

More client asset fines in the pipeline, FSA says, as Rowan Dartington and Close follow JP Morgan

Jun 08 2010 Joanne Wallen

The Financial Services Authority has continued its promised clampdown on client asset breaches with two more fines, one worth more than half a million pounds. Aside from the client money issues there are serious lessons about implementing new IT systems and training staff to be learnt. The regulator fined Rowan Dartington £511,000 and Close Investments £98,000 for client money breaches.

The fines come less than a week after the industry was shocked by the massive £33.3m fine imposed on JP Morgan Securities. They also follow a number of warnings from the FSA that it was cracking down on the handling of client money. At the beginning of the year the regulator sent out a "Dear CEO" letter on client assets and published a report on client money and assets.

A consultation paper on changes to the Client Assets Sourcebook was followed by an HM Treasury consultation paper on the same subject. As *Complinet* reported, **Pierre Labuschagne**, [founder of PL International] which specialises in advising on derivatives and related areas such as client money and margin/collateral protection, said that the huge JPMSL fine showed the importance the FSA placed on the protection of client money. **Labuschagne** also said that the case showed that the FSA's asset protection team was becoming increasingly well resourced.

Rowan Dartington was fined for failing to segregate and protect client money over a period of two years. Close Investments similarly failed to hold client money in segregated accounts with trust status. The firm also failed to implement and maintain adequate controls over its client money as required by FSA rules. In particular, for two years it failed to verify that certain accounts had been appropriately set up as client money accounts.

Rob Moulton, a partner at Nabarro, told *Complinet* that although the concept of client money was not particularly difficult, the practice was more complex. "I think the rules are pretty simple to read and understand, but the practice is quite difficult to 'do'. As with so many regulatory issues, it is often legacy businesses or mergers that cause the operational complications that lead to failings such as on client money," Moulton said.

Not just the JP Morgans

A spokeswoman for the FSA told *Complinet*: "This shows that it's not just the big JP Morgans of the world that have an issue with client money. This affects firms of all sizes. She pointed out that more than a year ago, the FSA sent a "Dear Compliance Officer" letter out on the subject.

"Firms have had plenty of warning. They have had constant reminders," she said. There are more enforcement cases in the pipeline and any firm that has not yet reviewed its client assets handling would be well advised to do so immediately.

The Rowan Dartington final notice also threw up some interesting issues concerning the choice of IT systems and

the implementation of those systems. In 2007 the firm implemented a new software system, which, according to the final notice, "significantly affected Rowan Dartington's ability to comply with its obligations under the CASS Rules".

Despite carrying out due diligence before purchasing the software, the system RD bought did not work properly with the designated banking model it was operating at the time as it had been designed to operate alongside a pooled banking model. The software would need to be modified to fit the RD model and this modification for various reasons took at least nine months to be implemented. The firm was supposed to carry out manual reconciliation in the interim. It was also supposed to train staff to use the new software. The FSA said that this training was at times inadequate. The firm also relied on the training to identify shortcomings in the system rather than having an organised programme of testing.

Ultimately responsible

The FSA also pointed out that although in some cases training was carried out by a third party, "the firm was ultimately responsible for ensuring that training provided to staff was adequate prior to implementing the software. Rowan Dartington eventually was forced to begin operating a "pooled" banking model to ensure that