

Safe Custody – What does it Really Mean?

Disclaimer: this is a plain English general guide only and does not form part of Reyker's terms and conditions of business. It is a summary of some of the principal risk and control procedures that can be expected of a good quality custodian and is not necessarily a detailed guide to what we do or all of our procedures. Clients who have queries about specific matters or procedures should enquire about them directly with us and may not rely upon this general information guide.

The Financial Conduct Authority (FCA) has clear rules to protect client assets and client money. These are mainly encapsulated in client money and client asset rules (CASS) and conduct of business rules (COBS). We thought it might be helpful for clients to understand Reyker's approach to this, which makes your assets and money as safe as possible in our custody.

The information below is not everything that we do but gives clients a bit more information on the really important things that a good custodian, nominee and administrator does.

Client Money

Client money is cash and deposits. It may include income yields and investment redemptions received by the firm on behalf of clients, as well as funds placed with the firm that are intended for investment. Client money is protected in several ways:

1. Keep client money separate from the firm's own money

We keep client cash in bank accounts that are entirely separate from the firm's own.

We never use client money to cover any costs of the firm. This is strictly forbidden under CASS rules

Every member of staff at every level from top to bottom is quite clear that breaching this rule would likely get them dismissed from Reyker immediately for gross misconduct. But we have controls in place anyway to prevent breaches.

2. Use reputable banks

We don't keep client money ourselves. It is banked directly into designated client money accounts in our name with a range of reputable UK banks such as NatWest – this helps to spread the risk from the unlikely event of a major bank failure. As we have seen from the publicly funded rescue of RBS no one can ever eliminate the risk of a major bank going bankrupt, but we make sure we have sensible relationships with reputable banks and conduct regular checks and annual due diligence assessment.

We reconcile these bank accounts every day and a manager review them every day to ensure that any reconciling items, such as say an unexplained deposit because an investment application form has arrived late, are cleared promptly.

Dealing with reconciling items quickly is fundamental to spotting any problems. In addition, we use systems that enable us to see the money balances all the time on active accounts – transparency is important to the review and checking process.

3. We don't let our corporate clients hold client money either

This may also sound obvious but it is important. Our role is to be the custodian. Unless corporate clients have client money holding permissions they must not hold client money or assets at any time. This includes things like redemptions and income receipts. They must not accept cheques for new applications either. All of these things must come directly to Reyker. We make sure our corporate clients understand the importance of this.

4. Chinese walls matter

This often misunderstood phrase really has significance: it is all to do with division of responsibilities and strong internal controls.

Our staff who deal in shares for clients have no access to systems permitting withdrawal or transfer of funds from client money bank accounts. They can administer an instruction to pay away money on instruction from a client, but they cannot implement this instruction without it being checked and reviewed by a back office person on the other side of the Chinese wall.

For anything larger than moderate payments multiple checks are a requirement. In addition, managers monitor significant cash flows and promptly query anything that appears unusual.

The Chinese Walls extend to other key controls. For example, staff who deal or who advise clients cannot close an account or transfer securities from an account without approval from an independent person in the “back office” team, and such events are also subject to managerial review. This control helps to prevent misappropriation of client assets.

5. We do not let clients go overdrawn

This may sound obvious but can be a pitfall for the unwary. Let's take an example of a stockbroking firm who lets a client buy a large block of shares on the promise that funds to pay for them are “in the system”. However, the funds may fail to arrive and in the meantime the shares have fallen sharply in value, wiping out the client's holding and sending him or her overdrawn. As a result, there is now a hole in the client money account. The client can't pay and it is up to the firm to cover it. What if they can't? Firms are supposed to maintain adequate capital and solvency – but large client losses can affect this.

The key control is never allow clients to trade beyond de minimis amounts in securities or instruments unless cash is in place to cover the transaction. We have absolutely strict rules about this. So, you will never have your client money exposed to the losses of another of our clients.

6. Make sure the firm is adequately capitalised

Firstly, we are a public limited company so we must have more minimum capital than ordinary limited companies.

Regulated Financial institutions such as ourselves are required to maintain capital specified by the regulators. This is usually known as our “Core Tier 1 Capital” and in simple terms it is a sum of money what we are required to set aside to cover “shocks or stresses” to the business that are unforeseen.

The capital is related to the type and scale of our business and it is independently verified by the external audit process each year as well as continually reviewed by management.

Any quantifiable liabilities that are foreseen have to be fully provided for in our accounts, so our Core Tier 1 Capital is on top of this.

We maintain capital of typically 250% or more of our regulatory requirement. Very few firms do this. It puts our shareholder funds at risk far in excess of what the regulator requires. But we believe in giving our clients confidence that we have a great deal of capital headroom.

We are required by the governing regulations to maintain a solvency ratio of 140%. Again, we make sure that intra day and at the end of every day we have solvency very substantially in excess of the regulatory requirement.

We have to report on our capital and other key measures, quarterly to the FCA. We also report monthly on

client assets. Reyker has never been late with any FCA report.

Client Assets

By client assets we mean investments that clients have made. Hence it does not include cash or deposits held pending distribution or investment.

Leaving aside complex financial instruments, there are three main types of client assets:

- Virtual securities
- Physical securities (sometimes called “residuals”)
- Physical bearer securities

Virtual securities cover most stocks and shares, unit trusts etc. Shares are “dematerialised”, which just means they are electronic rather than paper, and held in a central clearing and settlement system which proper custodian firms should ideally be a member of in their own right. Reyker does have appropriate memberships of clearing organisations, as well as being a full member of The London Stock Exchange

In addition to the client money controls described above, there are a range of asset controls, some of which are outlined below:

7. Depot controls

Depots are third party depositories where “virtual” securities are held as part of the market settlement system.

UK securities are typically held in CREST and International securities are held in Euroclear. Similar systems exist for other types of securities. These clearing and settlement systems are independent and act rather like a bank, except they register securities rather than cash.

8. Physical controls

Physical securities are traditional paper share certificates, bonds and similar instruments. They are often held for unquoted securities. When we act as safe custodian, we record them in a register and keep them in a bank vault or sometimes we use our own safe.

Physical bearer securities are readily transferable between parties and the party who holds them is prima facie the “owner” – in much the same way as a £50 note is a bearer instrument. Therefore, a high degree of physical security and careful registration is required for bearer securities. If we hold bearer securities, these are always held in a bank vault.

Physical securities are checked regularly.

9. Nominee separation

Our client money and client asset accounts are held and inside a “nominee” company, which is a distinct legal entity and accounted for entirely separately to the transactions of the firm itself.

The nominee represents our clients but the assets themselves always remain belonging to clients. We effectively run our “client side” accounting as a separate entity. There is no crossover with Reyker Securities plc.

10. Settlement controls

When we buy and sell securities on behalf of our clients we place an order with a market maker. This gives rise to a contract note, which we issue within 24 hours.

The trades are reported in the CREST or Euroclear system (or other systems for other instruments such as unit trusts) and we must check our records of what trades we expected to be done on behalf of our clients, against what the market has reported. We do this check every day. Our entire stock settlement system is continually reconciled on a rolling basis. We ensure that we clear reconciling items promptly and report trades within the required timeframe established by the FCA.

This reconciliation process – which has a number of control layers to it – is fundamentally important. The first control is to ensure that there is managerial oversight of what our dealers do. Trades are reviewed intra day and at the end of the day and signed off by a manager.

11. Never part with both cash and securities

We always make sure when looking after client investments that we are never “out of cash and out of stock” at any time. This is a key control in terms of interacting with, say, promoter clients so that we ensure the underlying retail clients are never exposed to a loss of the quantity (as opposed to value) of assets or money.

12. Independent oversight

We are required to report to the FCA every month on our reconciliation processes for client money and client assets. We “age” reconciling items: not only do we have very few, they are also very current. This is fundamental in a well-controlled firm. This is in addition to our quarterly capital reporting.

Other Important Aspects of Control

13. Compliance

This is a regulated role that is designed to check that firms comply with all relevant rules, including anti money laundering procedures and collecting sufficient information about clients.

Unusually, we have dual compliance officers as we attach significant importance to this function.

Our compliance officers are senior managers, who can enquire from any member of staff at any level, including directors, about any transaction at any time.

Our compliance team is supported by more junior staff and the team can conduct audit checks across the board in our business regularly and this is formally reported to our Management Board every month.

We send our compliance officers on regular training and refresher courses and we support them in every aspect of their role.

14. Full Audited accounts

You may be surprised to discover that many firms offering regulated services to investors do not publish full statutory accounts. In many cases they publish abbreviated accounts and many firms also avoid an independent audit because they are not large enough for this to be a legal requirement.

As a plc we produce full accounts. They are independently audited every year. We file these accounts publicly within six months of our 31 December year end.



Our auditors also report independently to the FCA about us every year. They must do this by 30 April each year. Reyker has never had an audit qualification of any kind and has never had a matter brought to the attention of the FCA by our auditors.

In addition, in nearly 35 years in business Reyker has experienced three recessions and has never made a loss. We are an extremely prudent and careful professional firm.

15. Medium sized firm

Reyker is classified by the FCA as a “medium sized firm” and as a direct result of this we are required to report monthly to the regulator on client money and assets and on the reconciliation process.

This provides our clients with even more confidence that our reconciliation procedures must be well controlled.

16. FSCS levy

Reyker participates in the Financial Services Compensation Scheme (FSCS) for all relevant clients (some types of clients, typically market professionals for example, are not covered). We pay a substantial annual levy each year that is related to the size of the firm and the assets we hold in custody or manage.

17. Overall risk management

Controls can only do so much. If the firm undertakes risky business, and this goes wrong, then some disruption to clients can arise.

Reyker has been trading for 35 years. We are a prudent firm and we are risk averse. Our appetite for risk is moderate. So for example we do not take positions on our own account that puts significant capital at risk.

Unlike many financial institutions we are emphatically not highly leveraged.

We take pride in performing our safe custody, nominee and administration duties very well indeed, without exposing either our clients or our business to unnecessary additional risk.

In some ways, our attitude to risk is the best security of all.

What we can't do

It perhaps goes without saying, but in the interests of completeness we will say it anyway: there are some things we can't do.

For example, other than for discretionary clients, we have no control or influence over investment decisions made by our clients or their advisers.

Investment values may go up, but they may also go down and we cannot protect against this - the factors causing it are outside our control. We also cannot protect against counterparty banks failing. These things are market risks.

Our web site reminds clients that the value of their investments may go down as well as up. We also give clients appropriate risk warnings and we try hard to encourage promoters with whom we deal to make risk warnings fair and prominent.

Contacting Us

If any of our clients has any concerns about any aspect of our services, please email us. Our contact details can be found in the contacts section of our website www.reyker.com.

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