange and report back to the transfer agent the details of any such sanction. The ACD in conjunction with the transfer agent could then impose dealing/settlement sanctions and/or reporting requests from the investor – or in some cases not accept the trade instruction. The transfer agent should keep records of when an investor has been sanction checked, when any such sanction has been imposed upon them and also indicate the time that they are considered to be 'passed' AML status – all of which should be retrievable from the transfer agent.

In terms of ensuring accuracy of their register, the transfer agent, in conjunction with the ACD, should also perform regular mailings to ensure that their records are up-to-date. This, in turn, also provides register updates from the clients' responses, and also identifies any gone away clients with the returned mailings – which should also constitute a register change.

12.1.3 Shareholders

The most common source of reporting for shareholders is usually in the format of a holdings and transactions statement, where for retail clients the TA is required to provide a statement to the clients at the frequency specified on their application and should be no later than one year. The frequency may vary and could be provided monthly/quarterly/half yearly and should detail the product they are invested in – both wrapped and unwrapped. These regulatory statements should include the latest Markets in Financial Instruments Directive (MiFID) requirements and show charges/transactions levied onto the investor over the period.

To fulfil CASS obligations, TAs are also required to report on statements as frequently as monthly, weekly, and even daily. These reports are provided so that the counterparty/institution can perform their asset reconciliations to agree that their holdings match what is present on the funds register.

Distribution tax vouchers are also common reporting requirements. When a pay date passes on a distributing fund, the transfer agent has to provide details of the distribution via an acceptable medium whether this is post/email.

Corporate actions or regulatory updates – when a fund transitions and requires a shareholder notification, the ACD in conjunction with the transfer agency must coordinate a mailing to notify the shareholders of the incoming change, these must be within an agreed time frame which is usually three months prior to the event.

12.1.4 His Majesty's Revenue and Customs (HMRC)

ACDs, in conjunction with the TA, are required to provide reporting to the HMRC – which is subject to and dependent on the type of products the ACD/fund is offering.

As an example, the ISA10/14 report is to be submitted annually to HMRC, which will detail the amount invested into an individual savings account (ISA) product within that tax year. The report has to be in a specified format which has been defined by HMRC and has to be submitted as accurately as possible – including mandatory information such as national insurance number (NINO) and date of birth as a minimum requirement for investing into the ISA. Funds which do not offer wrapped products do not need to provide a report back to HMRC, or can submit a nil return if this is now closed. Where these details do not exist, the transfer agent should have a procedure/process in place to complete the registration on the account and request any missing data in writing.

12.2 Incident and Breach Reporting

Learning Objective

5.12.2 Understand the requirements for incident and breach reporting

Failing to comply with the FCA rules exposes a firm to risk of regulatory sanction. It may be fined by the regulator, which of course has a financial impact but also affects the firm's reputation. Additionally, the directors and any approved persons responsible for the firm's activities could be fined or banned from performing such roles in the industry. Even if the firm is not fined, defending itself against an FCA investigation is itself a costly exercise.

All firms must maintain a record of regulatory breaches that have arisen in order to demonstrate that any detriment to investors has been correctly resolved, and also to show that they have taken action to address any deficiencies in their processes or controls.

It is standard for firms to conduct 'root cause analysis' to determine whether individual breaches are isolated cases (eg, breaches resulting from simple human processing errors), or have arisen because of a broader weakness within the control mechanisms in place within the firm.

The FCA Handbook identifies certain events or breach types as requiring immediate notification to the regulator should they occur. These items tend to be suggestive of systemic failings within a firm's structure or operations, which the FCA is concerned could expose investors to significant risk.

12.2.1 Raising and Reporting of a Risk Event

When an error has occurred a risk event should be raised including:

- a detailed timeline of what has occurred
- information regarding the investor/client
- details of the transaction and/or function which should include if appropriate:
  - deal information
  - registration details
  - reconciliation break information.

In addition to the above, it is important to include the correct rule reference(s) and apply these to each part of the report and summary of the incident.

Risk events should be raised and notified to the AFM within 24 hours. Risk events are just that and may not have been identified as breaches. It is, therefore, best practice for the TA to raise a risk event with their client (the AFM) and void if it is found later not to have been a breach or incident.

12.2.2 Investigation and Root Cause

Once identified, the event should be thoroughly investigated, and reviews taken place to determine the cause/event/impact ensuring the following is included within the analysis:

- people
- process
- systems
- external factors, and
- understand the impact(s) (consider upstream/downstream processes).

This will detail the root cause and any other control failures allowing for the next stage within the process.

12.2.3 Corrective Actions

Upon the completion of the analysis above, corrective actions may be required and fully reported on. The report should fully explain what action has been taken to rectify the error/event – including dates and evidence where required. The financial impact of correcting the error which is being funded, paid to the investor and/or being retained by the management company should also be included.

12.2.4 Preventative Actions

Finally, details will need to be provided to confirm what, if any, preventative actions have been put in place to stop the occurrence of such errors in the future. This should include any interim fixes if system or technology updates are required that traditionally cannot be implemented immediately. In addition, TA operations will need to review their involvement in the error in respect of procedures and ensure checklists and processes have been updated as required.

12.2.5 Serious Regulatory Impact

For risk events that have matters having a serious regulatory impact, the management company has the responsibility to report the following to the FCA:

- the firm failing to satisfy one or more of the threshold conditions
- any matter which could have a significant adverse impact on the firm's reputation
- any matter which could affect the firm's ability to continue to provide adequate services to its customers and which could result in serious detriment to a customer of the firm, or
- any matter in respect of the firm which could result in serious financial consequences to the UK financial system or to other firms.

With the above list and firms' outsourcing, it is fundamental that communication between the TA and management company is open and transparent at all times. All management companies have to record and monitor all risk events as well as the reportable incidents to the FCA, to track actions, preventative actions, key trends and identify control failures, and will rely on the TA to provide these details in a correct and timely fashion.

12.2.6 CASS Breaches

In addition to the above, it is now more common practice to report incidents of a CASS-related nature to the firms immediately upon identification (and not wait for the 24-hour window) as the regulations defined in both CASS 6 and 7 contain lists of breaches that must be immediately notified.

CASS 6 and CASS 7 each contain a list of breaches or failures that, if they arise, must be immediately notified to the FCA.

Some of the significant breaches identified within the regulations are:

- its internal records/accounts are materially out of date/inaccurate/invalid, to the extent that the firm cannot distinguish client money held for different clients
- it is unable to (or materially fails to) identify and resolve discrepancies having completed an external reconciliation
- it is unable to (or materially fails to) complete the daily internal client money reconciliation
- having completed the internal client money reconciliation, it is unable to (or materially fails to) resolve an identified shortfall or withdraw an identified excess
- it is unable to (or materially fails to) perform its external client money reconciliation per the firm's internal policy, and
- it becomes aware that, during the past 12 months, the amount of client money actually segregated was materially different from the amount required to be segregated.

12.2.7 Data Breaches

In addition to the above, breaches in respect of the General Data Protection Regulation (GDPR) now have significant focus, and, once again, the TA being responsible for data on behalf of the management company must be vigilant in respect of any such incidents.

If the TA identifies that a breach has occurred, whether due to an internal failing, or an external attack on their databases, it must notify the Information Commissioner's Officer (ICO) within 72 hours of the breach being identified. Failing to notify the ICO can result in a fine of whichever is the greater of £10 million or 2% of the data controller's global turnover from the previous financial year (note that this refers to turnover rather than profit).

The same level of penalty can be applied if the data controller is considered guilty of various administrative breaches, including those relating to organisational obligations and data security.

Any breaches relating to infringements of the data subject's individual privacy rights can result in a fine of up to the greater of £20 million or 4% of the data controller's annual global turnover.

12.3 Product Sales Data (PSD)

The FCA collects product sales data (PSD) on a quarterly basis across the financial services sector to allow them to identify market trends to aid the regulatory supervision process. The FCA publishes the data it collects each year. The FCA splits the data it collects into three categories:

- pure protection contracts
- retail investments, and
- mortgages.

TAs typically provide retail investments data to the FCA. This data is sub-categorised into:

- pensions
- investments
- endowments
- (stocks and shares) ISAs, and
- long-term care insurance.

The investments and ISA data is the core of the data supplied by TAs, but other data may also be provided as part of their business.

12.4 Investment Association (IA) Data

The Investment Association (IA) is an industry body that represents the majority of UK-based fund management companies. The IA publishes regular statistics and insights on how UK savers are choosing to invest, as well as on the wider trends in the UK investment management industry. The data used by the IA is provided on a monthly basis to the IA by fund managers, normally via their TA.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **What would cause a client to be subjected to enhanced ongoing monitoring?**
   Answer reference: Section 1.6

2. **What due diligence is required for companies listed on regulated markets?**
   Answer reference: Section 1.7.3

3. **How does a firm ensure the protection of a client's assets?**
   Answer reference: Section 2.1

4. **List the two methods used to calculate client money requirement.**
   Answer reference: Section 2.9

5. **What are the possible benefits to a firm for adopting a small estates policy?**
   Answer reference: Section 3.2.2

6. **When an investor has entered a contract, when are redemptions required to be settled?**
   Answer reference: Section 4.1

7. **How do electronic payments involve an improved security compared to cheques?**
   Answer reference: Section 4.4.1

8. **What are the possible risks involved when dealing via email?**
   Answer reference: Section 6.3.4

9. **Why should the manager's box never have a negative number of units?**
   Answer reference: Section 9

10. **What types of distributions can a collective investment scheme (CIS) pay?**
    Answer reference: Section 11.2

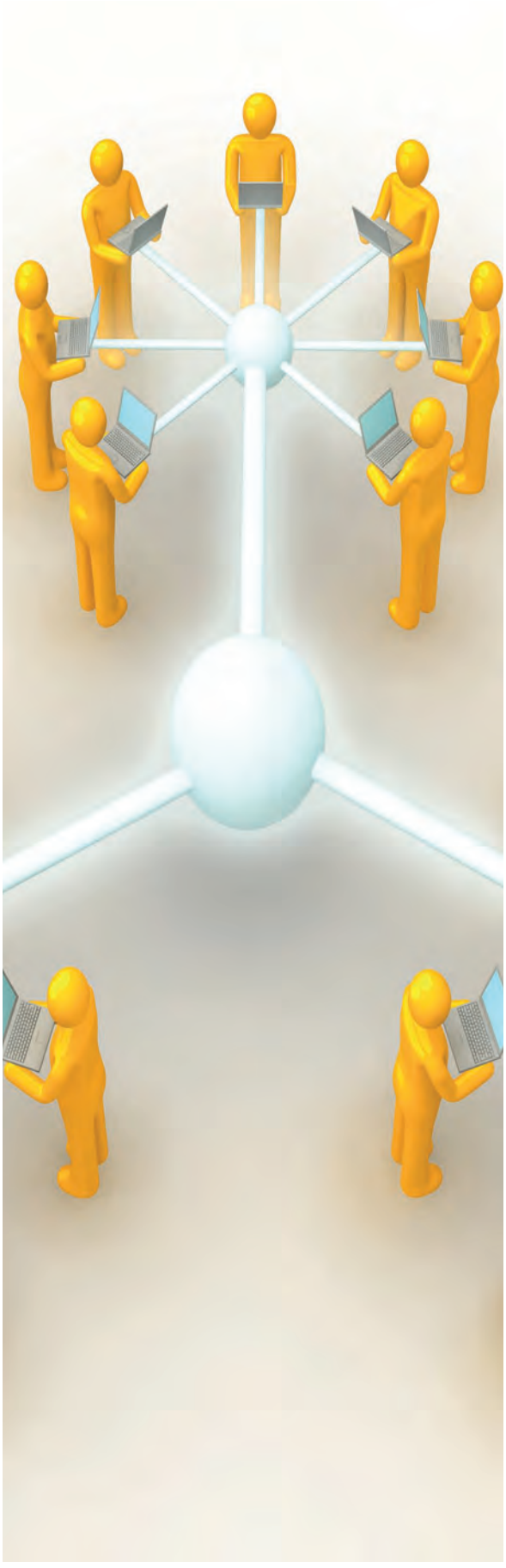
Chapter Six

Distribution, Front and Ongoing Charges

1. **Platforms** 193

2. **Agency Commission and Charging Structures** 197

This syllabus area will provide approximately 3 of the 100 examination questions



1. Platforms

Learning Objective

6.1.1 Know the range of investment types that can be offered by platforms

A platform is a service/company designed to provide direct retail customers and/or their independent financial advisers (IFAs) access to a wide range of asset types (including a multitude of funds offered by numerous fund companies, and offering a range of wrappers – allowing investors to consolidate their investments in a single account. Due to their very nature, and more recent entry into the marketplace, a platform has historically provided a more robust and functionally rich online presence, while other mediums of contact are available (ie, postal and telephone) a platform's operating model is often focused on a self-service aspect to keep costs as low as possible. Platforms will offer a range of assets that can be held on the platform and a range of products (often referred to a wrappers) in which the assets can be held. The platform operator and their technology will define the range of assets and wrappers that can be supported.

Platforms will also offer tools to be used by investors, their advisers or other relevant parties to support the investment process. These tools can help with risk profiling clients and in managing portfolios, including offering **model portfolios** with automatic rebalancing facilities. Platforms often compete with each other on the quality and breadth of tools available as there is often a large overlap between asset classes and wrappers.

1.1 Asset Classes

1.1.1 Funds

Platforms in the UK market typically offer a large selection of UK funds. The platform will offer access to funds suitable for sale to retail clients and can offer share classes which offer lower fund charges than those available to the general public direct from the fund manager. Fund managers are prepared to offer the share classes to platforms due to the volume of business that the platform can provide to the fund manager and the reduced costs the fund manager sees due to the aggregation of deals and reduction in the number of accounts held in the register.

Some platforms will also offer access to other fund types such as:

- **offshore funds** (often Luxembourg or Ireland registered)
- real estate investment trusts (REITs).

1.1.2 Cash

As noted above, the platform's purpose is to enable the investor to perform their investment activity under a single account and single interaction. Allowing transactions to be carried out across multiple funds and investment types or products (when regulations allow), the platform will often need to hold cash for the investor. This is not only as a means for paying for transactions (with multiple authorised fund managers (AFMs) and products there may be a need to hold cash for a period of time) but also to allow the investor to pay for the services and charges associated to the platform for using the service (such as annual, dealing and exit fees).

1.1.3 Exchange-Traded Assets

This covers a multitude of investment types:

- Investment trusts (described in more detail in chapter 3).
- Equities (ie, shares).
- Government bonds (gilts).
- Exchange-traded funds (ETFs).
- **Venture capital trusts (VCTs)**.

All of the above are placed on an exchange (for example the London Stock Exchange (LSE)) and will be available for purchase assuming there is a seller. Unlike an AUT or open-ended investment company (OEIC), the number of shares/bonds available at any time is fixed, and the exchange is the market mechanism for willing sellers to be paired off with willing buyers. The platform will execute transactions within these investment types (generally using a regulatory permission to deal in investments as agent), again facilitating the single interaction requirement of the client.

Exchange-traded assets are subject to pricing which is governed by supply and demand (ie, the higher the demand for a particular asset, the higher the associated cost to buy it). The party that created the asset (eg, the company issuing shares) only receives capital when the asset is first sold, being the party selling it.

Exchange-traded assets are not typically administered as part of the TA process but are managed via a broker. Some TAs in the UK market do offer services to support some types of exchange-traded asset such as ETFs or investment trusts, which are often marketed and sold by fund companies but are bought and sold in a similar way to equities.

Equities

An equity shareholding is the part ownership of a company. The performance of the company to which the shares are related to will determine the demand of ownership and therefore this will often relate to an increase in costs. The financial performance and, therefore, potential dividend pay outs, will also factor in the demand. It is worth noting, that with any asset/investment of this type, a poorly performing company can result in a significant capital loss to an investor (ie, the shares could become worthless).

Corporate and Government Bonds

A bond is an investment that typically pays a fixed rate of interest and is essentially an IOU from the corporate entity or government issuing it. There is also an expectation for the capital to be paid back at a specified time known as the maturity date. The bond issuer receives money from the initial buyer of the bond and will make regular interest payments to the bond holder. The regular interest rate is known as the coupon rate, and the date on which it is paid is known as the coupon date.

Although bonds rarely generate as much attention as shares, they are the larger market of the two in terms of global investment value. Bonds are issued by governments, supranational institutions and companies. Government bonds are issued by national governments and in the UK these bonds are known as gilts. Supranational bonds are issued by agencies such as the European Investment Bank (EIB) and the World Bank. Corporate bonds are issued by companies, such as the large banks and other large listed companies.

While the capital value of the bond at maturity is fixed, the market value can change over time depending on the demand , and is often affected by the interest rates being offered or the assumed risk of failure. If a bond fails to make the interest payments or pay back the capital on the maturity date, this is known as defaulting.

Bonds are generally considered less risky than shares, assuming the issuer remains solvent. Government bonds are incredibly low risk, unless there are serious economic problems within the country as was seen recently with holders of Greek government bonds who accepted losses as a result of the restructuring of the country's debt at various times since 2009.

Holders of corporate bonds, however, can face more real default risks (ie, if the issuing company becomes insolvent).

Exchange-Traded Funds (ETFs)

An ETF combines aspects of both a closed-ended fund and open-ended CIS in as much as they are listed on an exchange but unlike the closed-ended funds above, the number of shares in an ETF can change each day.

Assets owned by the fund are managed to generate an investment return. In the event that a seller cannot find someone to buy their shares, it is possible instead to redeem the holding for a portion of the fund's underlying assets. A similar process enables the fund to grow if an investor can offer suitable assets in return for new units.

Venture Capital Trusts (VCTs)

A VCT is a highly tax-efficient UK closed-ended CIS designed to provide private equity capital for small expanding companies and capital gains for investors. VCTs are companies that are listed on the LSE, and that invest in other companies which are not themselves listed on any exchange.

1.2 Wrappers

In addition to the full range of funds, the platform will commonly offer various products to allow their customers to make use of tax allowances and tax-efficient methods of saving and investing, such as ISAs or pension wrappers such as **self-invested personal pensions (SIPPs)**. In respect of the individual savings account (ISA), the platform typically act as the ISA manager and are therefore responsible for ensuring the product falls in line with the relevant regulations. The wrappers supported by platforms are outside the scope of the TA training material, but wrappers typically offered by platforms in the UK market include:

- general investment account, which is offered by all platforms and does not offer any tax efficiency for the investor as it is a straightforward account. It can typically hold all assets offered by the platform
- individual savings accounts, perhaps including Junior ISAs and Lifetime ISAs (LISAs)
- pensions, with a SIPP being the most common form of platform wrapper
- **offshore bonds**, and
- **onshore bonds**.

1.3 Platform Distribution Models

Platforms in the UK market can distribute to retail clients via a number of channels, with some focusing on a single channel while others offer multiple channels.

Offering products directly to retail clients in an execution-only model is common, with the platform offering information to clients, but not providing any form of advice as to which products and assets the client should purchase. This is the simplest form of model from a regulatory perspective although there is sometimes a fine line between marketing products to clients and advising them what to buy.

An alternative method of distribution for platforms is to offer products via a financial adviser, where the adviser assesses the needs of the client and makes recommendations as to which wrappers and what assets the client should purchase. The client then makes the decision whether to make the purchase or not.

A third distribution method supported by some platforms is a discretionary managed service, where a **discretionary fund manager (DFM)** will invest clients' money in whatever assets they see as offering the best return for the investor based on their risk appetite.

2. Agency Commission and Charging Structures

Learning Objective

6.2.1 Know commonly used charging structures

6.2.2 Know regulation and best practice in relation to the standardisation of commission

2.1 Fund Charges

An investor in a fund faces several charges, some of which will be explicit (although fully documented in the fund's annual report and accounts), such as the initial charge and the annual management charge (AMC), which is applied to cover the ongoing costs of the management and administration of the fund. These charges may be administered by the TA, such as any initial charge, or by the fund accountant as part of the fund's net asset value (NAV), such as the annual management charge.

Other charges, however, will be less explicit, as they are incurred in the necessary management of the fund, such as any audit costs for the fund. Managers of funds are entitled (under the terms of their management agreements) to charge certain other costs to the fund. These include:

- brokers' commission for trades undertaken
- legal and audit fees, and
- fees for specialist taxation advice.

The size of these other charges can of course have an impact on the performance of the fund and therefore the return for the investor.

UCITS funds are required to publish an ongoing charges figure (OCF) and quote this in the key investor information document (KIID). It is a standard way of measuring the annual cost of investing into a fund and is similar to the total expense ratio (TER) which some funds still publish where permitted.

The OCF is like the TER and takes into account various additional costs and fees subject to:

- the management company
- trustee, custodian and auditor
- costs for outsourced services and registration fees
- regulatory and audit fees, and
- payments to legal and professional advisers.

However, it does not include any one-off charges such as initial or exit charges, incidental costs, eg, performance fees or those costs associated to buying or selling assets in the fund.

It is a more accurate indicator of the charges and the effect they can have on a fund's performance than the quoted AMC. The OCF is quoted as a single percentage figure.

As noted above, funds may still publish a TER. The TER consists of the AMC and other charges such as the fees paid to the trustee, depositary, custodian, auditors and registrar. It also takes into account any performance fees, although they may be shown in a separate field.

2.1.1 Annual Management Charge (AMC)

The AMC is a fee collected automatically from the scheme property of a fund and is usually defined as a percentage of the assets under management in the fund. It covers the cost of the manager's investment management services, in-house research, analytics and portfolio management. The AMC is accrued daily and is built into the price of the fund.

The charge differs between funds and between share classes of the same fund. These will be available to retail or institutional clients depending on the client's level of investment, the service provided by the AFM or, as we will see below, the basis of any legacy commission still being paid. As expected, the institutional classes will generally have a much lower AMC.

2.1.2 Initial Charge

An initial charge is applied to a new investment in a fund and is calculated as a percentage of the price. A dual-priced CIS has the initial charge included within the offer price; for a single-priced fund, the initial charge would be in addition to the quoted mid-price.

2.1.3 Exit Charge

It is common practice for investors to be able to sell holdings within their investments at any time, with no minimum investment period and usually no penalty for encashment.

However, depending on the fund, an AFM may apply an **exit charge** to redemptions. This is typically designed to reduce over a period of time from the initial investment ensuring those longer-term investors will not incur any charge, (eg, 5% in year 1, reducing by 1% for each subsequent year).

2.1.4 Performance Fees

For many schemes, a simple AMC accruing at a fixed percentage rate will provide an adequate mechanism to pay the AFM. However, the COLL rules do permit AFMs to adopt a more complex approach (either alongside or in place of a standard AMC), particularly relevant to AFMs of funds that seek to generate higher returns than a benchmark index.

Performance-based fees can be made payable to the AFM or investment manager for certain funds if the investment performance of the fund achieves a certain level. This level will have been determined at the outset and could reflect a particular index.

The performance fee must be consistent with the relevant regulations and should consider the following factors:

- Paid only after consideration of all other payments.
- Against a reasonable benchmark.
- Based on a defined positive rate of return (referred to as the hurdle rate) which may be fixed or variable.
- The benchmark or hurdle rate may be carried forward to future accrual periods.
- The period over which it accrues and the frequency with which it crystallises should be reasonable.
- The price of sale or repurchase transactions are not adjusted within the accrual period.

The prospectus should be clear and contain the maximum amount or level of performance fee that can be made in any annual accounting period, together with examples of the operation of the performance fee.

2.2 Commission-Based Charging

For many years it was common for AFMs to also pay an initial commission to agents, such as IFAs, who introduced business. Such commission payments were commercial agreements reached between each AFM and each adviser firm, with the result that advisers could earn different amounts of income depending on the rates negotiated with different firms.

Following the implementation of the Retail Distribution Review (RDR) on 1 January 2013, UK advisers no longer get paid initial commission by the AFM on new investments. While historically initial commission may have been seen as a 'hidden' charge, the review ensured that the adviser has to clearly explain to their client how much the advice will cost and how it is to be paid. Overseas advisers can still be paid commission, but many fund managers use a blanket approach and do not pay any advisory commission.

2.3 Adviser Charging

Adviser charging is a fee-based structure which allows advisers to set their own fees to their clients for the services and/or advice they receive.

While the fee can be facilitated by the AFM (via the TA or administration service) and taken from either the payment prior to making an investment in the fund or via the periodic sale of shares/units, it is more commonly paid up front by the investor direct. The fee will cover either the initial advice, ongoing review, or be a simple ad hoc fee.

As the amount is agreed upfront, the client is fully aware of the cost of advice and therefore will only pay for true advice or effort from the adviser.

2.4 Trail Commission

Trail or renewal commission was a fee paid to financial advisers, by the AFM, based on their investor's holdings. It accrues on a monthly basis and usually pays every six months.

Trail commission is a percentage fee taken from the investment each year, but would be included by the AFM as part of the annual management charge and therefore not explicitly disclosed to the end client.

As we saw in chapter 2, section 2.1, the RDR stopped the payment of all commission, including trail, on any new investment products bought after 31 December 2012. However, investments made before 31 December 2012 can still pay trail commission and, therefore, trail commission is still paid by the AFM on legacy holdings.

For existing investments, trail commission will cease following a disturbance event. This could be as significant as the client selling their holding or simply switching to a new share class.

It is worth noting that intermediaries, such as discount brokers and platforms, may still receive trail commission where they only provide investment information and execute the purchase of a product (execution only), rather than providing personalised advice or a specific recommendation, though AFMs will come under pressure to consider the appropriate charge levels for their funds as the amount of commission being paid reduces.

2.5 Annual Management Charge (AMC) Rebates

Learning Objective

6.2.3 Know regulation and best practice in relation to annual management charge (AMC) rebates

An AMC rebate is paid to distributors depending on the contract they have with the AFM. There are numerous calculation methods although, more commonly, it is a fixed percentage charge directly linked to the AMC value or a tiered rebate depending on the level of assets held. In many instances, the companies who distribute investment funds to retail investors receive rebates from the fund providers on an ongoing basis.

AMC rebates are accrued by the AFM on a specified set of holdings on the basis of the aforementioned contract. On a regular basis, the AFM will either automatically pay this back to the distributor as a rebate payment or reinvest and purchase further units. On a similar basis, the distributor may calculate their own expectation of the rebate value and invoice the AFM. The invoice will be validated against the holdings and payment made accordingly and dependent on the AFMs tolerance levels to the amount being invoiced.

The RDR, implemented in 2013, aimed to enhance transparency and address potential conflicts of interest in the UK fund market. As part of the RDR, the Financial Conduct Authority (FCA) introduced rules requiring advisers to explicitly disclose and separately charge their fees, rather than receiving commissions from product providers.

Fund managers are encouraged to provide clear and transparent information to investors about the AMC and any potential rebates or discounts. This includes explaining the basis on which rebates are calculated, how they are paid, and any associated terms and conditions. Additionally, fund managers are expected to treat all investors fairly and avoid any potential conflicts of interest when handling AMC rebates. Rebates should be allocated in a fair and consistent manner that does not disadvantage any group of investors.

Fund managers must communicate clearly with investors regarding any changes to the AMC or rebate arrangements.

Best practice includes the following:

- **Transparency** – clear and transparent communication is crucial when it comes to AMC rebates.
- **Fair Treatment of Investors** – best practice requires that all investors are treated fairly when it comes to AMC rebates. There should be no discrimination or favouritism among investors, and rebates should be allocated in a fair and consistent manner.
- **Clear Disclosure** – investors should be fully informed about how the rebate system works and any potential changes that may occur.
- **Investor Communication** – regular and timely communication with investors is essential. Financial institutions should provide clear and accurate information about any changes in AMC or rebate arrangements that may affect investors' holdings or future payments.
- **Internal Governance and Oversight** – financial institutions should have robust internal governance and oversight processes in place to ensure that the handling of AMC rebates is conducted in a controlled and responsible manner.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **Why are fund managers prepared to offer the share classes to platforms?**
   Answer reference: Section 1.1.1

2. **Why do platforms need to hold cash for investors?**
   Answer reference: Section 1.1.2

3. **List three investment types that are exchange-traded assets.**
   Answer reference: Section 1.1.3

4. **What is a discretionary managed service?**
   Answer reference: Section 1.3

5. **What is an ongoing charges figure and where should this be quoted?**
   Answer reference: Section 2.1

6. **How often is the annual management charge (AMC) accrued?**
   Answer reference: Section 2.1.1

7. **What kind of fund is the initial charge included within the offer price?**
   Answer reference: Section 2.1.2

8. **When might a fund have an exit charge?**
   Answer reference: Section 2.1.3

9. **When can performance-based fees be made payable to the AFM or investment manager?**
   Answer reference: Section 2.1.4

10. **What is adviser charging and when is the amount agreed?**
    Answer reference: Section 2.3

Chapter Seven

Customer and Investor Relations

1. **Customers and Investors** **205**
2. **Customer Service** **207**
3. **Complaint Handling** **212**

This syllabus area will provide approximately 7 of the 100 examination questions



1. Customers and Investors

Learning Objective

7.1.1 Know the required content of customer agreements

7.1.2 Know general considerations for setting up a new account

7.1.3 Know the taxable status of different entities

The nomenclature for describing the clients with whom fund managers interact is not well defined, the terms 'customer', 'client', 'consumer' and 'investor' are all used in various documentation, legislation and regulation. 'Investor' is commonly used to describe someone who is an account holder, but the term 'account holder' itself is often replaced by 'unitholder' (and shareholder for open-ended investment companies (OEICs)) and generally means someone who has an investment with the fund manager. For the ease of reading, we will use the terms 'customer' and 'client' in this chapter to mean those who invest with the fund manager, those who plan to, or are discussing investing, and any third party who may have the right to discuss the details of an account with the fund manager to enable the servicing of the account unless we are quoting from regulation that uses other terms.

As we have mentioned in earlier chapters, clients themselves are often sub-categorised by fund managers into:

- retail clients who appear on the register with a name and address
- aggregators or distributors who provide record-keeping services themselves for other clients (often, but not exclusively retail); platforms fit into this category, and
- institutional investors, such as local government, pension funds and charities who tend to be professional investors.

In respect of client relations, the focus from a regulatory point of view is on retail clients, and the bulk of this chapter will focus on that area.

A customer agreement is typically required when a financial institution or transfer agent provides services to clients, investors or fund managers. This agreement outlines the terms and conditions of the services being offered and serves as a legally binding contract between the service provider and the client. The agreement helps establish the rights, responsibilities, and obligations of both parties involved.

Prior to clients becoming investors, an account must be opened for them. In order for a client to be permitted to be an investor, an application form (either in paper or electronic form) must be received by the TA which will tie the client to terms and conditions as part of a customer agreement. In the UK market, accounts are typically set up when the first investment is received, and any account-opening documentation is expected at this point in time. The investor will need to go through anti-money laundering (AML) checks before being permitted to remove money from the account, but this typically takes place after the first investment. The UK market differs from most other European markets in this respect as European markets would typically expect an account to be opened and AML checks to be completed before accepting any money from the investor.

The client information needed to open an account very much depends on the type of investor and is covered in some detail in chapter 5. One key piece of information that is required, irrespective of the client type, is the investor's tax domicile. The tax domicile of individuals is important in the distribution process as this process pays tax directly to His Majesty's Revenue and Customs (HMRC) and if the investor is not a UK taxpayer then this needs to be held on the register so that UK tax is not paid by the investor. The investor will be given a tax voucher as part of the distribution process to inform them of any tax paid and it allows them to provide the correct information to the tax authorities. The tax payable by an investor depends on their tax domicile and any tax wrapper that may be used to ensure the investor is tax efficient.

1.1 CASS Related Disclosures

The CASS Sourcebook outlines rules and requirements related to the handling and protection of client assets by financial firms in the UK. When it comes to customer agreements in the context of CASS, there are specific disclosures that might be required to inform clients about how their assets will be treated. CASS disclosures should include the following:

- **Custody arrangements** – if the customer agreement involves custody or safekeeping of client assets, it is to disclose how these assets will be held, segregated, and protected in accordance with CASS regulations. The agreement should detail how client assets will be safeguarded from the firm's own assets and liabilities.
- **Use of client money** – if the firm will be handling client money, the agreement should disclose how client money will be held and managed in accordance with CASS rules. Clients should be informed about whether their money will be held in a segregated client bank account and about any interest or charges associated with it.
- **Disclosure of CASS compliance** – the agreement might include a statement indicating that the firm is compliant with the CASS rules and that client assets will be treated in accordance with the regulations.

- **Client protections** – the agreement should outline the protections available to clients in the event of the firm's insolvency, including the FSCS compensation scheme and the processes for returning client assets.
- **Reporting and information** – the agreement might include provisions about how clients will be provided with regular statements or reports on their assets held by the firm, including details about any reconciliation processes.
- **Changes to CASS policies** – if the firm's CASS policies or procedures change, the agreement should include a clause outlining how clients will be notified of these changes and any implications for their assets.

2. Customer Service

Learning Objective

7.2.1 Know the relevant regulation and best practice in relation to information and advice giving

7.2.2 Know methods for identifying vulnerable customers

7.2.3 Know legal considerations relating to vulnerable customers

2.1 Identifying Customers

Call-handling staff must go through a process of verifying any customer who calls before giving information relating to the customer's investments. It is possible to give out information relating to products without customer verification and to standard processes, such as how to invest, but if any account-specific information is requested, such as the account balance or the status of a transaction, then verification is needed. The information needed to verify the customer may be dependent on several factors, including:

- the fund manager's risk appetite, and
- the customer type – retail customers will be asked for different information to corporate or nominee clients.

Examples of information that may be requested for retail customers include:

- first line of address
- date of birth
- recent transaction history, and
- bank details held on file.

Failure to pass the verification steps may lead to a suspicious activity report (SAR) being raised, so would any discrepancy between the customer's voice and the characteristics that would be expected, such as a person with a male voice purporting to be a female.

For written communication, the customer's address would normally be verified, but the checking of the customer's signature is dependent on the fund manager's risk appetite. Any response to a written communication would be to the address held on file for the customer to minimise the risk of fraud.

2.1.1 Investment Advice

The Retail Distribution Review (RDR) regulatory framework introduced by the Financial Conduct Authority (FCA) included regulation to improve the standards of advice provided to retail clients. It aims to ensure that financial advice is given based on the client's best interests, without being influenced by commissions or other conflicted remuneration. The RDR requires advisers to meet certain professionalism and qualification standards and to disclose their services and fees transparently.

Transfer agents (TAs) are not generally qualified to give advice to investors. TAs must ensure that anything communicated to an investor cannot be considered to be investment advice. Therefore, TAs should avoid commenting on the types of investment an investor should make. Avoiding offering advice can be made more difficult by investors asking seemingly straightforward questions of call-handling staff as to a choice of funds to invest in or how they think the fund might perform.

2.2 Amending Customer Agreements

There are several circumstances in which amending a customer agreement might be considered appropriate. These include:

- **Regulatory changes** – if there are changes to regulations or legal requirements that impact the provision of transfer agency services, the customer agreement might need to be amended to ensure compliance with the new rules. This could include changes related to data privacy, reporting requirements, or investor protection regulations.
- **Service enhancements** – if the transfer agency is introducing new services or technological enhancements that benefit both the service provider and the customer, an amendment to the agreement might be needed to outline the scope, pricing and terms of these new offerings.
- **Fee changes** – if there are changes to the fee structure for the services provided by the transfer agency, the customer agreement may need to be amended to reflect these new fees. It's important to provide clear and transparent communication about fee changes to avoid any misunderstandings.
- **Changes in terms and conditions** – if there are changes to the general terms and conditions that apply to the relationship between the transfer agency and its customers, an amendment to the agreement might be necessary. This could include changes related to communication methods, dispute resolution, or liability provisions.
- **Mergers and acquisitions** – in cases where the transfer agency is involved in a merger or acquisition, there might be a need to amend customer agreements to reflect changes in ownership, branding, or administrative procedures.
- **Market developments** – if there are significant changes in the market landscape or industry standards that affect the provision of transfer agency services, the customer agreement might need to be updated to address these developments.
- **Risk management** – in situations where there is a need to mitigate certain risks or address potential conflicts of interest, amendments to the customer agreement might be necessary to establish appropriate safeguards.

Any amendments to customer agreements must be communicated clearly to customers.

2.3 Vulnerable Customers

Understanding whether a customer is vulnerable can be a complex decision, as customers in this position will require support when dealing with the administrator. It is a common misconception that vulnerability is simply a customer who has succumbed to the frailties of advancing age, but this is obviously not always the case. A customer, at any time, may be in a circumstance or situation which will impair their abilities to engage or understand fully when dealing with financial matters.

To ensure that vulnerable customers are initially identified, the FCA defined a vulnerable customer as:

> *'someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care'.*

This highlights that vulnerability can, in respect of a vulnerable adult, happen at any time and relate to one or more of the following:

- Living in residential or sheltered accommodation.
- Receiving certain types of health and social care.
- Receiving certain types of welfare support.
- Detained in lawful custody.
- Older people who are physically or mentally frail.
- Learning disabilities.
- A mental health condition such as dementia or personality disorder.
- Ill and need help to carry out normal daily functions.
- Physical disabilities.
- Have undergone a recent trauma, eg, bereavement, divorce or job loss.
- May be in abusive relationships or are homeless.

Verification of the individual will, of course, depend on the nature of the product or service requested.

Acknowledging the difficulties presented by determining vulnerability is important as no exhaustive list can be defined. However, vulnerability indicators may present as:

- a decision that is unusual, unexpected or out of character
- a close friend, relative, carer or clinician may highlight a concern
- applications, transactions and/or contract notes may not be understood, or
- inability to understand the information and explanations provided in written or telephone communications.

Noting the above, it is plausible that by failing to identify, or manage a customer appropriately when identified, could result in complaints and reputational damage. It is, therefore, prudent that a firm defines their best practice and ensures their staff have an awareness and understanding of the issues surrounding vulnerability.

2.3.1 Verification of the Vulnerable

Where appropriate, a firm should seek to verify a vulnerable person in line with the Joint Money Laundering Steering Group's (JMLSG's) standard requirements for private individuals, applying a risk-based approach as appropriate.

Electronic verification should also be considered to validate the individual if the product meets the requirements envisaged by the JMLSG. However, caution, and therefore reduced expectation, should be exercised and applied given the potential that such individuals may not possess the breadth and depth of electronic data to create a meaningful footprint.

Should electronic verification be unsuccessful, firms should seek 'traditional' standard paper-based evidences in certified copy (preferably) or original form; recognising, as noted above, that documents may be limited in number thereby creating verification constraints. Should this be the case, firms must consider what other documents may be available and which might be produced from reliable and independent sources sufficient to discharge the requisite responsibility under the regulatory system.

As firms are required to compensate for difficulties that individuals may have when asked to provide standard evidence of identity, a reasonable approach should be adopted to verify the individual.

Further, SYSC 6.3.7(5) states firms should ensure systems and controls include:

> *'appropriate measures to ensure that procedures for identification of new customers do not unreasonably deny access to its services to potential customers who cannot reasonably be expected to produce detailed evidence of identity'.*

The FCA Rules on financial exclusion will be apparent in some cases but where members identify and document an individual cannot reasonably meet the standard verification requirements, consideration should be given to gathering evidences from the following sources:

- Department for Work and Pensions (DWP) entitlement letter
- HMRC or local authority entitlement letter
- identity confirmation letter issued from either the DWP or local authority
- letter from a care home manager/warden of sheltered accommodation or refuge, or
- solicitor's letter or equivalent confirming identity verification.

Where firms identify an applicant or beneficial owner as vulnerable or one who does not have the capacity to manage their financial affairs, or if they are informed that a person is losing or lacking capacity, it should be documented to ensure the client continues to be treated appropriately.

As with all notifications, and especially if delivered by a third party, without evidence they should be treated with caution given the potential that such notice might be vexatious and open to challenge should the named individual not be suffering in any way. Ultimately, it is essential that firms obtain evidence of any authority to act, in addition to having appropriate systems and controls to identify potential financial exploitation, which is, sadly, an inevitable consequence prevalent in vulnerability cases.

Where appropriate, further verification methods should include obtaining:

- original (or certified on each page) power of attorney (POA) documents, or
- an original (or certified) Court of Protection order.

Where a lasting power of attorney (LPOA) is provided, firms should follow and document validity in line with the Office of the Public Guardian's (OPG's) requirements. Court of Protection validation requirements are similar.

Where an account is taken over by a personal representative, firms should ensure they have in place the appropriate framework to document each appointment.

Firms may also rely on introducer certificates from regulated intermediaries authorised on the account, or from professional persons known to the investor. Verification can consist of:

- confirmation of verification of identity certificate (CVI)
- letter on headed paper confirming evidence and verification in line with the JMLSG, or
- a solicitor's letter or equivalent confirming verification of identity.

It is important to document where reliance has been placed and evidenced in line with a firm's policy.

2.3.2 Mitigation of Impersonation Risk

Non-face-to-face verification can increase the fraud risk with authentication dependent on a firm's risk assessment. Therefore, where appropriate, additional measures should be applied to mitigate such risk. Examples of mitigation techniques may include:

- payment to the source account, where a clear record is available from customer onboarding
- payment to a new account held in the name of the customer, but care of an attorney or similar, with appropriate evidence gathered to enable this to be achieved, or
- independent clarification with the named attorney(s) subject to satisfactory verification having first been established.

2.4 Consumer Duty Requirements

The FCA Consumer Duty requires firms to take a proactive and customer-focused approach to ensure that vulnerable customers are treated fairly and are not disadvantaged in any way. This includes identifying and responding to vulnerability, providing appropriate support, and monitoring outcomes to ensure that the needs of vulnerable customers are met.

3. Complaint Handling

Learning Objective

7.3.1 Know the principal requirements for a complaints-handling procedure

7.3.2 Know the regulatory procedures for handling customer complaints

7.3.3 Understand Summary Resolution Communication (SRC)

3.1 The FCA Requirements for Complaints Handling

Occasionally a client may have been dealt with in a way they felt was insufficient and will therefore raise a complaint against the firm as a whole or a specific individual. The FCA requires authorised firms to deal with all complaints from eligible complainants within a timely manner, and, most importantly, this has to be fairly judged.

The FCA defines a complaint as:

> *'Any expression of dissatisfaction, whether oral or written, and whether justified or not, from or on behalf of an eligible complainant about the firm's provision of, or failure to provide, a financial service'.*

Further, the FCA defines an eligible complainant as:

'(1) a consumer
(2) a micro-enterprise:
  (a) in relation to a complaint relating wholly or partly to payment services, either at the time of the conclusion of the payment service contract or at the time the complainant refers the complaint to the respondent, or
  (b) otherwise, at the time the complainant refers the complaint to the respondent
(3) a charity which has an annual income of less than £6.5 million at the time the complainant refers the complaint to the respondent, or
(4) a trustee of a trust which has a net asset value of less than £5 million at the time the complainant refers the complaint to the respondent
(5) (in relation to CBTL [consumer buy-to-let] *business) a CBTL consumer*
(6) a small business at the time the complainant refers the complaint to the respondent, or
(7) a guarantor.'

Therefore, if a customer expresses dissatisfaction, in any way, the firm is obliged to investigate and, if needed, put the customer right.

At the very outset, the FCA rules in the Dispute Resolution: Complaints Sourcebook (DISP) state that a client must be able to raise a complaint by any reasonable means. In addition to traditional postal methods, this also includes electronically or by telephone. If by telephone, the number advertised must not apply premium rate charges.

Having received a complaint or expression of dissatisfaction, the firm must assess the case in a competent and fair manner – this will result in the handler deciding whether the complaint is upheld and whether any remedial action should be taken.

Firms are required to have the appropriate written procedures for handling these expressions of dissatisfaction from eligible complainants. Regardless of the method by which the complainant chose to use, the same procedures should be followed. Similarly, regardless of whether the complaint is justified or not, as long as it relates to the firm's provision of, or failure to, provide a financial service, the process should be followed to prove the final outcome.

Given the specific timings as set out by the FCA, complaints-handling procedures should cover in detail the:

- the identification of how and when complaints are received
- acknowledgement and resolution of complaints in a timely manner
- requirement to appropriately investigate the complaints
- need to notify the complainants of their right to go to the **Financial Ombudsman Service (FOS)** when relevant.

Among other requirements, the complaints-handling procedures require the firm to issue its final response to the complainant within eight weeks of the date of the original complaint and the complainant must be notified of their right to refer their complaint to the FOS if they are dissatisfied with the firm's response.

When investigating and subsequently dealing with a complaint, the requirement is that a member of staff of sufficient competence owns the process. In addition, they should not be directly involved and, therefore, should be independent of the process or person the complaint targeted. The complaint handler/team must have the authority to settle the complaint, including offering redress if appropriate, or have the direct access to the appropriate staff with this authority.

In all cases, responses should adequately address the subject matter of the complaint and, if the complaint is upheld, offer the appropriate redress. If the firm decides that redress is required, the firm must provide the complainant with fair compensation for any acts or omissions for which it was responsible and comply with any offer of redress the complainant accepts. Any redress for financial loss should include consequential or prospective loss in addition to actual loss.

The firm must take reasonable steps to ensure that all relevant employees (including any of the firm's appointed representatives) are aware of the firm's complaints-handling procedures and endeavour to act in accordance with these.

3.2 Complaint Resolution and the Summary Resolution Communication (SRC)

Assuming a firm can review and conclude the complaint within three business days from the date of receipt, the FCA rules provide a simplified process where the firm can issue a summary resolution communication (SRC) to the complainant, explaining the firm's response and noting that the firm accordingly considers the matter closed. This does not negate the right to allow the client their escalation to the FOS if still unsatisfied.

When issuing an SRC, it must contain the following detail:

- a summary of the complaint
- detail on how the complaint has now been resolved
- the options open to the client in respect of escalation to the Ombudsman (if not satisfied) including the firm's expectation around the relevant time limits as defined in DISP 1 Annex 3R
- the Ombudsman's website address and explanation that more information is available online.

Unlike complaints resolved in greater than three days, there is no requirement to acknowledge acceptance or rejection (just confirm the complaint is resolved). In addition, there is no requirement to send a copy of the FOS leaflet.

However, completing a complaint in this manner does provide several benefits, namely it:

- shows focus by the firm which can, if resolved appropriately, result in a more positive client experience
- ensures the firm reviews and captures potentially damaging systemic errors earlier
- reduces any follow-up correspondence defined under the rules, and
- reduces administration overhead in reporting.

If a complaint cannot be resolved within three days, which can be due to resourcing, operational issues, or the complexity of the case, usually in respect of the time period of the errors, a more detailed complaints-management process must be adopted. FCA rules require that the firm provides an acknowledgement that the complaint has been received and is being reviewed and must keep the complainant informed of progress over the course of investigation.

Within eight weeks, it will be expected that during the normal course of business, the complaint should be resolved, and a final confirmation sent to the client, confirming correction and remediation as required. If this is not possible, then the response must instead provide an explanation and indicate when completion is expected. Regardless of whether a final response or just an update is issued, the complainant must be advised that they can from that point escalate their complaint to the FOS.

The final response should contain the following information:

- a summary of the complaint
- transparent acknowledgement of any mistakes made (if any)
- confirmation as to whether the complaint is accepted, offer redress to settle and a clear explanation of how this was derived, or
- confirmation if the complaint is rejected and again clear reasons as to why
- the options open to the client in respect of escalation to the Ombudsman (if not satisfied) including the firm's expectation around the relevant time limits as defined in DISP 1 Annex 3R
- provide the Ombudsman's website address and explain that more information is available online
- copy of the FOS leaflet.

Records of the complaints received, and the measures taken to resolve each complaint must be kept for a minimum of three years, although in practice this will normally be much longer.

3.3 The Financial Ombudsman Service (FOS)

The FOS is an independent body and was established to administer and operate a dispute resolution scheme. It is funded by compulsory industry contributions. It is designed to resolve complaints about financial services firms quickly and with minimum formality. Eligible complainants can refer complaints to the FOS if they are not satisfied with the response of a financial services firm.

Costs associated with any complaint referred to the FOS are borne by the firm (this would be either the third-party administrator (TPA) or AFM depending on specific agreements, regardless of the outcome). The FOS may reject claims out of hand if it considers them frivolous or vexatious or feels that the complaint clearly does not have any reasonable prospect of success, or that a fair and reasonable offer of compensation has already been made. They will consider what is fair and reasonable in all the circumstances of the case in determining a complaint, taking into account the relevant law and codes of practice.

The decision of the FOS is binding on firms, although not binding on the person making the complaint. Under the legislation that established the FOS, financial services businesses are required to cooperate with the Ombudsman service and the Ombudsman's decision is final and binding on the business.

The Financial Ombudsman can require the firm to pay over money as a result of a complaint. This money award against the firm will be of such amount that the Ombudsman considers to be fair compensation; however, the sum cannot exceed £350,000. Where the decision is made to make a money award, the Ombudsman can award compensation for financial loss, pain and suffering, damage to reputation and distress or inconvenience.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **How does the UK market differ from European markets in respect to AML checks?**
   Answer reference: Section 1

2. **List the factors that could influence what information is needed to verify a client?**
   Answer reference: Section 2.1

3. **Why must anyone communicating with an investor avoid commenting on what investments they should make?**
   Answer reference: Section 2.1.1

4. **List three indicators that could show that a customer may be vulnerable.**
   Answer reference: Section 2.3

5. **Why might electronic verification of an individual that is vulnerable be difficult?**
   Answer reference: Section 2.3.1

6. **What techniques could be used to mitigate impersonation risk?**
   Answer reference: Section 2.3.2

7. **Explain the FCA Consumer Duty requirements.**
   Answer reference: Section 2.4

8. **By what means must a client be able to raise a complaint?**
   Answer reference: Section 3.1

9. **What should the complaints-handling procedures cover in detail?**
   Answer reference: Section 3.1

10. **List the details that a summary resolution communication (SRC) must contain.**
    Answer reference: Section 3.2

11. **How long should records of a complaint and the measures taken to resolve it be kept for by a firm?**
    Answer reference: Section 3.2

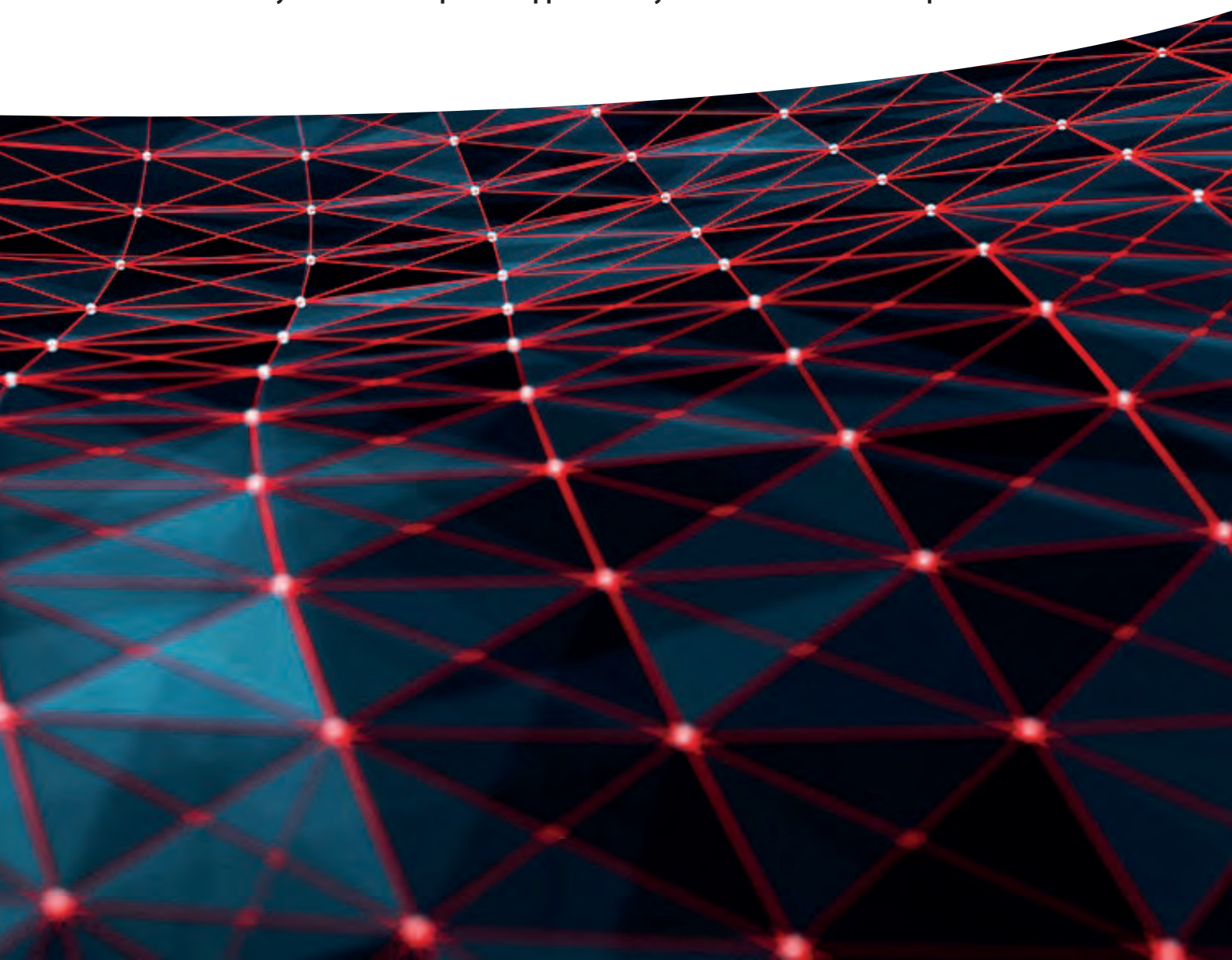
12. **When would the Financial Ombudsman Service (FOS) reject complaints referred to them?**
    Answer reference: Section 3.3

Chapter Eight

Compliance and Oversight

1. **Oversight – Three Lines of Defence** **219**
2. **Operational Risk** **224**
3. **Compliance** **228**

This syllabus area will provide approximately 4 of the 100 examination questions





1. Oversight – Three Lines of Defence

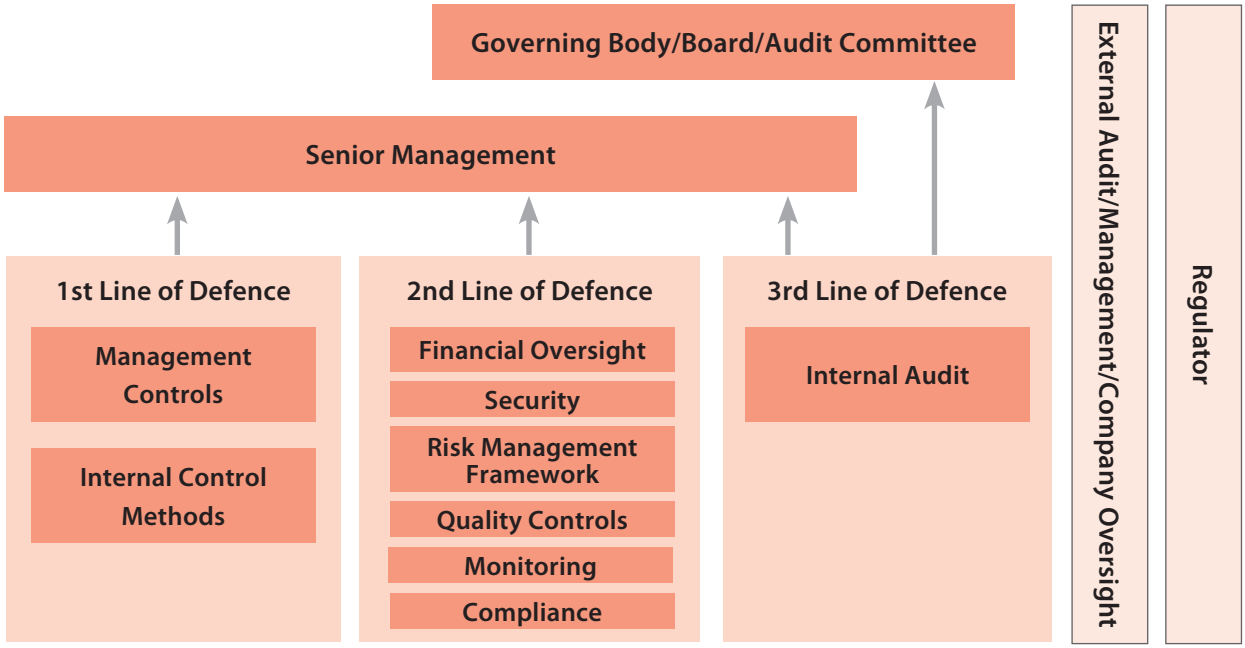
Learning Objective

8.1.1 Understand the principles of the three lines of defence model

1.1 Three Lines of Defence

Firms will have numerous functions with the organisations that will help monitor and control various risks within the organisation. At times, these controls will have duplication and even gaps, which can become a problem if responsibilities are not clearly defined while at the same time ensuring that best practices are identified and implemented.

The 'three lines of defence model' is now commonplace in firms. It uses the differences between functions of the firm that own and manage risks, functions of the firm that oversee risks and those functions that provide independent verification. The 'three lines of defence model' can provide an effective way to improve communications on risk management and control by redefining key roles and responsibilities within the organisation. The 'three lines of defence model' ultimately comes together at board level within the firm, so that the very senior staff are fully aware and supportive of the risk management approach at the firm.



The board of directors will have the final responsibility for ensuring the success of the overall risk management at the firm. These responsibilities and accountabilities should be clearly defined and agreed in order that the firm remains properly governed. However, one of the key issues is the volume of risk information that is produced. Board members need to be able to focus on the key issues that will require their immediate attention. The committee needs to define very clearly what risk information it requires, in what format, and over what timescale.

If appropriate, firms will have a documented risk management framework and are likely to have a risk management committee that will have overall responsibility and accountability to plan, implement and monitor their various departments' daily risk environment. They will also advise on the treatment of the identified risks, should they occur. The line managers of the departments will need to report to the operational risk management committee:

- key risk issues identified and what has been implemented to reduce the incidence of these
- status of existing risk mitigation actions implemented to reduce risks
- key risk indicators (KRIs), comprising a 'traffic light' system of warning importance, for example, red, amber or green
- control effectiveness indicators
- actual incidents that have occurred, including full details of the incidents, and
- details of any other internal or external audit items that remain unresolved.

There is ultimately no uniform way in which firms can adopt and implement the three lines of defence model as firms differ greatly in terms of their size and complexities among other factors.

In some smaller firms, some of these lines of defence might be combined; for example, the internal audit function might be combined with the firm's risk management or compliance function. The board of directors and senior management must be advised of, and agree to, the combining of these lines of

defence and also the possible risk impact to the firm as a whole. It is, however, important to establish the boundaries and responsibilities among the various risk management functions, ie, business operational management, risk management and compliance functions, and internal audit.

1.1.1 First Line of Defence – Business Operational Management

As the first line of defence, the responsibility for ownership falls to business operational management as they are aware of the risks within their own business units. The first line of defence establishes and maintains the controls in order to deal with the day-to-day risks and control procedures.

To ensure the aims of the department in respect of risks is achieved, operational management will:

- identify
- assess, and
- mitigate.

All of the above must be in conjunction with and understanding of the firm's risk appetite, the risks faced and the need to implement suitable controls, checks and means of monitoring, reporting and escalating any identified risks.

Operational management serve as the focus of the first line as they will build the controls that will fit into the systems and processes. Adhering to these processes and assuming all is sufficient with the design, risk will be reduced, and an appropriate risk environment attained.

Users working in the business line itself will also have the experience and knowledge and could therefore be called upon to identify amendments to current processes and controls in order to work more efficiently and improve existing controls. However, caution is needed to ensure that those improvements are effective and robust and not focused solely on the single department/process – effectively damaging controls elsewhere. Staff training and departmental awareness sessions are key if reliance is placed in this as a process.

Overall, there should be adequate managerial and supervisory controls in place to ensure compliance and to highlight control breakdown, inadequate processes, and unexpected events. The first line of defence provides management of the firm with verification and provides feedback to the audit committee by identifying risks and business improvements, implementing controls, and reporting on progress.

1.1.2 Second Line of Defence – Risk Management and Compliance Functions

The second line of defence helps the operational risk management function to facilitate and monitor the implementation of effective risk management systems and controls by the firm's management. This line of defence relates more to the oversight of risk, the reviewing of the risk management procedures that have been implemented and also challenging what has been implemented to ensure that those procedures remain effective at managing risk within the firm. It also helps management in reporting risk-related information. This gives management an independent oversight of business processes and risks.

Ideally only one line of defence should be required within an organisation to ensure effective risk management, but this will often prove to be insufficient. The firm will have risk management and compliance functions to monitor the actions of the controls that are being used under the first line of defence.

The second line of defence is reinforced by the advisory and monitoring functions of risk management and compliance. The risk management function implements effective risk management controls to monitor the operational manager's business routine activities and also to help to define the target risk exposure and reporting mechanisms and procedures which will then be used throughout the firm as a whole. The compliance function will ensure that the firm complies with the rules and regulations that apply to the firm and will report separately to senior management and/or the board of directors.

There are many functions in companies that are linked to risk management and compliance roles including:

- enterprise risk management (ERM)
- quality monitoring
- compliance
- IT security
- legal
- health and safety, and
- environmental.

These management functions will form part of the business unit's risk committees and will review risk reports and validate the compliance with the risk management framework requirements, to help ensure that the risks identified are properly and actively managed.

Risk management and compliance functions will be relatively independent from the business line itself and will be able to provide a wider perspective on the effectiveness of controls, making suitable suggestions accordingly. However, their level of knowledge and expertise in the activities of the business line itself might not be sufficiently high for them to fully understand and implement changes to controls.

1.1.3 Third Line of Defence – Internal and External Audit

The third line of defence describes the independent assurance provided by the firm's audit committee and the internal audit function that reports to that committee. The independent assurance also includes any external audits undertaken by relevant third parties.

The internal audit function undertakes a programme of risk-based audits covering all aspects of both the firm's first and second lines of defence to ensure that the operational risk management arrangements are sufficient and effective. The internal audit function might well take some assurance from the work of the second line functions and amend its checking of the first line of defence. They also provide assurance to the firm that the processes and procedures they have implemented to help manage risk remain effective and valid for the environment in which they operate.

The internal audit function will give to the board of directors and senior management assurances based on the highest level of objectivity within the firm. They will review and report on the effectiveness of internal risk controls, governance and risk management arrangements within the organisation. The assurances that internal audit give to senior management and/or the board of directors will cover such areas as:

- the effectiveness of business operations, arrangements to safeguard assets of clients and the firm, the reliability and usefulness of reporting procedures and how successfully the firm complies with the applicable rules and regulations
- the effectiveness of the risk management and internal control procedures. This will include reporting on the effectiveness of the firm to identify and assess risk and take appropriate remedial action should risks occur in practice, and
- how the overall organisation, departments, subsidiaries, operating units and various other functions are performing in terms of risk management.

The level of assurance taken will depend on the effectiveness of the second line of defence and the internal audit function will need to coordinate its involvement with the compliance and risk management at the firm. The feedback from the internal and external audits will need to be communicated back to all three lines, ie, the accountable line management, the executive and oversight committees, and the board audit committee of the firm, to ensure that any required action is taken.

Internal and external audits will provide a detailed view of the business lines, taking into account a wide variety of factors, and also from external sources in the case of external auditors. Their overall view will provide an invaluable picture of where the firm is in terms of its operational risk management. However, their suggestions can be quite general in nature sometimes and the business lines might not benefit greatly in practice from such a high-level view of the organisation.

There is a reasonable assumption that the internal audit function will identify any weaknesses in both the first and second lines of defence which might otherwise have led to significant loss at the firm or which could lead to loss in the future. All three lines of defence have specific roles in the internal risk control governance model:

- the model of management control in the first line of defence
- the oversight challenge in the second line of defence, and
- the independent verification in the third line of defence.

2. Operational Risk

Learning Objective

8.1.2 Understand the root causes of operational risk events in simple, practical examples: incorrect data; delayed processing and documentary omissions; regulatory non-compliance; project mismanagement; fraud and theft; unforeseen litigation; information technology failures

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. It includes legal risk, but excludes strategic and reputational risk.

- **Process and/or procedure failure** – this can be a simple process whereby data is not captured correctly, there are a lack of controls, poor documentation or the inability to recover from other failures within the chain to allow the business to continue to operate (such as straight-through processing (STP) dealing feeds, pricing file failures).
- **People failure** – people/staff fail for a number of reasons, including fraud, error or due to poor staff training, lack of supervision or resourcing levels.
- **System failure** – the reliance on systems and automation is fundamental when operating a third-party administrator (TPA). Poor system design in respect of the delivery of service, and insufficient controls or business contingency planning (BCP) all contribute to system failure.
- **External events** – these can be significant, from acts of God and war through to changes within the financial or political environment, crime and, of course, a failure in any external supplier's systems or services. Of all the risks identified above, none can be reviewed independently.

Each risk will have a knock-on effect on two or three of the others, and therefore, to ensure an effective approach in managing these risks, each needs to be considered fully.

For instance, if staff are using old, labour intensive, and incompatible systems, the reliance on their integrity and expertise to deal with system-related problems is greater and the complexity of the process design to ensure control is increased. This will have an impact on the firm's ability to adapt to its changing environment and its effectiveness in controlling its risk environment.

Conversely, adopting an efficient straight-through processing (STP) system will greatly reduce people risk, but will increase technology risk, due to the increased reliance on IT.

2.1 Cause and Effect

The outcome of a risk event resulting in a loss is commonly where firms focus to determine how best to manage that risk in future (or mitigate it completely). Operational risk management ultimately relates to understanding the relationship between risk events and the cause of the event.

Operational risk management is undertaken to reduce the effects of risks by implementing controls for those identified.

As we have seen above, internal causes essentially relate to processes, systems and people. A risk event is the realisation of a potential risk (something that could go wrong) into an actual risk (something has gone wrong). It can have many different causes and can trigger several different effects.

The consequence or impact of the risk event occurring might have any of the following effects such as:

- financial loss due to a customer or client claim
- contractual loss impacting revenue
- reputational damage, or
- sanctions and/or regulatory issues.

Once causes are understood, firms can implement the appropriate controls to manage the events. Action plans will need to be implemented and regularly updated to ensure that the causes (which can frequently change) are monitored.

Because of the breadth of operational risk, the potential events that link root causes to effects cover a wide range of activities that can eventually result in loss. Some of the important events are:

- incorrect data
- delayed processing and documentary omissions
- regulatory non-compliance
- project mismanagement
- fraud and theft
- unforeseen litigation, and
- technology failures.

2.1.1 Incorrect Data

A transfer agent (TA) will process, create and store huge amounts of sensitive data that is often kept in various forms, formats and across multiple systems. Data can be wrong for a number of reasons:

- a conversion from a third-party source data could be captured incorrectly or failed during transition (a conversion between two administrators)
- it has been captured incorrectly by a user (dealing information, client details, pricing information)
- systems were not designed to capture all the required data (problematic system enhancements).

While the third-party administrator (TPA) will strive to automate data capture as much as possible (which can bring its own issues) data is often captured manually. At any point there is human interaction, there is a chance of error due to miskeying. It is paramount that there are robust controls in place to capture these errors as the impact could be wide ranging depending on the scale from investor communications (single or multiple) through to significant breaches in data protection.

2.1.2 Delayed Processing and Documentary Omissions

Delays and documentary omissions are often caused by the inability of a process to be scalable, such as abnormally high volumes (often highlighted when there is a process weakness following a technology failure such as STP) or too much change affecting the business which is often seen with significant increase in regulatory change over a short period of time.

For example, the inability to process a high volume of deals via STP could lead to delays in the box management process and, subsequently, to delays in issuing prices for funds, which in turn could have knock-on impacts to third-parties.

2.1.3 Regulatory Non-Compliance

TPA has to operate within a set of industry rules and regulations defined by law, or industry guidelines enforced by their regulators and client base. Often significant change in regulations without clear guidance or resulting in multiple options on how to implement may cause a failure due to inadequate analysis, people, processes or technology. The recent updates and implementation of the CASS handbook highlighted this for a number of companies.

2.1.4 Project Mismanagement

Any significant change to the operational process, systems or functions are implemented within the TA by means of a project. Projects range in size and the level of governance required. As size and complexity increases, either dedicated personnel within a department or a dedicated project team will be required to staff the project. The expectation is that the project is implemented as per the scope, costs and expected outcome.

Projects can be as follows:

- **System implementation** – changes in products and services offered, as well as advances in technology result in the requirement of new software and/or hardware to be installed. New systems, either developed or purchased, are subject to testing, data transfer and final integration into other systems which can take a significantly long time to complete.
- **Regulatory change** – recent years have seen significant regulatory updates that affect the TA's systems and controls, including the Senior Manager Certification Regime (SMCR) in 2019, the Retail Distribution Review (RDR) in 2013, MiFID II and the updated CASS handbook in 2015.
- **Cultural changes** – implementing the changes to team structures, and defining new roles and processes.

At all times, project risk needs to be managed with regular reporting and tracking to ensure that its failure, or partial failure, to meet its objectives is mitigated as this can lead to financial loss or reputational damage.

2.1.5 Fraud and Theft

Fraud and/or theft can be committed by internal and external parties. A fraudster will target areas of any operation where there are known weaknesses in either design, process or controls.

TA operations will implement numerous mitigating actions to limit these opportunities, ensuring processes have appropriate control compared to the risk. For example:

- letters sent to both old and new addresses when changing a client's address
- confirmation of any register or account details sent to the investor, and
- appropriate division of duties within the operational areas (dealing/registration and cash functions).

2.1.6 Unforeseen Litigation

Considering the contractual nature of financial services, the risks and implications due to a failure between parties could well result in one feeling sufficiently aggrieved as to commence legal proceedings and sue, for example, due to:

- failure to provide services to an appropriate level (ie, failing key performance indicators (KPIs))
- failing to adhere to regulatory requirements, bringing reputational damage or fines against either party, and
- project failings, which increase costs and impact services while corrections are made, or the cancellation of the entire project.

2.1.7 Technology Failures

Failures in technology can be catastrophic for a firm, and can result in significant losses, either directly or indirectly. The failure of a firm's technology could include:

- power failure in either the mainline feed or the back-up generators
- system failure as significant as the entire infrastructure or only focused systems
- overload of system causing slow down or crashes, and
- bugs or viruses affecting applications.

2.1.8 Operation Resilience

Financial Conduct Authority (FCA) rules on operational resilience came into force on 31 March 2022 when any firms that are in scope needed to have:

- identified their important business services
- set impact tolerances for the maximum tolerable disruption as per the FCA definition
- carried out mapping and testing, and
- identified any vulnerabilities in their resilience.

As soon as possible after 31 March 2022 and no later than 31 March 2025 firms must have:

- performed mapping and testing so that they can remain within impact tolerances for each important business service, and
- made any investments/arrangements necessary to enable them to operate consistently within their impact tolerances.

3. Compliance

Learning Objective

8.2.1 Understand the responsibilities and accountabilities of management and staff for compliance with regulations

8.2.2 Understand how to monitor an individual's compliance with regulations and internal policies and procedures

8.2.3 Know the purpose of a compliance monitoring programme: risk-based; reporting; planned

3.1 Management and Staff Responsibilities and Accountabilities

It is expected that a firm has clear guidelines and policies in place to ensure that their management team and all staff understand their responsibilities relating to the operational running of the business. The accountabilities set within each team should reflect appropriate control ensuring that business as usual activities are compliant with any applicable regulations, including Conduct Rules and SM&CR as set out in chapter 2.

Procedures are defined and set by teams, and should be reviewed regularly to ensure both their continued compliance and outcomes are still as expected. A stakeholder utilising these processes must have the ability to escalate any concerns or even improvements for consideration by management. It is the responsibility of management to make training available to staff and this training is not only relevant to a person's current role, but also satisfies a firm's regulatory training (such as AML, CASS, anti-bribery and corruption) and a firm's expectations in relation to any specific policies or procedures such as IT security. As with all training requirements, while a firm can set and monitor the activities and results of their staff, it is the employee's responsibility to ensure that the relevant study, continued development and results are achieved.

To protect a business and build a more structured basis of ethical behaviour, a firm will define and train staff on their company code of conduct and, if an employee fails to adhere, they will have the right to take disciplinary action as necessary. Breaches of a code of conduct can be both a human resources (HR) issue, such as unapproved email traffic and unauthorised engagement with clients, or a regulatory issue, such as personal account dealing or insider trading. It would be expected that staff have the opportunity and tools at their disposal to voice any concerns in respect of the personal conduct of fellow employees, and as with all training, conduct should be continually measured on a regular basis.

An individual employee can of course have completed all the expected training and adheres to the policies and procedures set out. As part of any day-to-day coaching, it will be the responsibility of the management chain to ensure that the employee is coached effectively and when necessary appropriate feedback, training or mitigating actions are put in place which ensure that work is completed to a satisfactory standard and the performance of any individual is maintained to the standards set.

In addition, a rigorous quality checking (QC) process should be implemented depending on the risk of the process and down-stream impact which will identify issues as they occur.

In more detail, the following list provides the methods by which monitoring can be achieved:

- **Regular feedback/appraisal and personal development review (PDR)** – not all feedback will be formal, as a daily catch-up or support conversation can be provided by anyone in a management position. More formal reviews which will take place on a monthly, quarterly and half-yearly basis should both measure the factual performance of an employee and allow a chance to have constructive discussions on the next stages of development and expectations.
- **QC and assurance processes** – as mentioned above, a QC process will target specific work items or individuals depending on the risk appetite of the firm or the experience of the individual. QC can be as simple as a manual check, a four eye-check (authorised by two separate individuals) or double keying where inputs are made by two employees and the results are compared (this is often seen when completing manual dealing).
- **Exception and error reports** – automated system reports may be used to identify where non-compliance may occur – highlighting if actions or processes are completed quicker than expected (ie, a checking process), or complaints and breaches are increasing in specific areas.
- **Testing on a periodic basis** – high risk areas or those areas with the greatest impact to regulatory or end client satisfaction will be tested, at minimum, on an annual basis (eg, CASS, internal policies). Sessions cannot focus simply on a test but will also contain a refresher module to ensure any new developments have been captured.
- **Self-certification by the individual** – responsibility is often placed on an individual employee to declare they have understood and adhered to a firm's policies and procedures, providing an opportunity to review actions within the time period and highlight concerns due to non-compliance.

3.2 Compliance-Monitoring Programme

A firm's compliance-monitoring programme defines the quality assurance testing carried out on the day-to-day activities of the business. It will review and focus on specific policies and procedures depending on the results of any compliance risk assessment. In addition, the monitoring programme should also cover the firm's expectations and education of employees in respect of compliance matters. It should be designed to fulfil a complete coverage of the business and driven by the risk management assessment over a defined period of time.

The compliance monitoring team is usually a function within the compliance department and, therefore, provides an independent review of the operational work performed by the firm, with a focus on whether:

- operational tasks are being performed in line with operational procedures, and
- those operational procedures continue to reflect current regulatory requirements.

The programme's content will focus on the business areas that offer the greatest impact and regulatory risk within the firm; however, the plan will not ignore low-risk areas, and. as stated above, it should ensure full business coverage over a defined period of time. Given the sheer scale of the work required and the controls within the business, it would be both impractical and uneconomical to review every item of processed work. Compliance monitoring is therefore risk-based. A firm will allocate sufficient resources to cover the appropriate volume of work within each risk to provide the appropriate assurance.

The monitoring approach will review procedures, documentation and completed work items based on agreed working papers advising senior management of the scope. Once completed, findings, if identified, will be shared and recommendations on making improvements documented. It is important that the monitoring team also have access to the subject matter experts for each review to ensure testing is carried out correctly.

Upon completion, the monitoring team will provide reporting on their findings to senior management and the board including proposals and expectations on any remedial action. It is key that the reporting contains information that focuses on key risks and their root causes. Senior management will be initially tasked to review and acknowledge reporting and ensure any historic or current actions are completed as per the agreed timeframes.

End of Chapter Questions

Think of an answer for each question and refer to the appropriate section for confirmation.

1. **What is the role of the business operational management as the first line of defence against potential risks?**
   Answer reference: Section 1.1.1

2. **What aspects and areas does the third line of defence, the internal and external audit function, focus on?**
   Answer reference: Section 1.1.3

3. **Describe the cause of potential operational risk by system failure.**
   Answer reference: Section 2

4. **What potential consequences could a risk event have on a firm?**
   Answer reference: Section 2.1

5. **What are the risks of human involvement in data capture?**
   Answer reference: Section 2.1.1

6. **Describe the cause for potential risk when there are significant changes in regulations.**
   Answer reference: Section 2.1.3

7. **Name three possible projects that implement significant change to the operational process, systems or functions within a third-party administrator (TPA).**
   Answer reference: Section 2.1.4

8. **Whose responsibility is it to ensure that, in regards to an employee's training, the relevant study, continued development and results are achieved?**
   Answer reference: Section 3.1

9. **Describe the method of 'exception and error reports' used to monitor employee training and ensure necessary feedback or action is given.**
   Answer reference: Section 3.1

10. **What is the focus of the compliance monitoring team's independent review of the operational work performed by the firm?**
    Answer reference: Section 3.2



Glossary

Accumulation Units/Shares

Units/shares where net income is automatically reinvested back into the fund and is reflected in the price of the units/shares. The unitholder/shareholder benefits from not having to pay an initial charge on the reinvested income.

Agent

1. One party officially representing another and acting on its behalf.
2. Role adopted when party to an investment transaction when the transaction will settle on the external market rather than within the firm (as distinct from a principal deal).

Aggregation

The process of consolidating a large number of relatively low-value buy or sell orders from retail clients into a single order that can be serviced by the destination firm.

Alternative Investment Fund (AIF)

A collective investment scheme as defined by the Alternative Investment Fund Managers' Directive (AIFMD).

Annual Management Charge (AMC)

A charge usually in the order of 0.75% to 1.75% of the value of the fund levied for the management of the collective investment scheme.

Auditor

An independent party, with expertise in the review of business operations and/or financial record keeping, retained by a firm to ensure its operations are effective and accurate.

Authorised Corporate Director (ACD)

A body corporate and an authorised person given powers and duties under Open-Ended Investment Companies Regulations 2001 to operate an OEIC.

Authorised Fund Manager (AFM)

A firm authorised and regulated by the FCA, eg, for the provision of fund management control and the operation of collective investment schemes.

Authorised Unit Trust (AUT)

A unit trust scheme authorised by the FCA. Authorised unit trusts can be offered for sale to the general public.

Benchmark

A standard against which the performance of a security, mutual fund or investment manager can be measured. Generally, broad market and market-segment stock and bond indexes are used for this purpose.

Beneficial Owner

The person or entity who ultimately benefits from the asset. See also Registered Owner.

Bid/Offer Spread

The difference between the bid and offer prices, expressed as a percentage of the offer price of units in a unit trust.

Bid Price

The price paid to unit holders redeeming their units in a unit trust. In the case of large deals, a lower price may be payable.

Bonds

Bonds are essentially IOUs; the issuer of the bond receives money from the initial buyer of the bond, and undertakes to pay the holder of the bond regular interest and then return the money (the capital) at a particular future date. The regular interest rate that is paid by the issuer is known as the coupon rate, and the date on which the interest is paid is known as the coupon date.

Business Day

Any day other than a Saturday, Sunday, Christmas Day, Good Friday or a bank holiday under the Banking and Financial Dealings Act 1971.

Capital Gains Tax (CGT)

Capital gains tax is payable by the individual taxpayer at the rate equivalent to the taxpayer's highest rate of tax on gains arising from the sale of securities and other assets.

CASS

Abbreviated name for the Client Assets Sourcebook, part of the FCA Handbook of Regulations.

CASS Resolution Pack (CRP)

A set of documents that a firm must maintain to assist an insolvency practitioner understand and operate the CASS model if the firm was to become insolvent.

Central Securities Depository (CSD)

An entity which holds securities, either in certificated or uncertificated (dematerialised) form, to enable settlement by book entry transfer. In some cases, these organisations also carry out centralised comparison and transaction processing such as clearing and custody-type services relating to securities.

Client Asset

A term including both client money and safe custody assets.

Client Bank Account

A bank account opened by a firm specifically to hold client money rather than corporate money.

Client Money

Money of either of the following types:

a. money received by a firm from/for a client in respect of designated investment business (unless some exemption applies), or
b. money that the CASS rules specifically require a firm to segregate as client money (such as prudent segregation).

Collective Investment Scheme Sourcebook (COLL)

Part of the FCA Handbook covering those rules relating to the operation of collective investment schemes such as unit trusts and open-ended investment companies.

Conduct of Business Sourcebook (COBS)

Part of the FCA Handbook covering those rules relating to the conduct of business by companies authorised by the FCA to conduct investment and other business under the Financial Services and Markets Act.

Contract Note

A document sent to the investor on a purchase or sale being made, detailing the price at which the units or shares were bought or redeemed.

Conversion Factor

Income units/shares and accumulation units/shares are linked by a conversion factor so from day to day the two types of units/shares will always move in line. Each time the income units/shares are quoted ex-dividend (XD), the conversion factor is adjusted, so there will be a proportionate difference between the two types of units/shares. The conversion factor tells you that each accumulation unit/share is the equivalent of that number of income units/shares. The factor is calculated to five significant figures.

CREST

Computerised system for the transfer of uncertificated shares on a stock exchange.

Custodian

A regulated firm that specialises in the safeguarding and administration of transferable securities and other safe custody assets.

De Minimis

Below the level to be taken into account, eg, where the amount available for distribution to unit/shareholders in a CIS is below the minimum laid down by scheme regulations.

Deposit

A sum of money held by a bank or similar institution, and treated as a balance sheet item of the bank rather than a sum of client money held.

Depositary

In respect of CISs, a regulated firm responsible for protecting unitholders' rights and holding the scheme's assets on behalf of the unitholders. The terms 'trustee' might also be used if the CIS is a unit trust.

Discretionary Fund Manager (DFM)

An investment manager that makes the buy-sell decisions without referring to the account owner (client) for every transaction. The manager, however, must operate within the agreed-upon limits to achieve the client's stated investment objectives.

Due Diligence

A review process undertaken by a firm when selecting a bank or custodian to appoint in respect of its holdings of client assets. Periodic reviews may also be performed.

Equities

Equities, or shares, are direct investments in companies. Holding shares in a company is the same as having an ownership stake in that company. So a shareholder in, say, the global bank, HSBC, is a part-owner of HSBC.

Exchange-Traded Fund (ETF)

An investment fund traded on a global stock exchange in the same manner as a typical equity. The price of an ETF reflects the value of its investment portfolio.

Exit Charge

Under FCA regulations, unit trust managers and consequently some AFMs of CISs have been given the option to levy a charge on redemption of units/shares in place of or in combination with their initial charge. This charge is referred to as an exit charge.

Financial Conduct Authority (FCA)

Successor to the FSA responsible for overseeing the conduct of retail and wholesale financial business and market regulation for all firms, and regulation of all firms not regulated by the Prudential Regulation Authority. Agency designated by HM Treasury and funded by the financial services sector.

Financial Ombudsman Service (FOS)

Deals with complaints arising from investments. Previously there were multiple ombudsmen depending on how investments were purchased. Now all complaints are dealt with by the FOS.

Financial Services Authority (FSA)

Former regulatory authority for the financial services sector. Its duties were taken over by the Financial Conduct Authority in April 2013.

Firm

Term used to identify a legal company (or, for example, sole trader and partnership) that is authorised and regulated by the FCA to conduct designated investment business.

Forward Pricing

A system of pricing where investors deal blind, ie, the price of the units/shares at which they sell or buy is determined on the next valuation point of the fund.

Funds

Can refer to all collective investment schemes such as authorised unit trusts (AUTs) and open ended investment companies (OEICs).

Gearing

The relationship between borrowing and capital. High gearing means that prior charges are large in relation to the rights of shares. Low gearing means the reverse.

General Investment Account (GIA)

A type of wrapper which holds all investments that are neither pension fund investments nor the subject of tax restrictions. This type of account is usually available to all private individuals as well as charities and may be operated in joint names (eg, married couples or business partners).

Gilt

A bond issued by the UK government.

Group 1 Units/Shares

CIS units/shares that the holder purchased in a previous accounting period (and on which any return of capital due has already been affected).

Group 2 Units/Shares

CIS units/shares that the holder purchased in the most recent accounting period (and on which no return of capital has yet been made).

Hedge Funds

A hedge fund is an investment fund, open to a limited range of investors, that undertakes a wider range of investment and trading activities than traditional long-term investment funds, and that, in general, pays a performance fee to its investment manager.

Every hedge fund has its own investment strategy that determines the type of investments and the methods of investment it undertakes.

Hedge funds, as a class, invest in a broad range of investments including shares, debt and commodities. As the name implies, hedge funds often seek to hedge some of the risks inherent in their investments using a variety of methods, most notably short selling and derivatives.

Income Share

Income shareholders in an investment trust company have the right to:

- all the income received from the underlying portfolio and distributed as dividends, and
- a fixed repayment of capital when the company is wound up.

Independent Financial Adviser (IFA)

A financial adviser who selects suitable investments from the complete range of product providers who offer products in the sector in which the adviser specialises.

Individual Client Balance (ICB) Method

One of the standard methods of internal client money reconciliation.

Individual Savings Account (ISA)

A tax-efficient savings structure introduced by the government in 1999, enabling investors to subscribe an annual amount for investment in various assets.

Initial Charge

A charge which may be applied to new investment in a CIS, calculated as a percentage of the price. For a dual-priced CIS, the initial charge is included within the offer price; for a single-priced fund, the initial charge would be in addition to the quoted price.

Instrument of Incorporation

Legal document which sets out the constitution and internal regulations of an OEIC. Broadly similar to a Companies Act company's Memorandum and Articles of Association.

Interim Accounting Period

One or more periods ending on dates prior to the end of a CIS's annual accounting period in respect of which interim distributions of income are paid.

Investment Association (IA)

The trade body representing the industry.

Investment Company with Variable Capital (ICVC)

An ICVC is more commonly known as an open-ended investment company (OEIC).

Investment Objectives

The reason why an investor is investing. For example, it might be to increase income, grow capital or plan for future events, such as the need to pay off a mortgage or to fund retirement.

Investment Trust (IT)

An investment trust is simply a listed public company whose business is to hold and manage a portfolio of investments. The shares are dealt on the stock exchange at prices which depend upon supply and demand and which are not necessarily related to the value of the company's assets; 85% of its income must be distributed.

Junior Individual Savings Account (JISA)

A version of an ISA wrapper, which can be opened by the parents of children up to age 16 (and by the child themselves between the ages of 16 and 18). At the age of 18, the JISA converts to an ISA.

Key Investor Information Document (KIID)

The UCITS IV Directive, effective from 1 July 2011, introduced a document that is clearer and more standardised than the simplified prospectus for UCITS. This document is called the Key Investor Information Document (KIID). Any UCITS funds created must produce a KIID upon their launch. Non-UCITS funds may continue to issue a simplified prospectus and key features document.

Liquidity

The part of a CIS portfolio which is held in cash or near-cash. This may include some gilt-edged securities and certificates of deposit.

Markets in Financial Instruments Directive (MiFID)

Establishes a set of EU rules on the information that must be supplied to consumers when financial services are sold at a distance, eg, via the internet, and sets minimum periods of withdrawal from distance contracts. MiFID was implemented in November 2007 and took the place of the Investment Services Directive.

Model Portfolio

A preselected portfolio of assets with a specific set of targets and objectives and level of risk, which provides a guide for any investor who has the same desired outcomes.

Net Asset Value (NAV)

This is the value of the underlying shares held in the portfolio based on quoted mid-market prices, together with other assets, less liabilities, then divided by the number of shares in issue. The NAV is quoted in pence per unit/share.

Nominee

This usually refers to a legal entity which holds shares on behalf of others. It can be a method of concealing the beneficial owner.

Offshore Bond

A type of insurance bond where the product is created and domiciled in locations outside the UK where companies can offer customers growth on their funds that is largely free from tax.

Offshore Fund

An investment scheme of which the trustees or operators are not resident in the UK (for example, unit trusts operated under Jersey laws and Belgian SICAVs).

Onshore Bond

A type of insurance bond where the product is created and domiciled in the UK.

Open-Ended Investment Companies (OEICs)

Open-ended investment companies (pronounced 'oiks') are corporate bodies established for collective investment purposes.

Periodic Charge

See Annual Management Charge.

Platforms

A term being used to describe firms, like fund supermarkets, who offer a range of suppliers' products such as ISAs, life and pensions products, equities, and a single administration service for the investor/IFA. They may also offer various (often online) tools for dealing, valuation and product selection.

Platform Service

A service that involves arranging, safeguarding and administering investments, and distributing retail investment products that are offered to retail clients by more than one product provider.

However, this is neither solely paid for by adviser charges nor ancillary to the activity of managing investments for the retail client.

Principal

Role adopted when a firm deals for a client using the assets or money owned by the firm (as distinct from an agent deal).

Prospectus

Every CIS is required to have a prospectus. It contains details which investors and professional advisers would reasonably require before making a judgement about the merits of investing in a company.

Prudent Segregation

A specific process by which a firm can set aside a sum of corporate money to protect the client money pool against any potential shortfall.

Qualified Investor Scheme (QIS)

FCA CIS Sourcebook (COLL) introduced FCA-authorised collective investment schemes for non-retail investors. Such schemes are for sophisticated investors, ie, those with significant knowledge of investment, either private individuals or businesses. They are less heavily regulated than ordinary retail schemes.

Register

A list of the owners of a company's or unit trust's shares, updated on an ongoing basis.

Registrar

The company which maintains the register of shareholders and may issue share certificates where applicable.

Registration

The recording of the ownership of an asset – particularly in the main register maintained by the issuer of an asset.

Reportable Persons

Persons whose details and transactions (distributions of income and capital repayments) are reported to HMRC under the Savings Directive.

Risk Profile

A methodology used by financial advisers to measure a client's appetite for risk. A number of different methods may be used to assess how a client feels about investment risk, including questionnaires, software applications and training/investment information.

Safe Custody Asset

An asset held by a firm as part of providing a custody service to a client.

Savings Plan

Schemes run by CISs enabling investors to purchase units/shares conveniently on a regular, usually monthly basis. Similar schemes are offered by some investment trusts.

Segregation

The legal and physical separation between money and assets of the firm and the money and assets that the firm may hold on behalf of its clients.

Self-Invested Personal Pension (SIPP)

A type of UK government-approved personal pension scheme, which allows individuals to make their own investment decisions from the full range of investments approved by HMRC; in other words, the investor can choose from a much wider range of investment products than they could in an insured personal pension.

Service Level Agreement (SLA)

That part of a service contract in which a certain level of service is agreed upon.

Settlement

The exchange of assets and/or money at the conclusion of a financial services transaction.

Shortfall

The position where the resource calculated as part of an internal client money or asset reconciliation or records check, or the actual client money held, as part of an external client money or asset reconciliation is less than the calculated requirement.

SICAV

An open-ended CIS common in continental Europe, especially Luxembourg, Switzerland, Italy, Spain, Belgium, Malta, France and the Czech Republic. SICAV is an acronym for the French *société d'investissement à capital variable*, which can be translated as 'investment company with variable capital'.

Single-Pricing

Pricing system widely used outside the UK, where CISs quote only one price instead of a bid and an offer price. A sales charge is usually added when units are purchased. OEICs always use single-pricing of units/shares.

Stamp Duty Land Tax (SDLT)

A taxation charge which applies to the purchase or lease of land or property – and which is sometimes payable on transfers of ownership of property or land when no money is exchanged.

Stamp Duty Reserve Tax (SDRT)

A taxation charge which applies to agreements for the sale of securities if the transfer of ownership does not require a stock transfer or other stampable instrument.

Statement of Recommended Practice (SORP)

A SORP provides standards for the preparation of accounts. A new SORP covering both unit trusts and OEICs has been issued by the Investment Association (IA).

Straight-Through Processing (STP)

Working practices and systems that enable transactions to move seamlessly through the processing cycle, without manual intervention or redundant handling.

Subcustodian

A custodian bank that only operates within one jurisdiction. Together, the global custodian and its subcustodians form a global network.

Senior Management Arrangements, Systems and Controls handbook (SYSC)

The 'Senior Management Arrangements, Systems and Controls' Sourcebook, part of the FCA Handbook.

Tax Credit

Dividend distributions, whether paid or reinvested, are treated as the top slice of income and carry a tax credit of 10%. A tax credit voucher is usually issued half-yearly. Investors liable to tax at the basic rate or lower rate band will have no further liability to tax. Higher rate taxpayers will have a further liability to tax.

Tax Voucher

A document sent to an investor that shows the amount of income to which the holder is entitled (whether paid out or reinvested) and the value of the tax credit due to the investor or, in the case of an interest distribution, the amount of income tax deducted.

Tax Year

The period for which the UK government maintains its accounts. It runs from 6 April to 5 April in the following year.

TISA Exchange (TeX)

An industry 'contract club' that will facilitate the electronic transfer and re-registration of assets.

Total Expense Ratio (TER)

The total expense ratio represents the 'drag' on fund performance caused by all annual operating costs, not just the basic annual management charge.

Trail Commission

Commission usually paid annually for introducing IFAs to encourage long-term investment. Also referred to as 'renewal commission'.

Transaction

An agreement to exchange a specific type and quantity of one asset (or money) for a specific type and quantity of another. A transaction will either be subject to the rules of the exchange on which it is executed, or the terms and conditions defining a service. Firms may, therefore, process a wide range of transactions – both internal and external.

Trust Deed

An instrument in writing by which a unit trust scheme is normally constituted.

Trustee

An institution, such as a bank or insurance company, which acts as custodian of a unit trust fund's assets on behalf of unitholders and watches their interests generally. Broadly similar to a depositary in an OEIC.

Undertaking for Collective Investment in Transferable Securities (UCITS)

A European directive governing Undertakings for Collective Investment in Transferable Securities. It is designed to harmonise the operation of CISs, which includes authorised unit trusts throughout the EU, with a view to facilitating the sale of funds in other member states. There have been several updates to the directive; the most current is referred to as UCITS V and came into effect in 2016.

Valuation Point (VP)

The date and time at which the NAV of an open-ended fund is calculated which enables the dealing prices to be determined.

Venture Capital Trust (VCT)

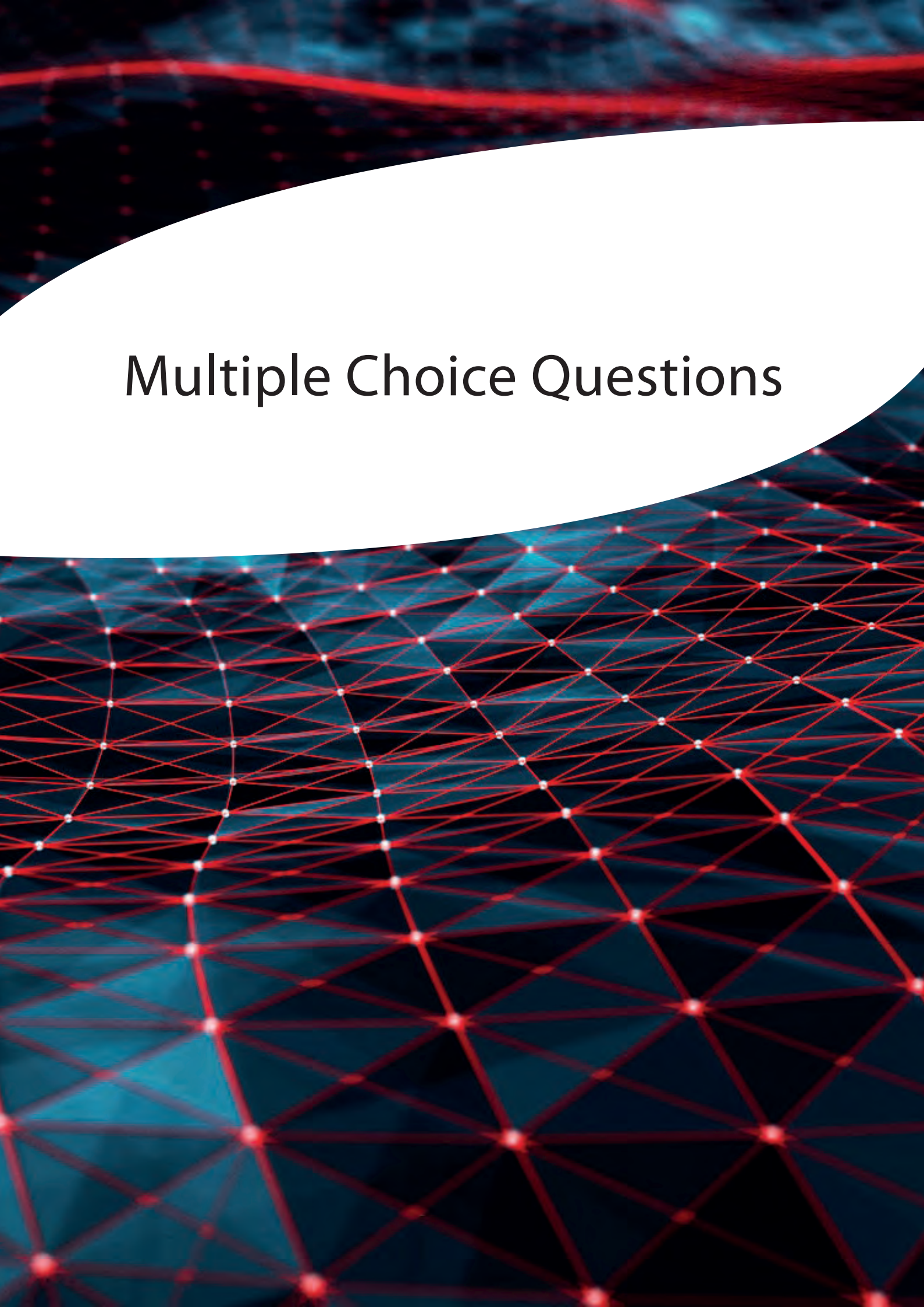
A highly tax-efficient UK closed-end CIS designed to provide private equity capital for small expanding companies and capital gains for investors. VCTs are companies that are listed on the London Stock Exchange and invest in other companies which are not themselves listed.

Warrant

An equity warrant offers the holder the right to buy the underlying equity at a predetermined price on specified dates, or at any time, up to the end of a predetermined time period. A warrant differs from an option in that options usually have a life of less than one year. Warrants are usually issued by companies or by securities houses and have a life span of more than one year. The exercise of a company-issued warrant will result in an increase of the capital of that company.

Wrapper

A financial services product, defined by terms and conditions, in which an investor might hold and trade assets. Most wrappers available on a platform will enable some form of tax exemption/tax efficiency.



Multiple Choice Questions

The following additional questions are for learning and revision purposes. While they are based on the syllabus, they do not necessarily replicate actual examination standard questions and are included to test your knowledge and understanding of the relevant sections of the workbook.

1. Which type of units may be offered by collective investment schemes (CISs)?

A. Only income units
B. Only accumulation units
C. Both income and accumulation units
D. Any unit providing the terms are fair

2. The costs of maintaining sub-registers operated by the authorised fund manager (AFM) can be paid out of the property of the scheme if it gives:

A. 10 days' notice
B. 30 days' notice
C. 45 days' notice
D. 60 days' notice

3. Layering is the process of:

A. purchasing luxury assets or investments with 'clean' money
B. putting large sums of cash into banks with little or no validation
C. moving money between assets, foreign currencies, shares and bonds or between countries
D. tipping off a suspect of any investigations of suspicious activity.

4. Which of the following is included in the 5th Anti-Money Laundering Directive (5AMLD)?

A. Implementing the same standard of due diligence for all customers
B. Focusing on clients from international jurisdictions
C. Identifying fraud among senior board directors
D. Ensuring a risk-based approach to money laundering

5. When registering a beneficial interest in a fund, when do details of the underlying beneficial owners need to be recorded? Only:

A. where the owner is a regulated firm
B. if the owner is a nominee company
C. if the underlying owner is not the legal/registered owner but has a claim to some or all of the benefits
D. if the underlying owner is a politically exposed person (PEP)

6. What is a feature of a closed-ended collective fund? Investors buy and sell:

A. directly with the fund and increase/decrease the units held in the fund
B. on the open market and increase/decrease the units held in the fund
C. directly with the fund but cannot alter the amount of units in the fund
D. on the open market but cannot alter the amount of units in the fund

7. Which of the following is a major source of income for a CIS? Income from:

A. dividends
B. dealing profits
C. profits from box management
D. stock lending

8. Which of the following is a key responsibility for a person working for the third line of defence?

A. Carrying out internal audits
B. Conducting financial oversight
C. Implementing management controls
D. Implementing quality controls

9. It is a regulatory requirement that firms must issue a final response to any complainant within a maximum of:

A. 4 weeks
B. 8 weeks
C. 12 weeks
D. 16 weeks

10. What must a firm do in respect of account validation for PEPs?

A. Refuse to deal for them and refer them to the money laundering reporting officer (MLRO)
B. Perform enhanced monitoring of their account
C. Ensure only senior management deal with their account
D. Refuse to deal for them and refer them to the Financial Conduct Authority (FCA)

11. An investor has decided to sell their units of a UK fund. What is the maximum length of time the investor need to wait for the sale to settle?

A. Two days
B. Three days
C. Four days
D. Ten days

12. Frank has a small investment in a UK unit trust and he has recently emigrated to Germany. As a result, he wants to change his agent associated with the unit trust. Which of the following is most likely to happen?

A. It will have to be sold in the UK and bought back in Germany
B. It is a trigger event and compliance will need to be informed
C. The agent noted as Frank's will simply need to be swapped over
D. Frank will not be able to change the agent so nothing will happen

13. If an authorised fund manager's (AFM's) box holds insufficient units to meet the need of investors they are entitled to:

A. borrow units
B. decline client orders
C. instruct the trustee to create new units
D. take a short position

14. Who is responsible for making sure the assets of the unit trust are safeguarded? The:

A. unit trust manager
B. custodian
C. trustee
D. Financial Conduct Authority (FCA)

15. A power of attorney (POA) can only be terminated by:

A. a court order
B. a deed of revocation
C. the donee
D. the trustees

16. Which of the following would be allowed to be the registered holder of an investment?

A. A partnership
B. A social club
C. A society treasurer
D. An NHS trust

17. Which of the following is designed to inhibit the ability of individuals linked to terrorism from operating freely in financial services?

A. Account reconciliation
B. Box management
C. Deferred redemption
D. Sanctions screening

18. Which of the following is a bank account typically administered by a transfer agency? A:

A. current account
B. deposit account
C. distribution account
D. money market account

19. It is a regulatory requirement for redemptions to be settled no later than:

A. the defined settlement date for the trade
B. one day after the settlement date of the trade
C. two days after the settlement date of the trade
D. three days after the settlement date of the trade

20. Who defines the responsibilities of the transfer agent and the authorised fund manager? The:

A. transfer agent only
B. Financial Conduct Authority
C. parties between themselves
D. AFM only

21. If a UK fund is processing a transfer it should use the standard form developed by the:

A. Financial Conduct Authority
B. Financial Reporting Council
C. Investment Association
D. Transfer Agency Forum

22. Which of the following is a type of company that is specifically structured to invest in other companies?

A. A closed-end investment company
B. An open-ended investment company (OEIC)
C. An investment trust
D. A transfer agency

23. When undertaking the validation of bank accounts for clients, which of the following procedures is it recommended that a firm should undertake?

A. It should engage with a registered digital identity service
B. It must ensure hard copies of documents are seen
C. The relevant bank must be contacted to check validity
D. It should ensure that the client signs a disclaimer to prevent liability

24. Which of the following is important when establishing a suspicious transaction reporting scheme? The:

A. volume of transactions
B. client's desired investments
C. number of staff within the firm
D. firm's investment experience

25. Which of the following is a mandatory corporate action? A:

A. rights issue
B. placing
C. fund closure
D. tender offer

26. For a transfer agency to have offshore processing, which of the following must it have in place? It must ensure:

A. at least two senior managers are based in the offshore location
B. offshore staff are trained and have the correct skills to process the work
C. the agency has a physical presence in the offshore location
D. it has been approved by the local regulator in the offshore location

27. Which of the following is usually supported by the enforcement of a pseudo valuation price (VP)?

A. Box management
B. Collateral management
C. Business as usual (BAU) dealing
D. Sub-register dealing

28. It is a regulatory requirement to disclose the costs and charges incurred by an investor on a:

A. monthly basis
B. quarterly basis
C. semi-annual basis
D. annual basis

29. Firms processing a deceased customer's account normally require a certified copy of the death certificate obtained from the:

A. Department for Work and Pensions
B. National Health Service
C. family of the deceased
D. General Register Office

30. An administrator for a financial firm has been told that a manager is holding a departmental meeting concerning the second line of defence. Which of the following scenarios is the meeting most likely to be about?

A. The internal management controls surrounding new IT systems
B. The improvements to be made to the existing procedures and systems
C. An update on an internal audit undertaken in the last month
D. A review of how the firm has been managing and mitigating risks on a day-to-day basis

31. If a fund has its accounting end date in April it must distribute income no later than:

A. May
B. June
C. July
D. August

32. The price of a dual-priced fund is based on:

A. bid and offer prices
B. creation and cancellation prices
C. bid and cancellation prices
D. creation and offer prices

33. Deals placed by investors via a platform are:

A. held on a sub-register
B. classed as business as usual dealings
C. given priority over other orders
D. executed after other orders

34. Lifetime individual savings accounts (LISAs) are only available for investors aged between:

A. 16 and 29
B. 16 and 39
C. 18 and 29
D. 18 and 39

35. Which process is an automated solution used to capture and process third-party instructions?

A. Box management
B. Fill or kill
C. Intermediary dealing
D. Straight through processing (STP)

36. A board member of a transfer agency has recently taken on a new employee. Who is responsible for ensuring the new employee understands the firm's policies and procedures? The:

A. new employee
B. new employee's line manager
C. Head of Compliance
D. training manager

37. Jerry is an adviser at a financial firm. He has an investor client called Tom who he has known for 15 years and, though Jerry has not seen Tom for five years when he last reviewed his circumstances he knows that nothing has changed in Tom's circumstances since he frequently sees him at the local pub. The firm has decided that they should review all of their clients' information. Should the firm also review Tom's accounts?

A. Yes, as the firm has a responsibility to provide ongoing reviews
B. Yes, as the firm has a responsibility to review their clients every three years
C. No, as Tom has been a client for 15 years and his circumstances have not changed
D. Yes for best practice, but there is no regulatory requirement to review clients

38. What are the rules concerning the marketing of an Undertakings for Collective Investment in Transferable Securities (UCITS) scheme? The fund:

A. can be freely marketed to all investors throughout the European Union
B. can be freely marketed to all investors throughout the world
C. can only market to investors in its home country
D. is only allowed to market to sophisticated investors

39. Who is responsible for alerting the authorities to suspicious transactions?

A. The money laundering reporting officer (MLRO)
B. The fund manager
C. The chief executive officer
D. The senior directors

40. A bounced cheque can remain unpaid for as many as:

A. three days
B. four days
C. five days
D. six days

41. In which of the following circumstances would a transfer agent typically provide services? A:

A. new venture capital trust (VCT) is set up
B. fund transfers real estate assets
C. fund decides to provide individual savings accounts (ISAs)
D. company decides to apply for listing

42. What measure is designed to protect client money if a firm believes it may be insufficient in the event of insolvency?

A. Box management
B. Net negative add-back
C. Prudent segregation
D. Stabilisation measures

43. The annual management charge (AMC) of a fund is accrued:

A. daily
B. weekly
C. monthly
D. yearly

44. A calculation of the effective yield of a bond is based on:

A. actual income
B. actual cash flows
C. expected coupon income
D. expected lifetime cash flows

45. A unitholder register is allowed to have a maximum of:

A. two names per holding
B. four names per holding
C. six names per holding
D. eight names per holding

46. What is the overall purpose of the Client Assets (CASS) rules? To:

A. protect customers when making payments
B. prevent online attacks
C. identify and report financial fraudsters
D. segment client money from the firm's money

47. Why should firms seek to collect additional information about their customers? To:

A. meet data protection requirements
B. ensure they are treating them fairly
C. comply with money laundering regulations
D. enable suspicious transaction reporting

48. Distribution warrants are normally valid for what length of time after the payment date?

A. 3 months
B. 6 months
C. 9 months
D. 12 months

49. If a lasting power of attorney (LPOA) is provided on behalf of a vulnerable client, the transfer agency should abide by validity requirements issued by the:

A. Financial Conduct Authority
B. Investment Association
C. Office of the Public Guardian
D. Transfer Agency Forum

50. What does a Client Assets (CASS) mandate mean?

A. An investor agrees for the firm to buy and sell shares on his behalf
B. The firm agrees to send all suspicious transactions to the authorities
C. A client instructs the firm to carry out a cash transaction on their behalf
D. The firm makes cash instructions on client assets it does not hold

51. Who is responsible for setting the maximum price that a unit trust can sell its units? The:

A. fund manager
B. fund manager's custodian
C. market demand and supply
D. Financial Conduct Authority

52. What happens when a systemic operational failure occurs? It must be reported to the:

A. AFM immediately
B. AFM within 24 hours
C. FCA immediately
D. FCA within 24 hours

53. With respect to the Statement of Recommended Practice (SORP) requirements, which document is designed to summarise investment performance? The:

A. auditor's report
B. depositary's report
C. comparative table
D. statement of total return

54. Which of the following can be used as a risk indicator to assess the quality of transaction capture and processing activity?

A. Breaks
B. Calls
C. Closures
D. Puts

55. Which of the following has oversight of a transfer agent's activities? The:

A. aggregator
B. depositary
C. investment manager
D. transfer agent

56. Which party has an oversight responsibility for sub-registers? The:

A. authorised fund manager
B. custodian
C. depositary
D. transfer agent

57. Which of the following accurately describes the concept of gearing?

A. A unit trust is oversubscribed but the unit trust continues
B. An investment trust borrows funds to invest
C. An open-ended investment company (OEIC) borrows funds to increase its liquidity
D. An investor buys enough to take control of the fund

58. What are switches used for?

A. Box management
B. Hedging
C. Rebalancing portfolios
D. Tax efficiency

59. Annual management charge (AMC) rebates are paid directly to:

A. fund managers
B. clients
C. distributors
D. regulators

60. How does client money and assets reporting (CMAR) differ from other reporting requirements? It is:

A. produced daily for transfer exchange
B. produced monthly to the Financial Conduct Authority
C. provided quarterly to the trustee
D. provided annually to Financial Action Task Force (FATF)

61. Janice has met a new client, Claire, and there is an issue with her online verification checks. How can Janice resolve this in the first instance?

A. Request her firm carry out an enhanced risk assessment
B. Ask Claire for her online username and password
C. Request paper copies of verification documents
D. Escalate the issue to the IT department for their help

62. Which of the following was the pre-cursor to new regulations restricting commission payments? The:

A. Foreign Account Tax Compliance Act (FATCA)
B. Markets in Financial Instruments Directive (MiFID)
C. Retail Distribution Review (RDR)
D. Sarbanes-Oxley Act (SOX)

63. What happens after the income per unit of a collective investment scheme is calculated? Units are quoted:

A. cum-distribution until the payment date
B. ex-distribution until the payment date
C. cum-distribution until the settlement date
D. ex-distribution until the settlement date

64. Which of the following investments are offered by platforms and represent part of a company? A:

A. bond
B. deposit account
C. gilt
D. share

65. What is the minimum period of time a fund must wait before transferring unclaimed distributions to its capital property?

A. Six months
B. One year
C. Six years
D. Ten years

66. Where a regulated firm has a risk-based approach to money laundering, they will:

A. ensure the same level of due diligence is applied to all customers of the firm
B. only identify transactions over a set amount to be investigated as high risk
C. set the money laundering policy at different levels depending on client circumstances
D. use the Financial Conduct Authority's set policy to reduce risk to financial markets

67. What is the minimum percentage of investment a collective investment scheme (CIS) can have in gilts before it can make an interest distribution?

A. 25%
B. 30%
C. 50%
D. 60%

68. Which of the following is an aggregator investor in the transfer agency process? A:

A. large professional investor with many proprietary accounts
B. fund manager who holds accounts for its fund and clients
C. retail client who holds a number of different accounts
D. foreign investor who holds accounts based in the UK

69. When opening an account for a charity, it is a requirement to record named beneficiaries with a minimum interest of:

A. 10%
B. 15%
C. 20%
D. 25%

70. What is the main purpose of adopting a good online practice in cyber security? To:

A. protect the firm's data
B. protect the firm's competitive advantages
C. help customers navigate through the website
D. ensure employees work efficiently

71. The more errors a firm detects when reconciling positions after settlement date, the:

A. less profitable the firm will be
B. more profitable the firm will be
C. lower the level of risk the firm may be exposed to
D. higher the level of risk the firm may be exposed to

72. Ms McGuire decides to invest in 500 units of a fund via a platform. The platform invests in 2,000 units in the fund's nominee account. What information will Ms McGuire have access to? Details of:

A. her own and the other individual unit holdings
B. her own and the total amount of units in the fund
C. only the total amount held by the fund manager
D. only her own number of units held

73. Calculate available income based on the data below:

Income brought forward	300
Gross	7,700
Equalisation	180
Charges	3,090
Tax	1,000

A. 2090
B. 3910
C. 4090
D. 8180

74. Which of the following correctly identifies the transfer rules between two firms, named 'A' who holds the assets and 'B' who will receive the assets?

A. A must allow the transfer out and B must accept the transfer in
B. A must allow the transfer out and B is not obliged to accept the transfer in
C. A is not obliged to transfer out but B must always accept the transfer in
D. A is not obliged to transfer out and B is not obliged to accept the transfer in

75. Which of the following is a method of intermediary dealing? Placing:

A. an order with an authorised fund manager (AFM)
B. an order with an adviser
C. a limit order
D. an execution only order

76. Why would a firm outsource its transfer agency operations? It:

A. is a regulatory requirement to ensure less conflict of interest
B. is usually cheaper than setting up an in-house service
C. helps to reduce liquidity risk
D. enables the firm to bring onboard international investors

77. Income distributions made via Bankers Automated Clearing Services (BACS) are credited as clear money for the holder:

A. on the due date
B within one day of the due date
C. within two days of the due date
D. within three days of the due date

78. The Financial Conduct Authority's (FCA's) definition of conduct risk follows on from the theme of:

A. the money laundering regulations
B. treating customers fairly
C. cyber risk management
D. good online practice

79. An error has been found in the register of investors. Who must make the instruction to amend the register?

A. The investor
B. The custodian
C. The authorised fund manager
D. A notary

80. What is meant by a soft closure of a fund? A soft closure is where the:

A. fund has reached the maximum amount of investment that the fund can have
B. fund manager reduces or stops the flow of new money into the fund
C. fund manager has set a limit on the amount individual investors can invest
D. investors of the fund have called for the fund to close

81. Which of the following fees ceased to be levied after the Retail Distribution Review (RDR) was implemented? The:

A. initial commission
B. annual management charge
C. performance fees
D. exit charge

82. What level of income tax do collective investment schemes (CIS) pay on taxable revenue?

A. 20%
B. 40%
C. 45%
D. 50%

83. If a power of attorney (POA) is not signed as a deed by the donor, it must always:

A. be signed by the donor
B. have two witnesses
C. give the donee specific powers
D. give the donee general powers

84. Data anonymisation:

A. allows data to be stored and processed
B. commits firms to the permanent deletion of information
C. surrounds personal data with technical security
D. removes the threat of reverse engineering

85. Which of the following is ultimately responsible for the management of an open-ended investment company's (OEIC's) investments on a day-to-day basis? The:

A. depositary
B. authorised corporate director (ACD)
C. trustee
D. fund manager

86. What is likely to happen if an investor decides to move his assets from one platform to another platform? The:

A. custodian's authorisation is required
B. fund manager's authorisation is required
C. investor may need to re-register the asset
D. transfer can only be done electronically

87. Which of the following individuals would be identified as a vulnerable customer? A:

A. student
B. person detained in custody
C. single mother or father
D. pensioner

88. There is a regulatory requirement for medium or large Client Assets (CASS) firms to appoint a:

A. Senior Management Function (SMF) 18 or 22
B. Senior Management Function (SMF) 14 or 16
C. Senior Management Function (SMF) 14 or 18
D. Senior Management Function (SMF)16 or 22

89. A UK investor is looking to maximise their tax advantages when buying a collective investment scheme. Which of the following wrappers would be suitable?

A. Individual savings accounts (ISAs) only
B. Pensions only
C. Individual savings accounts (ISAs) and pensions
D. Offshore accounts

90. What is one of the benefits of a nominee company using one single pooled account?

A. It is more cost efficient
B. It has less regulatory requirements
C. It always receives dividends gross
D. The fund manager can charge more

91. All retail schemes have a regulatory requirement to prepare reports and accounts that are:

A. issued within 12 months of their launch
B. known as the long report and the short report
C. prepared in accordance with Clients Assets Sourcebook (CASS)
D. available to any shareholder who requests a copy

92. Which body is responsible for setting the standards for Client Assets (CASS) audit reviews? The:

A. Financial Conduct Authority
B. Financial Reporting Council
C. Institute of Chartered Accountants in England and Wales
D. Transfer Agency Forum

93. At what price does a fund manager usually repurchase units in a fund?

A. Combining the value of the underlying investments with charges
B. Deciding the price themselves as long as no majority investor opposes
C. Pricing the units in the open market based on supply and demand
D. Receiving authorisation from the custodian for the price for which they can buy them

94. How often should a transfer agent reconcile its safe custody accounts? At:

A. the end of every business day
B. least weekly
C. least monthly
D. least quarterly

95. Which of the following are the responsibilities of the senior management in respect of combating financial crime? To:

A. take potential personal responsibility for the firm's legal obligations
B. ensure the firm has adequate funds for legal action against it
C. ensure that clients are aware they will be reported for financial crime
D. stipulate their financial crime process on all marketing literature

96. Nicole has received notification that an investor wishes to pay some of their funds to a new bank account. Which of the following should Nicole do?

A. Pay the funds across without delay, providing the instruction has come from the investor's usual email address
B. Contact the bank itself to check that the details of the account match the investor's and then pay it
C. Contact the investor directly and ask them to send a copy of their new bank account details
D. Inform the investor that they will need to come into the branch in person if they want to amend their bank account details

97. The Foreign Account Tax Compliance Act (FATCA) requires firms to:

A. apply US accounting procedures
B. disclose their charging structure for their client base
C. identify all reportable US persons within their client base
D. maintain tax records for up to five years

98. How is a unit trust legally established? As a:

A. partnership
B. trust
C. limited company
D. financial instrument

99. What must a firm do in respect of validating bank accounts in high risk jurisdictions, in the first instance?

A. Consider additional checks
B. Refuse to accept them
C. Escalate it to the Financial Conduct Authority (FCA)
D. Escalate it to the Financial Action Task Force (FATF)

100. In which of the following circumstances, if ever, is it possible for an authorised fund manager to contract out its regulatory obligations to a transfer agent? It is:

A. never allowed under any circumstances
B. only allowed if the transfer agent is also authorised
C. only allowed if agreed by a contract between the firms
D. only allowed if the Financial Conduct Authority (FCA) has given its explicit permission

Answers to Multiple Choice Questions

1. D Chapter 3, Section 1.7

Under the COLL Sourcebook, the rules enable AFMs to propose any type of unit/share class, providing that it is fair to all holders and can be explained in terms of its nature and operation to prospective investors.

2. D Chapter 5, Section 8

60 days' notice must be given to holders.

3. C Chapter 4, Section 1.2

Layering is the process of moving money between material assets that can be bought for cash and sold, or in the cash of the financial industry the buying and selling of foreign currencies, shares/bonds or collective investment schemes to make it more difficult for any authority to detect money laundering activity and ultimately the beneficial owner of the funds. If possible, the launderer will also move these assets between countries to further cloud the trail.

4. D Chapter 5, Section 1.1

The 5th Anti-Money Laundering Directive was passed in the UK as the Money Laundering Regulations 2017 which required firms to employ policies and procedures such as introducing the risk based approach and removing automatic exemptions from due diligence.

5. C Chapter 1, Section 3.2.3

A person who is not the legal/registered owner of an asset, and who was neither of the parties to the contract that purchased the asset, but who has a claim to some or all of the benefits that the asset provides is often referred to as a beneficial owner.

It has become important in recent years for some 'beneficial ownership' details to be captured by financial services firms as part of increased detail in anti-money laundering controls. It is not, however, necessary for a regulated firm to obtain the details of underlying beneficial owners if its client is a regulated firm or its nominee.

6. D Chapter 3, Section 1.2

Unlike an AUT or an OEIC that has variable capital (shares or units can be created or cancelled), a closed-ended fund raises a fixed amount of capital at launch, creates a number of shares in relation to this capital, and the number of these remains fixed. Shares within a closed-ended fund may not always be available to buy as existing investors may hold the entire allocation. Listed closed-ended funds are traded and valued throughout the day, unlike an OEIC or AUT which has a fixed valuation point.

7. A Chapter 5, Section 11

Generally, the income of a CIS comes from the dividends or interest from the underlying assets held, underwriting fees or simply interest the fund may hold on cash deposits.

8. **A** **Chapter 8, Section 1.1.3**

The third line of defence describes the independent assurance provided by the firm's audit committee and the internal audit function that reports to that committee.

9. **B** **Chapter 7, Section 3.1**

Among other requirements, the complaints-handling procedures require the firm to issue its final response to the complainant within eight weeks of the date of the original complaint and the complainant must be notified of their right to refer their complaint to the FOS if they are dissatisfied with the firm's response.

10. **B** **Chapter 5, Section 1.6**

All clients identified as higher risk are subject to enhanced ongoing monitoring by the firm.

11. **C** **Chapter 1, Section 4.4**

When the investor decides to sell, they need to instruct the fund manager (or ask their adviser or the supermarket to instruct the fund manager), who then has up to four days from receipt of the instruction and necessary paperwork in which to settle the sale and remit the proceeds to the investor.

12. **B** **Chapter 4, Section 2.1**

Trigger events can include change of agent (especially if overseas).

13. **C** **Chapter 5, Section 9**

On a dealing day, if the AFM finds that the box does not hold sufficient units/shares to meet the need of the investors, they will instruct the trustee to create and the units/shares and have them added to the manager's box.

14 . **C** **Chapter 3, Section 2**

The trustee is assigned to ensure that the fund manager adheres to the fund's investment goals and objectives. It is also the trustees' job to safeguard the assets of the trust.

15. **B** **Chapter 5, Section 3.1**

Once a POA has been put in place, it can be terminated at any time using a Deed of Revocation of POA.

16. **D** **Chapter 1, Section 3.2.1**

Partnerships, unincorporated bodies such as clubs and official capacities such as '*The Trustees of...*' or '*The Treasurer and Secretary of...*' would all normally not be accepted for registration. There are some unusual corporate bodies which are also acceptable, such as NHS trusts.

17. **D** **Chapter 4, Section 2.6**

Financial sanctions prevent the use of monies relating to certain individuals or organisations considered by the international community to be unfit (due to crime and/or terrorism). Being unfit and linked in this way ensures that there is no financial benefit from these activities.

18. C Chapter 5, Section 10.1

TAs typically administer many bank accounts on behalf of fund managers. These bank accounts fall into three main categories:

- client money accounts
- dealing (or firm) accounts
- distribution accounts.

19. A Chapter 5, Section 4.1

The regulations require redemptions to be settled on no later than the defined settlement date for the trade.

20. C Chapter 1, Section 1.2

The services performed by a transfer agent will be set out in agreements between the TA and the AFM.

21. C Chapter 5, Section 7.2

From December 2007, money laundering regulations imposed a requirement on fund managers to verify the identity of all registered holders of their funds and any underlying beneficial owners or controllers. For this reason, the Investment Association (IA) developed a standard form for UK funds.

22. B Chapter 3, Section 3

An OEIC is a type of company that is structured to invest in other companies.

23. A Chapter 5, Section 1.4

Firms are recommended to engage with a registered digital identity service to independently validate data for the opening of online accounts. In the UK there is a register of digital identity and attribute service, which provides a list of organisations currently certified against the trust framework. The trust framework is a set of government backed rules which draws on existing guidance, standards and best practice for trustworthy and secure digital identity services.

24. A Chapter 4, Section 2.2

Companies will normally have both manual and automated monitoring processes in place based on the size of their business and the volume of transactions being processed.

25. C Chapter 5, Section 5

Mandatory corporate actions are far more common with the most common being a distribution, with some funds distributing monthly. Other mandatory corporate actions that are often seen in the TA world are fund closures. Funds can close for a number of reasons and the AFM will work with the trustees to plan the closure and ensure all regulatory requirements are met before the fund closes.

26. B Chapter 1, Section 5

The TA must be able to demonstrate oversight of the offshore location and ensure that staff in the offshore location have the correct skills to be able to process work effectively.

27. D Chapter 5, Section 9.3

Deals placed by investors directly with a platform are held on a sub-register. When dealing, the platform will enforce a pseudo VP prior to, or dealing cut off in advance of, the fund manager's valuation point.

28. D Chapter 2, Section 1.1

There is a requirement to disclose the costs and charges incurred by investors on an annual basis.

29. D Chapter 5, Section 3.2.1

A death certificate obtained from the General Register Office is referred to as a certified copy on the document itself

30. D Chapter 8, Section 1.1.2

The second line of defence helps the operational risk management function to facilitate and monitor the implementation of effective risk management systems and controls by the firm's management. This line of defence relates more to the oversight of risk, the reviewing of the risk management procedures that have been implemented and also challenging what has been implemented to ensure that those procedures remain effective at managing risk within the firm.

31. D Chapter 5, Section 11

Funds must distribute income within four months from the accounting end date.

32. A Chapter 1, Section 4.1

A dual-priced fund allocates a separate price to a transaction depending on whether it is being bought or sold – these two prices are known as the 'bid' and 'offer'.

33. A Chapter 5, Section 9.3

Deals placed by investors, directly with a platform are held on a sub-register.

34. D Chapter 3, Section 5.1.4

Lifetime ISAs (LISAs) have been available to investors since the 6 April 2017 and only for those aged between 18–39.

35. D Chapter 5, Section 6.3.1

Straight-through processing (STP) is an automated solution used by the TA to capture and process instructions from any number of third parties with which they have regular interactions.

36. A Chapter 8, Section 3.1

Self-certification by the individual – responsibility is often placed on an individual employee to declare they have understood and adhered to a firm's policies and procedures, providing an opportunity to review actions within the time period and highlight concerns due to non-compliance.

37. A Chapter 5, Section 1.5

A firm must determine based on risk sensitivity, how to conduct ongoing monitoring of entities they have relationships with. This means scrutinising transactions to ensure that they are consistent on how the firm expects the entity to act, and ensuring that the firm's knowledge about the relationship with the entity remains current.

38. A Chapter 3, Section 1.8

Most AUTs and OEICs comply with UCITS regulations ensuring that they can be freely marketed within the European Union (EU) without needing to register with the regulator in each country. In fact, it is expected that a firm will initially seek authorisation first as a UCITS fund.

39. A Chapter 4, Section 2.5.1

The Money Laundering Reporting Officer's (MLRO's) responsibilities include making sure that information in respect of the suspicion of money laundering is properly disclosed to the relevant authority.

40. D Chapter 5, Section 4.3.1

Cheques can be bounced unpaid up to six days.

41. C Chapter 1, Section 1.3

The typical administration functions carried out by a transfer agent would include the provision of services in respect of some or all of the following fund structures and product types:

Product structures
- direct register holdings otherwise known as unwrapped holdings
- indirect holdings, eg, wrappers. An individual savings account (ISA) is a type of wrapper but not all wrappers are ISAs.

42. C Chapter 5, Section 2.8

In some instances, it may be determined that there is an exposure to the risk that in the event of insolvency, the total amount of segregated client money may not be sufficient to pay each client the due amount. The CASS rules, therefore, permit a firm to protect their clients against this risk and place corporate money into the client money bank account. This is known as prudent segregation.

43. A Chapter 6, Section 2.1.1

The AMC is accrued daily and is built into the price of the fund.

44. D Chapter 5, Section 11.6

Effective yield takes account of all expected cash flows from a bond over its lifetime.

45. B Chapter 1, Section 3.2

The name and address of each holder – up to four names may be registered per holding (as with property generally under English law and as specified under the OEIC Regulations 2001).

46. D Chapter 5, Section 2.1

The key purpose of the Client Assets (CASS) Rules is to ensure that if the firm were to become insolvent, investors' money is returned to them in a timely manner, and this is achieved by ensuring that any client safe custody assets and client money that the firm may hold on behalf of its clients are clearly distinct from any assets that the firm may hold for its own account – and that when a firm says it holds a given asset (or sum of money) for a particular client that it does indeed hold that asset/money.

47. C Chapter 4, Section 2

In respect of money laundering and terrorist financing, firms must consider international standards, eg, the Financial Action Task Force (FATF), and at a minimum, comply with the UK Money Laundering Regulations 2017 (as amended 2022) by implementing due diligence policies and a control framework that covers:

- verification of the customer's identity
- collection of additional information about the customer, and
- ongoing due diligence to monitor transactions and activity for reasonableness to ensure that money laundering or terrorist financing is not taking place.

48. B Chapter 5, Section 11.8

Distribution warrants are normally valid for six months from the payment date.

49. C Chapter 7, Section 2.3.1

Where a lasting power of attorney (LPOA) is provided, firms should follow and document validity in line with the Office of the Public Guardian's (OPG's) requirements.

50. D Chapter 5, Section 2.4.1

The CASS 8 mandate rules apply in the situation where a firm receives and retains a 'means' by which it can issue instructions that affect assets of a client (or the indebtedness of the client) that the firm itself does not hold.

51. D Chapter 1, Section 4.1

The maximum price at which the fund manager is able to sell new units is prescribed by the FCA.

52. C Chapter 5, Section 12.2

The FCA Handbook identifies certain events or breach types as requiring immediate notification to the regulator should they to occur. These items tend to be suggestive of systemic failings within a firm's structure or operations, which the FCA is concerned could expose investors to significant risk.

53. D Chapter 2, Section 3.2.1

The statement of total return summarises the results of the fund, by confirming the net investment gains or losses.

54. A Chapter 5, Section 4.5.2

The volume of unreconciled events (or breaks) is commonly used as a risk indicator to assess the quality of the transaction capture and processing activity.

55. B Chapter 1, Section 2

Oversight of the transfer agent and any of the work that has been delegated (dealing or interaction with investors) is undertaken by them and continually monitored through regular annual reviews/inspection limits.

56. C Chapter 5, Section 8

Sub-registers are subject to oversight by the trustee/depositary.

57. B Chapter 3, Section 4

Gearing the portfolio allows money to be borrowed for the trust's benefit with the objective of earning a better return than the cost of that gearing.

58. C Chapter 5, Section 6.4.1

A switch is a two-sided transaction processed when an investor chooses to rebalance their portfolio either by moving a percentage or a specific amount between funds in the same account.

59. C Chapter 6, Section 2.5

An AMC rebate is paid to distributors depending on the contract they have with the AFM.

60. B Chapter 5, Section 12.1.1

FCA reporting such as the CMAR reporting is produced monthly and reports the highest balances held in client money over that period.

61. C Chapter 5, Section 1.6

Key points in reference to enhanced monitoring, therefore, are:

- subject to periodic review for appropriateness
- an appropriate e-ID tool to the requisite JMLSG standard
- integrated system functionality, informing processes, including hard-stop
- firms are to retain the right to gather paper-based evidence where required, and
- firms' ability to gather annual attestations.

62. C Chapter 2, Section 2.1

The Retail Distribution Review (RDR) came into effect on the 1 January 2013 and is a piece of UK specific regulation that focused both on the qualifications required of an independent financial adviser (IFA) and also the way in which they were paid for their services. It highlighted a number of problems in this area and, therefore, brought about new regulations restricting commission payments.

63. **B** **Chapter 5, Section 11**

Once the income per unit/share has been determined, the unit/share price is quoted ex-distribution until the payment date.

64. **D** **Chapter 6, Section 1.1.3**

An equity shareholding is the part ownership of a company.

65. **C** **Chapter 5, Section 11.8**

Any distribution payment remaining unclaimed six years after the payment date is transferred to, and becomes part of, the capital property and neither the unit/shareholder nor payee, if different (or their executors), can reclaim the income.

66. **C** **Chapter 4, Section 2.3**

Firms that apply a risk-based approach to anti-money laundering (AML) can focus AML resources where they will have the biggest impact.

67. **D** **Chapter 5, Section 11.2**

Interest distributions are made for funds that have 60% or more invested in **gilts**, UK or overseas bonds and/or money market deposits throughout the accounting period (ie, a fund with predominately interest-bearing assets).

68. **B** **Chapter 1, Section 1.4**

Aggregators will hold investor level records themselves but will typically have an aggregated account with the AFM to hold assets belonging to the underlying investors. These will usually show on the register as a holding in the name of a nominee company that is either owned or controlled by the regulated aggregator or in the name of a platform service provider.

69. **D** **Chapter 5, Section 1.7.1**

Record any named beneficiaries with at least a 25% interest on the register.

70. **A** **Chapter 4, Section 3**

Cyber security is the application of processes, techniques and controls designed to protect a firm's digital data stored or transmitted or used within systems.

71. **D** **Chapter 5, Section 4.5.2**

The more errors a firm detects when reconciling its many positions after the settlement date has passed, the higher the level of risk the firm may be exposed to.

72. **D** **Chapter 1, Section 3.2.6**

Each unitholder knows their own holding but rightly has no awareness of the total aggregate number of units held by the nominee at the AFM. Each party knows only the activity in the adjacent links of the chain.

73. **C** **Chapter 5, Section 11.4**

(300 + 7,700 + 180) – (3,090 + 1,000) = **4,090**

74. **B** **Chapter 3, Section 5.1.5**

Although it is a legal requirement for ISA providers to permit transfers out, there is no corresponding rule for accepting transfers.

75. **B** **Chapter 5, Section 6.1**

There are several dealing channels by which a client may transact directly with an AFM. In addition, they also have the option to place deals via an intermediary or adviser.

76. **B** **Chapter 1, Section 6**

TA is usually outsourced to gain access to specialist skills at a lower cost than that achievable by an in-house service, as well as to reduce overall operational risk.

77. **A** **Chapter 5, Section 11.10**

For the holder, income is credited as cleared money on the due date, ie, there is no cheque-clearing delay.

78. **B** **Chapter 4, Section 4**

This theme of conduct risk follows and expands upon an earlier regulatory focus of Treating Customers Fairly (TCF).

79. **C** **Chapter 1, Section 3.2.2**

If an error is found in the register, the data must be corrected. Such corrections may require units/shares to be issued or cancelled, which requires the appropriate instruction from the AFM.

80. **B** **Chapter 3, Section 1.9**

Soft closure is a technique used by the AFM to reduce or stop the flow of new money into a CIS. This is typically because the AFM feels that the CIS is no longer able to efficiently invest new money into the underlying assets that make up the fund due to the availability of suitable new investments or to the size of investments in existing assets.

81. **A** **Chapter 6, Section 2.2**

Following the implementation of the Retail Distribution Review (RDR) on 1 January 2013, UK advisers no longer get paid initial commission by the AFM on new investments.

82. **A** **Chapter 1, Section 4.8**

The current rate of income tax for a CIS is 20%.

83. **B** **Chapter 5, Section 3.1**

A POA must be signed as a deed by the donor; or if not signed by them, signed at their direction and in their presence, and in the presence of two witnesses.

84. **A** **Chapter 2, Section 1.2.2**

Anonymisation allows data to be stored and processed, while completely preserving its privacy.

85. **B** **Chapter 3, Section 3**

The role of the ACD is in respect of the day-to-day management of the fund which includes managing the investments, providing valuations, pricing and dealing with the investors, all of which can be undertaken by themselves or delegated out.

86. **C** **Chapter 1, Section 3.2.5**

Moving an asset between wrappers on a platform may require the platform to re-register the asset (ie, when different nominee accounts are used for the different wrappers). However, re-registration may also be necessary if an investor chooses to move their affairs from one platform to another.

87. **B** **Chapter 7, Section 2.3**

Vulnerability can, in respect of a vulnerable adult, happen at any time and relate to one or more of the following:

- living in residential or sheltered accommodation
- receiving certain types of health and social care
- receiving certain types of welfare support
- detained in lawful custody
- older people who are physically or mentally frail
- learning disabilities
- a mental health condition such as dementia or personality disorder
- ill and need help to carry out normal daily functions
- physical disabilities, or
- undergone a recent trauma, eg, bereavement or divorce.

88. **A** **Chapter 5, Section 2.11**

There is a requirement for a firm meeting the criteria for a CASS medium or CASS large firm to appoint a SMF18 or SMF22 with appropriate skill, expertise and experience.

89. **C** **Chapter 3, Section 5**

A wrapper is a product that allows a client to invest in funds, typically in a tax efficient way. In the UK, the two most common wrappers would be an ISA or a pension.

90. A Chapter 1, Section 3.2.4

One single, pooled nominee account – the platform uses one large nominee account to hold all assets relating to all its client holdings across all the wrappers it offers. This approach offers maximum aggregation of transactions and minimises the number of asset positions maintained. It is generally the most cost-efficient model to operate.

91. D Chapter 2, Section 3.1

After each annual and interim accounting period, a retail scheme under COLL must prepare reports and accounts as defined by the SORP (Statement of Recommended Practices). It is commonly known as the 'long report' and must be made available to any shareholder who requests a copy.

92. B Chapter 5, Section 2.12

The Financial Reporting Council (FRC) is the body responsible for setting the standard for CASS audit reviews.

93. A Chapter 1, Section 4.1

The maximum price at which the fund manager is able to sell new units is prescribed by the FCA. It is known as the maximum buying price and, under dual pricing, comprises the creation price (ie, the price the manager must pay to the trustee to create new units, which broadly consists of the value of the underlying investments and an allowance for dealing costs) plus the fund manager's initial charge. The price at which the fund manager will repurchase units is calculated in a similar manner.

94. C Chapter 5, Section 2.2

Safe custody reconciliations must be performed at least monthly by the TA.

95. A Chapter 4, Section 2.5

The directors and senior management of an authorised financial firm are expected to understand the potential personal liability if legal obligations are not met.

96. C Chapter 5, Section 1.3.1

Proof provided by investors – investors can alternatively provide proof of their bank account to evidence the link between them and the account. Firms will have appropriate checks in place to identify this evidence of tampering or forgery. Such proof could be provided in one of the following forms:

- a subscription cheque (eg, accompanying a paper application)
- an original voided cheque
- an original/photocopy of a postal bank statement, or
- a copy of an internet bank statement

97. C Chapter 2, Section 1.3

The Foreign Account Tax Compliance Act (FATCA) places reliance on financial institutions (Foreign Financial Institutions or FFIs) to identify all reportable US persons.

98. **B** **Chapter 3, Section 2**

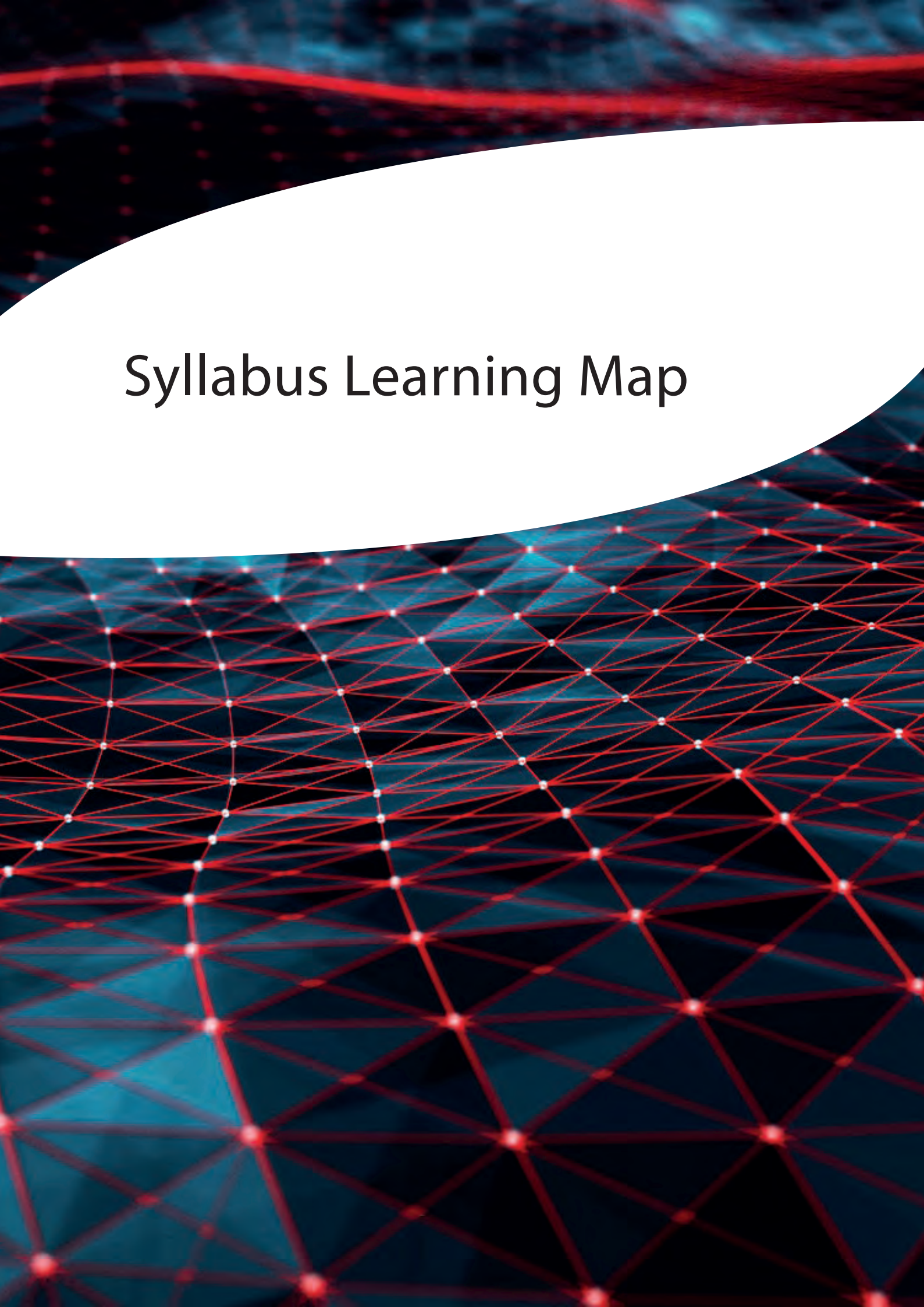
A unit trust is constituted by a trust deed, entered into by the unit trust manager and the trustee, who must in the same way as an OEIC and depositary, be independent of each other.

99. **A** **Chapter 5, Section 1.4**

Firms should consider whether additional checks (eg, call backs) are appropriate for accounts in jurisdictions deemed higher risk or with other high-risk factors (eg, value), to mitigate the heightened fraud risk.

100. **A** **Chapter 1, Section 1.1**

It is a fundamental principle of the FCA regulations that the regulated firm cannot contract out, eg, to another firm, its regulatory obligations to any other party. Therefore, while the administration function might be performed by the TA, the AFM's regulatory obligations remain unchanged, although the TA may have its own regulatory responsibilities.


Syllabus Learning Map

Syllabus Unit/ Element		Chapter/ Section

Element 1	The Transfer Agency (TA) Framework	Chapter 1
1.1	**Transfer Agencies** On completion the candidate should:	
1.1.1	know transfer agency business models	1.3
1.1.2	know how transfer agencies are structured	1.5
1.1.3	know the high-level responsibilities of the transfer agent	1.2
1.1.4	know the roles and interactions that form the entire transfer agency process	1.4
1.1.5	understand the interaction between the transfer agent and the other various players and their respective roles in the transfer agency process	1.4
1.2	**Depositary/Trustee** On completion the candidate should:	
1.2.1	know activities undertaken by depositaries	2
1.2.2	know activities undertaken by trustees	2
1.2.3	know how depositories and trustees interact with transfer agents	2
1.3	**Custody** On completion the candidate should:	
1.3.1	know the requirements for the establishment, maintenance and contents of a register or sub-register	3.2
1.3.2	know: • who can be registered as a holder of an investment • the status of the register as proof of ownership • the requirements for the collection of beneficial holder details	3.2.1
1.3.3	know the process for rectification of registration errors	3.2.2
1.3.4	know the registration treatment of third-party interests	3.2.3
1.3.5	understand the different types of custody model and how they are used: • pooled • segregated • multiple nominees • investor's own name	3.2.4

Syllabus Unit/ Element		Chapter/ Section
1.3.6	• know the methods by which internal/external transfers take place	3.2.5
1.3.7	• understand the chain of custody	3.2.6
1.3.8	know regulation and best practice in relation to processing new business, transfers and account closure: • permitted transfer of assets – cash and non-cash • different types of customer specific regulations in accordance with current relevant legislation • transition management • new products • rules for closing business • roles of the custodian, investment manager and consultants • residual income	3.2
1.4	**Fund Accounting** On completion the candidate should:	
1.4.1	know how unit trust units and OEIC shares: • are priced • the publication and notification requirements • the impact of pricing errors on client investments	4
1.4.2	know how shares and units are bought and sold	4
1.4.3	know the control processes that may apply in relation to investment pricing: • listed assets • private assets	4
1.4.4	know how collectives are settled	4
1.4.5	understand the use of reconciliations and resulting accounting and reporting processes	4.9
1.4.6	know the basis on which collective investment schemes (CISs) are taxed	4.8
1.5	**Offshoring** On completion the candidate should:	
1.5.1	know how firms manage the oversight of offshore activities • key risk indicators (KRIs) • key performance indicators (KPIs)	5
1.6	**Outsourcing** On completion the candidate should:	
1.6.1	• know the benefits and risks associated with outsourcing	6

Syllabus Unit/ Element		Chapter/ Section

Element 2	The Regulatory Framework	Chapter 2
2.1	**International Standards and Regulations** On completion the candidate should:	
2.1.1	know the responsibilities of transfer agencies in complying with European standards and regulations	1.1
2.1.2	know the responsibilities of transfer agencies in complying with the General Data Protection Regulation (GDPR)	1.2
2.1.3	know the responsibilities of transfer agencies in complying with the Foreign Account Tax Compliance Act (FATCA)	1.3
2.1.4	know the responsibilities of transfer agencies in complying with Automatic Exchange of Information (AEOI) agreements	1.4
2.2	**UK Regulation** On completion the candidate should:	
2.2.1	know the responsibilities of transfer agencies with respect to: • Market Abuse • Senior Managers and Certification Regime (SM&CR) • Consumer Duty	2
2.3	**Investor Communications** On completion the candidate should:	
2.3.1	know the FCA requirements in relation to: • reports and accounts • unit/shareholders meetings • proxy voting requirements • disclosure requirements	3
2.3.2	know the requirements of the Statement of Recommended Practice (SORP) in relation to the content of the half-yearly reports and accounts: • the statement of total return • the statement of changes in unit/shareholders' net assets • the balance sheet • the portfolio statement • notes to the accounts • distribution tables • comparative table	3

Syllabus Unit/ Element		Chapter/ Section

Element 3	Products	Chapter 3
3.1	**Collective Investments** On completion, the candidate should:	
3.1.1	know the difference between open-ended and closed-ended collective funds	1.1
3.1.2	know: • how collective investment schemes are launched • the alternative constitutional structures of authorised collective investment schemes • the types of funds and how they are classified (UCITS/NURS) • tax considerations • investing, lending and borrowing powers	1
3.1.3	know the comparative features, advantages and disadvantages in contrast to other forms of investment (direct and indirect)	1.6
3.1.4	know the permissible share and unit classes issued by schemes	1.7
3.1.5	know the purpose and principal features of collective investments: • scope • eligible investments • investment and borrowing limits • liquidity management • risk management requirements • diversification	1.8
3.1.6	know the difference between hard and soft closure	1.9
3.2	**Unit Trusts** On completion, the candidate should:	
3.2.1	know the definition and legal structure of a unit trust	2
3.2.2	know the role of the: • manager • trustee	2
3.3	**Open-Ended Investment Companies (OEICs)** On completion, the candidate should:	
3.3.1	know the definition and legal structure of an OEIC/ICVC/SICAV	3
3.3.2	know the role of the: • authorised corporate director (ACD) • depositary	3

Syllabus Unit/ Element		Chapter/ Section
3.4	**Investment Trusts** On completion, the candidate should:	
3.4.1	know the characteristics of an investment trust: • share classes • gearing • real estate investment trusts (REITs) • pricing • trading • investor rights and protections	4
3.5	**Wrappers** On completion, the candidate should:	
3.5.1	know the range of wrappers typically available and the advantages they provide	5
3.5.2	know regulatory limitations and restrictions associated with wrappers	5
3.5.3	know the ISA rules surrounding: • subscriptions • uninvested funds • transfers • eligibility • open market prices • withdrawals/flexibility • stock lending • using an ISA as security for a loan • additional permitted subscriptions (APS) • deceased partner's inheritances • child maintenance deduction orders • income and tax claims • correcting errors and compensating investors • HMRC direct recovery of debts • JISAs	5
3.5.4	know considerations for transfer agencies in relation to pensions	5.3

Syllabus Unit/ Element		Chapter/ Section

Element 4	Managing the Risk of Financial Crime	Chapter 4
4.1	**Financial Crime** On completion, the candidate should:	
4.1.1	know the stages of the money laundering process: • placement • layering • integration	1.2
4.2	**Financial Crime Controls** On completion, the candidate should:	
4.2.1	know examples of trigger events	2.1
4.2.2	understand the controls a firm should have in place to minimise its risk to fraud, money laundering and terrorist financing including a training programme	2
4.2.3	know the criteria for an effective suspicious transaction reporting system	2.2
4.2.4	know the responsibilities of directors and senior management in relation to anti-money laundering (AML), combating financial crime (CFC) and anti-corruption (AC) initiatives	2.5
4.2.5	know the role of the money laundering reporting officer (MLRO) (or equivalent) in relation to financial crime	2.5
4.2.6	understand the implications of using a risk-based approach to identify money laundering	2.3
4.2.7	know the rationale behind: • sanctions screening • screening individuals	2.6
4.3	**Cyber Risk Management** On completion, the candidate should:	
4.3.1	know the concept of good online practice	3

Syllabus Unit/ Element		Chapter/ Section
4.3.2	know the additional measures financial services firms can take to manage the risk of cybercrime originated or enabled by an employee: • training • improving the management of privileges for joiners, movers and leavers • classifying and segmenting data • embedding ethical practice in relation to data security • implementing whistleblowing procedures	3
4.4	**Practical Implications for Transfer Agencies** On completion, the candidate should:	
4.4.1	know the FCA definition of conduct risk and how it is addressed within transfer agencies	4
4.4.2	understand how service level agreements (SLAs) play an important role in transfer agency business with respect to managing regulatory and other risks	4

Element 5	Managing TA Operations	Chapter 5
5.1	**Anti-Money Laundering (AML) and Know your Customer (KYC)** On completion, the candidate should:	
5.1.1	know the TA Forum's guidance with respect to risk-rating investors	1
5.1.2	know obligations of transfer agencies in relation to money laundering directives	1
5.1.3	know operational best practice and regulatory requirements for: • investor bank validation checks • AML due diligence assessment • ongoing monitoring and enhanced monitoring • third-party payers	1
5.1.4	know operational best practice and regulatory requirements for: • electronic identification standards for opening online accounts • electronic verification techniques	1
5.1.5	know operational best practice and regulatory requirements for Bank verification checks	1

Syllabus Unit/ Element		Chapter/ Section
5.1.6	know required due diligence and AML checks for: • corporate clients • trusts • charities • third-party payers	1.7
5.1.7	know regulatory requirements relating to: • sanctions • politically exposed persons (PEPs)	1
5.2	**The UK CASS Regime** On completion, the candidate should:	
5.2.1	know the principles and activities covered within CASS 6, CASS 7, CASS 8 and CASS 9 and their impact upon transfer agencies	2
5.2.2	know the relevance of the following CASS features: • CASS mandate definitions and purpose • cash models • DvP exemption	2
5.2.3	know the relevance of the following CASS features: • prudent segregation and record keeping • client money reconciliation methods • client money statements, frequency and content • intraday cleared funds	2
5.2.4	know the relevance of the following CASS features: • CASS oversight and SMF 18/22 • the role of the auditor • Financial Reporting Council (FRC) audit standards • preparing for audits • CASS resolution pack • policy documentation	2
5.3	**Registration** On completion, the candidate should:	
5.3.1	know regulation and best practice in relation to powers of attorney	3.1
5.3.2	know the management of deceased investors, including small estates	3.2
5.3.3	know the registration process with respect to trusts	3
5.3.4	understand the entitlement to inspection	3

Syllabus Unit/ Element		Chapter/ Section
5.4	**Settlement** On completion, the candidate should:	
5.4.1	know the regulatory requirements for settlement	4.1
5.4.2	understand the different methods of settling investor transactions	4
5.4.3	know the causes and implications of late and failed trades	4
5.4.4	know the use and management of cheques plus other methods of payment and the pros and cons of each	4.3
5.4.5	understand the application of FinTech to settlement and payment processes	4
5.4.6	know the correct treatment of dormant assets	4
5.4.7	understand the components of the post-settlement phase: • reconciliation • inventory management • margin/collateral monitoring	4.5
5.4.8	know key controls associated with the post-settlement phase	4.5
5.5	**Corporate Actions** On completion, the candidate should:	
5.5.1	know: • types of corporate actions and events • the process required to execute corporate actions • the role of the various parties involved • client communications and proxy voting • the risks and regulatory requirements associated with corporate actions	5
5.6	**Order Management** On completion, the candidate should:	
5.6.1	know the methods for direct and intermediary dealing	6
5.6.2	understand the operational risks associated with: • direct dealing • intermediary dealing	6
5.6.3	know different methods of dealing communication and associated benefits and risks: • straight through processing (STP) • telephone dealing • fax	6.3

Syllabus Unit/ Element		Chapter/ Section
5.6.4	know the application of switches and *in-specie* transfers	6.4
5.6.5	understand the consequences of dealing errors and their impact upon profit/loss	6.5
5.6.6	understand the difference between right and best price	6.6
5.6.7	understand the difference between single and dual price dealing	6
5.7	**Transfer of Title** On completion, the candidate should:	
5.7.1	understand the processes and information requirements relating to transfers by the holder, in favour of the AFM, and by the operation of law	7
5.7.2	know the requirements for transfers: • by the holder • to the AFM • to third parties • by operation of law • by electronic transfer • via TISA exchange (TeX)	7
5.8	**Sub-Registers for Savings Plans, ISAs, and Pensions** On completion, the candidate should:	
5.8.1	know the requirements governing the sub-registers for savings plans, ISAs, and pension plans	8
5.8.2	know the rights of holders on sub-registers	8
5.8.3	know who has responsibility for sub-registers	8
5.9	**Box Management** On completion, the candidate should:	
5.9.1	understand the concept of box management	9
5.9.2	know the differences between sub-register dealing and business as usual (BAU) investor dealing	9
5.10	**Cash Management** On completion, the candidate should:	
5.10.1	know intraday cash management	10
5.10.2	know the differences between creation and liquidations versus subscriptions and redemptions	10
5.10.3	know what is meant by the term 'cash matching'	10

Syllabus Unit/ Element		Chapter/ Section
5.10.4	understand the significance of electronic receipts versus cheque receipts with respect to various account types including distribution accounts	10
5.10.5	understand the procedures for treasury reporting and liquidity management	10
5.11	**Income and Distributions** On completion, the candidate should:	
5.11.1	know the sources of income	11
5.11.2	understand the different treatment of income for income and accumulation shares/units	11
5.11.3	understand the reinvestment and distribution process including equalisation, rebate processing and bank account structure	11
5.11.4	be able to apply the timetable for distribution of income	11
5.11.5	be able to calculate the available income	11.4
5.11.6	know the requirements for calculation of the effective yield	11.6
5.11.7	know the difference between dividend, interest and property income distributions and the relevant criteria	11
5.11.8	know the customary payment processes and their associated requirements for the following: • tax vouchers • BACS/Faster Payments • distribution warrants	11
5.11.9	• know the treatment of unclaimed distributions	11
5.12	**Reporting** On completion, the candidate should:	
5.12.1	understand specific transfer agency reporting requirements: • statistical • AML • regulatory • shareholders and unitholders • HMRC	12
5.12.2	understand the requirements for incident and breach reporting	12.2

Syllabus Unit/ Element		Chapter/ Section

Element 6	Distribution, Front & Ongoing Charges	
6.1	**Platforms** On completion, the candidate should:	
6.1.1	know the range of investment types that can be offered by platforms	1
6.2	**Agency Commission and Charging Structures** On completion, the candidate should:	
6.2.1	know commonly used charging structures	2
6.2.2	know regulation and best practice in relation to the standardisation of commission	2
6.2.3	know regulation and best practice in relation to annual management charge (AMC) rebates	2.5

Element 7	Customer and Investor Relations	Chapter 7
7.1	**Onboarding** On completion, the candidate should:	
7.1.1	know the required content of customer agreements	1
7.1.2	know general considerations for setting up a new account	1
7.1.3	know the taxable status of different entities	1
7.2	**Customer Service** On completion, the candidate should:	
7.2.1	know relevant regulation and best practice in relation to information and advice giving	2
7.2.2	know methods for identifying vulnerable customers	2
7.2.3	know legal considerations relating to vulnerable customers	2
7.3	**Complaints** On completion, the candidate should:	
7.3.1	know the principal requirements for a complaints-handling procedure	3
7.3.2	know the regulatory procedures for handling customer complaints	3
7.3.3	understand Summary Resolution Communication (SRC)	3

Syllabus Unit/ Element		Chapter/ Section

Element 8	Compliance and Oversight	Chapter 8
8.1	**Oversight – Three Lines of Defence** On completion, the candidate should:	
8.1.1	understand the principles of the three lines of defence model	1
8.1.2	understand the root causes of operational risk events in simple, practical examples: • incorrect data • delayed processing and documentary omissions • regulatory non-compliance • project mismanagement • fraud and theft • unforeseen litigation • information technology failures	2
8.2	**Compliance** On completion, the candidate should:	
8.2.1	understand the responsibilities and accountabilities of management and staff for compliance with regulations	3
8.2.2	understand how to monitor an individual's compliance with regulations and internal policies and procedures	3
8.2.3	know the purpose of a compliance monitoring programme: • risk-based • reporting • planned	3

Examination Specification

Each examination paper is constructed from a specification that determines the weightings that will be given to each element. The specification is given below.

It is important to note that the numbers quoted may vary slightly from examination to examination as there is some flexibility to ensure that each examination has a consistent level of difficulty. However, the number of questions tested in each element and/or case study should not change by more than two.

Element Number	Element	Questions
1	The Transfer Agency (TA) Framework	18
2	The Regulatory Framework	5
3	Products	12
4	Managing the risk of financial crime	9
5	Managing TA Operations	42
6	Distribution, Front and Ongoing Charges	3
7	Customer and Investor Relations	7
8	Compliance and Oversight	4
Total		**100**



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Anti-Money Laundering
Understand AML legislation and regulation, the role of the MLRO, and the sanctions and penalties.



Client Assets and Client Money Essentials
Gain an overview of the principles and high-level rules associated with holding and protecting client assets.



Conflicts of Interest
Consider examples of conflicts of interest, tools, policies and procedures, enforcement action, and good practice.



Data Science
Digitisation of business operations has accelerated the speed of data capture. Harness the value of your data.



Diversity and Inclusion
Targeted at those responsible for diversity, equality and anti-discrimination, and those recruiting and managing.



Financial Crime
Gain an overview of insider dealing, market abuse, money laundering, terrorist finance and financial sanctions.



Financial Planning
Gain an overview of the financial planning process, key terms and the regulatory framework that governs it.



Greenwashing
This module explores the key concepts surrounding greenwashing, the wider implications, and the measures being taken to fight it.



Impact Investing
Aim to take ethical and sustainable investment principles a step further through intentional investment.



Integrity and Ethics
Understand ethics in finance, the importance of trust and trustworthiness, and compliance versus ethics.



Market Abuse
Examine offences, penalties, safe harbours, reporting obligations and the relationship with other offences.



Neuroscience at Work
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