

<b>ΤΕΧΝΙΚΗ ΕΓΚΥΚΛΙΟΣ:</b>	<b>4/2019 [ΤΕ 4_2019]</b>
<b>Προς:</b>	<b>Όλα τα Μέλη του Συνδέσμου</b>
<b>Από:</b>	<b>Επιτροπή Χρηματοοικονομικών Υπηρεσιών</b>
<b>Ημερομηνία:</b>	<b>22 Φεβρουαρίου 2019</b>
<b>Θέμα:</b>	<b>Ενδεικτικό πρόγραμμα λογιστικού ελέγχου σε σχέση με την έκδοση της Έκθεσης Ανεξάρτητου Ελεγκτή προς την Επιτροπή Κεφαλαιαγοράς Κύπρου (ΕΚΚ) δυνάμει της παραγράφου 10 της περί της Προστασίας των Περιουσιακών Στοιχείων των Πελατών, της Παρακολούθησης των Προϊόντων και των Αντιπαροχών Οδηγίας του 2017 της ΕΚΚ</b>

Η παράγραφος 10 της περί της Προστασίας των Περιουσιακών Στοιχείων των Πελατών, της Παρακολούθησης των Προϊόντων και των Αντιπαροχών Οδηγίας του 2017 της Επιτροπής Κεφαλαιαγοράς Κύπρου (εφεξής αναφερόμενη ως «η Οδηγία»), απαιτεί από τους εξωτερικούς ελεγκτές μιας Κυπριακής Επιχείρησης Παροχής Επενδυτικών Υπηρεσιών («ΚΕΠΕΥ») να υποβάλλουν τουλάχιστον ετησίως στην Επιτροπή Κεφαλαιαγοράς Κύπρου, έκθεση σχετικά με την καταλληλότητα των ρυθμίσεων δυνάμει των εδαφίων (8), (9) και (10) του άρθρου 17 του περί Επενδυτικών Υπηρεσιών και Δραστηριοτήτων και Ρυθμιζομένων Αγορών Νόμο του 2017 («ο Νόμος») και δυνάμει των διατάξεων του Μέρους II της Οδηγίας.

Για σκοπούς γενικής καθοδήγησης σε σχέση με την πιο πάνω έκθεση, η Επιτροπή Χρηματοοικονομικών Υπηρεσιών του Συνδέσμου έχει ετοιμάσει, στην Αγγλική γλώσσα, το συνημμένο πρόγραμμα ελέγχου το οποίο περιέχει προτεινόμενες διαδικασίες λογιστικού ελέγχου, που στοχεύουν στην ικανοποίηση των απαιτήσεων του Μέρους II της Οδηγίας. Η παρούσα Τεχνική Εγκύκλιος αντικαθιστά την Τεχνική Εγκύκλιο Αρ. 58 με ημερομηνία 17 Απριλίου 2014.

**Τονίζεται ότι τα γεγονότα και περιστάσεις που ισχύουν για κάθε ΚΕΠΕΥ πιθανόν να διαφέρουν από περίπτωση σε περίπτωση, επομένως το προτεινόμενο πρόγραμμα λογιστικού ελέγχου πρέπει να θεωρείται μόνο ως ενδεικτική αλλά όχι πλήρης λίστα των αναγκαίων διαδικασιών λογιστικού ελέγχου. Πρόσθετες διαδικασίες λογιστικού ελέγχου πρέπει να λαμβάνονται υπόψη κατά περίπτωση.**

Συνημμένο

**TECHNICAL CIRCULAR: 4/2019 [TC 4\_2019]**

**To: All the Members of the Institute**

**From: Financial Services Committee**

**Date: 22 February 2019**

**Subject: Indicative audit program in relation to the issuance of the Independent Auditor's Report to the Cyprus Securities and Exchange Commission (CySEC) pursuant to paragraph 10 of the CySEC Directive for the Safeguarding of Client Assets, Product Governance Obligations and Inducements of 2017**

Paragraph 10 of the CySEC Directive DI87-01 of 2017, for the Safeguarding of Client Assets, Product Governance Obligations and Inducements (hereafter referred to as “the Directive”), requires the external auditors of a Cyprus Investment Firm (“CIF”) to report at least annually to CySEC on the adequacy of the CIF's arrangements under sections 8, 9 and 10 of article 17 of the Investment Services and Activities and Regulated Markets Law of 2017 (“the Law”) and the provisions of Chapter II of the Directive.

For general guidance purposes in relation to the abovementioned report, the Financial Services Committee of the Institute has prepared the attached indicative audit program, in English, with suggested audit procedures aimed at addressing the specific provisions of Part II of the Directive. This Technical Circular replaces the Technical Circular No. 58 dated 17 April 2014.

**It is emphasized that the facts and circumstances of each CIF may vary from case to case, therefore the proposed audit program should be considered only as an indicative but not exhaustive list of the necessary audit procedures. Additional audit procedures must be considered on a case by case basis.**

Attachment

APPENDIX

**Indicative audit program in relation to the issuance of the Independent Auditor's Report to CySEC pursuant to paragraph 10 of Directive DI87-01 of 2017 for the Safeguarding of Client Assets, Product Governance Obligations and Inducements of CIFs**

**1. Safeguarding of client financial instruments and funds (section 1 of 10)**

Paragraph	Requirement	Indicative audit procedures
4(1)(a)	The CIF must keep such records and accounts as are necessary to enable it at any time and without delay to distinguish assets held for one client from assets held for any other client, and from its own assets.	<p>(I) (a) Obtain the Company's client list from the system which should contain as a minimum the following for each client: Client identification (ID) number, Client name, categorization (e.g. professional vs. retail) and closing balance as of the end of the reporting period.</p> <p>(b) Select a sample of clients from this list and check that the Company's systems (i.e. trading platforms and back office) can produce, at any point in time, a snapshot of each client's holdings, showing client name and/or ID, amount and type of investments, transaction date and time, opening and closing balance. In case of companies with own investments, check that the system can produce a similar snapshot for the own equity (i.e. cash and investments), giving particular attention to the name in which the own assets are recorded.</p> <p>(II) Review the Company's procedures for distinguishing assets held for one client from those held for another by verifying that each client is recorded in the system with a unique ID code.</p> <p>(III) (a) Take a sample of client money receipts and payments (e.g. deposits, withdrawals, dividends, interest, transaction settlements, etc.) and test that they are paid into or out of the client bank account no later than 3 business days after they have been received/need to be paid. In cases where there are no other alternatives or a client erroneously deposits money into a Company own bank account, check and verify that it is paid into a client bank account no later than the next business day following receipt. Withdrawals of client money should take place only based on prescribed</p> <p>(b) Test, on a sample basis, that client transactions (i.e. purchases and sales of client instruments) are recorded promptly and properly in the Company's internal records (trading platform, back office, accounting). Also check that internal records are updated promptly and properly with regards to the receipt of documents of title or other assets in physical form on behalf of clients, and their transfer to clients or other parties upon clients' request.</p>

## 1. Safeguarding of client financial instruments and funds (section 2 of 10)

Paragraph	Requirement	Indicative audit procedures
4(1)(b)	The CIF must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the financial instruments and funds held for clients, as well as that they can be used as an audit trail.	<p>(IV) (a) Check whether the Company maintains accurate records of the following items, and that such records can be used as an audit trail:</p> <ul style="list-style-type: none"> <li>i. Daily opening and closing balances, per client.</li> <li>ii. List of open positions providing trade details such as trade date and time, open price, instrument type, numbers of lots/units, unrealised profit/loss, etc.</li> <li>iii. Information on cash movements, i.e. deposits, withdrawals, receipts, transfers, credit limits, charges, fees, etc., per client.</li> <li>iv. Information on interest earned and bonus granted, per client, indicating amounts and dates paid to each client (here, also check the Company's workings for the calculation of the interest and bonus paid to each customer).</li> <li>v. Client money and Client instruments reconciliations.</li> <li>vi. Statements of holdings sent to clients on a periodic basis (in this respect, check also that statements are sent to clients at the required intervals, as specified by the client agreements).</li> </ul> <p>(b) Review customer complaints and correspondence with the Cyprus Securities and Exchange Commission for evidence of any issues concerning the accuracy of the internal records of the Company.</p>

## 1. Safeguarding of client financial instruments and funds (section 3 of 10)

Paragraph	Requirement	Indicative audit procedures
4(1)(c)	The CIF must conduct, on a regular basis, reconciliations between its internal accounts and records and those of any third parties by whom those assets are held.	<p>(V) (a) Check whether the Company has performed daily reconciliations of clients' money and clients' financial instruments throughout the year under review. Also, verify that reconciliations are performed as soon as reasonably possible after the date to which the reconciliation refers, and that any reconciliation differences are promptly identified, properly explained and cleared as soon as possible (where clearance entails any shortfall to be topped up and any excess to be withdrawn).</p> <p>The reconciliation of clients' financial instruments should consist of the comparison/matching of the trading platform(s) with external sub-custodian statements and should take into consideration not only the client instruments held by third party custodians, but also the ones held in physical form at the Company's premises (in which case the reconciliation will consist of a physical count and comparison with internal records) or in dematerialized form by the Company.</p> <p>As for the clients' money reconciliation, to be considered complete it should be performed at the following levels, or any combination of these:</p> <ul style="list-style-type: none"> <li>- Bank &amp; other Third-Party statements Vs. Client Assets (as per TB).</li> <li>- Bank &amp; other Third-Party statements Vs. Client Liabilities (as per TB).</li> <li>- Client Liabilities (as per TB) Vs. Clients' Equity (as per Trading Platform(s)).</li> </ul> <p>Our tests should consider whether the necessary controls exist to ensure that <u>all</u> client accounts and third-party statements are reconciled properly at regular intervals. For this purpose, obtain a list of all accounts opened in third parties, indicating the client accounts and whether they are used for holding funds or financial instruments.</p> <p>(b) Consider whether there is adequate segregation of duties between the person performing the reconciliations and the person(s) who maintain the records to be reconciled and are involved in the recording and moving of client assets, always with a view to the proportionality principle. Also consider whether there are appropriate procedures for review.</p> <p>(VI) For the year end, agree the total value of client funds to third party records, at the three levels indicated above. Where third party records are maintained by the third party on a client by client basis, agree on a sample basis the total value of funds per client to the third-party records. Consider sending on a sample basis confirmation letters to third parties where funds are kept. Investigate any difference upon receiving of confirmation replies. Perform alternative procedures for non-replies (e.g. review post year end movement)</p>

## 1. Safeguarding of client financial instruments and funds (section 4 of 10)

Paragraph	Requirement	Indicative audit procedures
<p><b>4(1)(d)</b></p>	<p>The CIF must take the necessary steps to ensure that any client financial instruments deposited with a third party, in accordance with paragraph 5, are identifiable separately from the financial instruments belonging to the CIF and from financial instruments belonging to that third party, by means of differently titled accounts on the books of the third party or by other equivalent measures that achieve the same level of protection.</p>	<p>(VII) (a) Obtain the statements of client instruments from third party custodians and check whether the title of client accounts indicates the client ownership (i.e. it contains the term “client(s)” or “client(s) account” or something similar).</p> <p>(b) In cases where Company own instruments are held by the same third-party custodian as client instruments, check and make sure that they are deposited in a different account than the account used to hold client instruments, and that the title of this account does not contain the term “client(s)”. Test this by checking the Company's reconciliations of its own portfolio, as well as the clients' portfolio reconciliations, for any evidence of lack of segregation (look for cases of reconciling items relating to client instruments kept in own accounts with the custodian, or vice versa). Where own and client instruments in third party custodian accounts are not separated due to legal reasons, the conditions of paragraph 5(3) of the Directive <sup>are</sup> applicable, and the audit procedures indicated in (XVI) below must be performed.</p> <p>(c) In cases where third party custodian records present client instruments on a pooled/aggregated basis without indicating the customer name, ensure that proper records are kept by the Company to enable it to distinguish the instruments that belong to each client separately. To test this, obtain from the trading platform a list of all clients' instruments by client and indicating the third-party custodian where each instrument is kept. If this information is not available, this can also be checked through the client securities reconciliations (i.e. test completeness of client instruments and third-party custodian accounts and investigate any difference between internal and external records).</p> <p>(d) For bearer documents of title, check that the owner can be identified at all times and that it is readily apparent which investments relate to the Company (if applicable) and which to the client.</p>

## 1. Safeguarding of client financial instruments and funds (section 5 of 10)

Paragraph	Requirement	Indicative audit procedures
4(1)(e)	<p>The CIF must take the necessary steps to ensure that client funds deposited, in accordance with paragraph 6, in a central bank, a credit institution or a bank authorized in a third country or a qualifying money market fund are held in an account or accounts identified separately from any accounts used to hold funds belonging to the CIF.</p>	<p>(VIII) (a) Obtain the statements of client accounts with banks and other third parties as per the Directive and check whether their title “contains the term “client(s)” or “client(s) account” or something similar. Examine whether the client accounts at third parties have a “trust status” (this can be checked by obtaining a written confirmation from the third party, stating that: <i>All money standing to the credit of the account is held by the Company as trustee (or if relevant, as agent) and that</i></p> <p><i>(i) the bank/third party is not entitled to combine the account with any other account or to exercise any right of set-off or counterclaim against money in that account in respect of any sum owed to it on any other account of the Company; and</i> ”</p> <p><i>(ii) the title of the account sufficiently distinguishes that account from any account containing money that belongs to the Company and is in the form requested by the Company.</i></p> <p>(b) An exception to the trust status mentioned in (a) above is where in the country the cash is deposited for brokerage purposes, the country's legislation does not provide for the concept of nominee (trustee) account holder. In these cases the auditor should ensure that the CIF correctly communicates this issue to the client in writing (e.g. via the client agreements) and advises him that the client cash is not segregated under MiFID II<sup>1</sup> (since it does not follow MiFID II) so his cash is not protected the same manner as in a MiFID II jurisdiction, in accordance with paragraph 4(3) of the Directive.</p> <p>(c) Where own funds are deposited with the same bank as client funds, test and verify that they are kept in one or more different bank accounts than the one(s) used to hold client funds, and that these accounts are under the Company's name. If own funds are kept in the same third-party account as client funds, ensure that there is a valid reason for doing so and that the Company is able to quantify the amount of its own money kept in client accounts at any point in time. A valid rationale would be that the own funds are equal to the credits granted to clients for facilitating their trading activity.</p> <p>(d) In the case where client funds are kept with third parties on an aggregated basis in pooled client accounts, ensure that proper records are kept by the Company to enable it to distinguish the portion of funds which relates to each client separately. To test this, check the client money reconciliations for completeness of client accounts and third-party statements, and investigate reconciliation differences between internal and external records upon receiving confirmation replies. Perform alternative procedures for non- replies (e.g. review post year-end movement).</p>

<sup>1</sup> Markets in Financial Instruments Directive (MiFID II) 2014/65/EU of the European Union.

## 1. Safeguarding of client financial instruments and funds (section 6 of 10)

Paragraph	Requirement	Indicative audit procedures
4(1)(f)	The CIF must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client assets, or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence.	<p>(IX) Test and ensure the adequacy of the procedures that the Company has put in place with respect to:</p> <ul style="list-style-type: none"> <li>(a) the prompt and proper recording of client transactions in internal systems, such as trading platform, back office and accounting and the proper review of transactions recording by control functions and/or senior management.</li> <li>(b) the carrying out of client money and instruments reconciliations on a regular basis (i.e. daily) and as soon as practically possible after the date to which the reconciliation refers (i.e. not later than 5 business days after the reconciliation reference date).</li> <li>(c) the allocation of responsibility for the client funds and instruments reconciliations and the escalating of reconciling items.</li> <li>(d) the record-keeping of client information, considering both physical and IT security issues (back up servers, hard files, etc.).</li> <li>(d) the safekeeping of clients' documents of title and any other client assets held in physical form (this can be achieved through safe boxes, fire-proof rooms and safes, restricted access via password-controlled doors or limited access to keys).</li> <li>(e) the carrying out of proper and continuing risk assessments of all third parties holding client money and client instruments.</li> <li>(f) the consideration for diversification of client funds when amounts are of sufficient size. The Large Exposures Directive may be considered on a case by case basis and depending on the particular circumstances of each CIF.</li> </ul>

## 1. Safeguarding of client financial instruments and funds (section 7 of 10)

Paragraph	Requirement	Indicative audit procedures
4(2)	<p>If, for reasons related to the applicable law, including in particular the law relating to property or insolvency, the CIF cannot comply with the requirements of sub-paragraph 1 for the safeguarding of clients' rights regarding compliance with sections 17(8) and (9) of the Law, then the CIF shall put in place arrangements to ensure that clients' assets are safeguarded, in order to meet the objectives of sub-paragraph 1.</p>	<p>(X) If there are legal reasons for the CIF not being able to comply with the requirements of sub-paragraph (1) of Article 4 of the Directive, inquire and review the arrangements that are put in place to ensure that the client's assets are safeguarded in order to meet the objectives of sub-paragraph (1).</p>

## 1. Safeguarding of client financial instruments and funds (section 8 of 10)

Paragraph	Requirement	Indicative audit procedures
<p><b>4(3)</b></p>	<p>If the applicable law of the jurisdiction in which the client funds or financial instruments are held prevents the CIF from complying with points (d) or (e) of sub-paragraph 1, the Commission shall prescribe requirements with equivalent effect in terms of safeguarding clients' rights.</p> <p>The CIF, when relying on such equivalent requirements under sub-paragraph 1(d) or (e), shall inform its clients that in such instances they do not benefit from the provisions envisaged under the Law and this Directive.</p>	<p>(XI) (a) If the applicable law of the jurisdiction in which the client funds or financial instruments are held prevents the CIF from complying with points (d) or (e) of paragraph 4(1) of the Directive, review that the prescribed requirements of the Commission that have an equivalent effect in terms of safeguarding clients' rights, are in place.</p> <p>(b) In such cases, review client agreements for the clauses informing the clients accordingly that they do not benefit from the provisions envisaged under the Law and the Directive.</p>

## 1. Safeguarding of client financial instruments and funds (section 9 of 10)

Paragraph	Requirement	Indicative audit procedures
<p><b>4(4)</b></p>	<p>The CIF shall ensure that security interests, liens or rights of set-off over client financial instruments or funds which enable third parties to dispose of the client's financial instruments or funds in order to recover debts that do not relate to the client or provision of services to the client are not permitted except where this is required by the applicable law in a third country jurisdiction in which the client funds or financial instruments are held.</p> <p>The CIF must, when entering into agreements that create such security interests, liens or rights of set-off, disclose that information to clients indicating to them the risks associated with those arrangements.</p> <p>Where security interests, liens or rights of set-off are provided by the CIF over client financial instruments or funds, or where the CIF has been informed that they have been provided, then these must be recorded in client contracts and to the CIF's own accounts in order to make the ownership status of the client's assets clear, such as in the event of an insolvency.</p>	<p>(XII) (a) Enquire the management as to whether the Company has made any arrangements with third parties which enable such parties to dispose of clients' financial instruments or funds in order to recover debts that do not relate to the client or to the services provided to the client. If such arrangements were made, discuss the reasons that the Company has consented to provide such security interests, liens or rights of set-off over client financial instruments or funds to the third party and whether this is due to a legal requirement in the jurisdiction of the third party.</p> <p>(b) Obtain the legal agreements signed between the Company and third-party custodians holding client funds and client financial instruments and check whether any of them contains any terms that grant to the third-party custodian a security interest, lien or right of set-off over client funds or financial instruments.</p> <p>(c) If such an arrangement exists, for a sample of the affected clients verify that the Company has informed them in writing, either through their agreements or an addendum to existing agreements, considering clients existing prior to the enforcement of the Directive, duly signed by the clients, of:</p> <ul style="list-style-type: none"> <li>i. The existence of security interests, liens or rights of set-off over their funds and/or financial instruments, specifying where relevant, the services or products that these relate to, and the reasons for their existence (legal requirements in the country in which a third-party custodian holds the assets in question).</li> <li>ii. The risks that are associated with such arrangements, clearly stating what the ownership status of the affected client assets will be in the event of an insolvency and how this will be recorded in the client's trading account and in the CIF's own accounts.</li> </ul>

## 1. Safeguarding of client financial instruments and funds (section 10 of 10)

Paragraph	Requirement	Indicative audit procedures
<p><b>4(5)</b></p>	<p>The CIF must make information pertaining to clients' financial instruments and funds readily available to the competent authorities, appointed insolvency practitioners and those responsible for the resolution of failed institutions. The information to be made available shall include the following:</p> <ul style="list-style-type: none"> <li>a) related internal accounts and records that readily identify the balances of funds and financial instruments held for each client;</li> <li>b) where client funds are held by the CIF in accordance with paragraph 6, details on the accounts in which client funds are held and on the relevant agreements with those firms;</li> <li>c) where financial instruments are held by the CIF in accordance with paragraph 5, details on the accounts opened with third parties and on the relevant agreements with those third parties, as well as details on the relevant agreements with the CIF;</li> <li>d) details of third parties carrying out any related (outsourced) tasks and details of any outsourced tasks;</li> <li>e) key individuals of the CIF which are involved in related processes, including those responsible for the oversight of the firm's requirements in relation to the safeguarding of client assets;</li> <li>f) agreements relevant to the establishment of client ownership over the assets.</li> </ul>	<p>(XIII) Check by inquiring the single responsible officer appointed per paragraph 9 of the Directive, or other, and make sure that the information described in this requirement (paragraph 4(5) of the Directive), is properly kept, updated regularly, readily available, can be easily retrieved from the Company's systems and/or records and its availability at any point time is regularly monitored, so that the Company is in a position to provide it to the indicated bodies immediately upon request.</p>

## 2. Depositing client financial instruments (section 1 of 4)

Paragraph	Requirement	Indicative audit procedures
<p><b>5(1)</b></p>	<p>A CIF may deposit financial instruments held on behalf of its clients into an account or accounts opened with a third party provided that the CIF exercises all due skill, care and diligence in the selection, appointment and periodic review of the third party and of the arrangements for the holding and safekeeping of those financial instruments.</p> <p>In particular, the CIF is required to take into account the expertise and market reputation of the third party as well as any legal requirements or market practices related to the holding of those financial instruments that could adversely affect clients' rights.</p>	<p>(XIV) (a) Obtain listing of third parties which hold financial instruments on behalf of clients</p> <p>(b) Inquire about and obtain listing of all third parties with which client financial instruments are deposited</p> <p>(c) Obtain the CIF procedures applied in the process of selecting and approving these third parties</p> <p>(d) Review the CIF procedures to determine that due skill care and diligence is exercised in the selection of these third parties. This can be evidenced through the following (<i>list is not exhaustive</i>):</p> <ul style="list-style-type: none"> <li>i. The third party is regulated in a reputable jurisdiction and is licensed to accept client financial instruments.</li> <li>ii. A detailed description of the relevant procedures followed by the third party has been obtained and reviewed by the CIF.</li> <li>iii. The third party carries out independent review of its relevant procedures and makes the report available to the CIF (e.g. ISAE 3402<sup>2</sup> report).</li> <li>iv. Client rights in the event of bankruptcy or other financial difficulty of the third party have been assessed by the CIF and found to be acceptable and at a minimum in line with the CySEC relevant requirements.</li> <li>v. The expertise of the third party has been adequately assessed by the CIF.</li> <li>vi. The rating of the third party (if applicable) is obtained and assessed.</li> </ul> <p>(e) Review the CIF procedures for monitoring the third party to ensure that this is an on-going process with at least annual updating of the eligibility of each third party used.</p> <p>(f) Select a sample of third parties and perform walk through testing to test whether the above procedures/policies are applied in practice.</p>

<sup>2</sup> International Standard on Assurance Engagements (ISAE) 3402 Assurance Reports on Controls at a Service Organization.

## 2. Depositing client financial instruments (section 2 of 4)

Paragraph	Requirement	Indicative audit procedures
5(2)	<p>The CIF may deposit client financial instruments with a third party, only where the third party is established in a jurisdiction where the safekeeping of financial instruments for the account of another person is subject to specific regulation and supervision and that third party is subject to this specific regulation and supervision.</p>	<p>(XV)(a) From the listing of third parties obtained for audit procedure (XIV) above, identify third parties operating in a foreign jurisdiction. In carrying out this audit procedure, also take into account third parties that hold client instruments on behalf of the CIF and which in turn delegate any of their responsibilities for the holding and/or safekeeping of client financial instruments to other third parties in foreign jurisdictions.</p> <p>(b) For each jurisdiction confirm whether the third parties are regulated. This can be evidenced for example by searching the local regulators' web site. If this is not feasible obtain evidence from the CIF to confirm that third party is appropriately regulated.</p>

## 2. Depositing client financial instruments (section 3 of 4)

Paragraph	Requirement	Indicative audit procedures
<p><b>5(3)</b></p>	<p>The CIF is not allowed to deposit financial instruments held on behalf of clients with a third party established in a third country that does not regulate the holding and safekeeping of financial instruments for the account of another person, unless one of the following conditions is met:</p> <p>(a) the nature of the financial instruments or of the investment services connected with those instruments requires them to be deposited with a third party in that third country;</p> <p>(b) where the financial instruments are held on behalf of a professional client, that client has requested the CIF in writing to deposit them with a third party in that third country.</p>	<p>(XVI) (a) Obtain a listing from the CIF of all client financial instruments deposited with a third party in a third country that does not regulate the holding and safekeeping of financial instruments for the account of another person.</p> <p>(b) Test this listing for completeness by selecting a sample from the listing of third parties obtained for audit procedure (XIV) above to ensure that they are correctly excluded from the list obtained for audit procedure (XVI) (a) above. This can be evidenced either by searching the local regulators' web site or by obtaining appropriate evidence from the CIF to support the conclusion that the third party is regulated.</p> <p>(c) For jurisdictions not regulating third parties for the holding and safekeeping of financial instruments for the account of another person, obtain evidence from the CIF to support that one of the following conditions is met:</p> <ol style="list-style-type: none"> <li>i. The nature of the financial instruments or of the investment services connected with those instruments requires them to be deposited with a third party in that third country.</li> <li>ii. Where the financial instruments are held on behalf of a professional client, that client requests the CIF in writing to deposit them with a third party in that third country.</li> </ol>

## 2. Depositing client financial instruments (section 4 of 4)

Paragraph	Requirement	Indicative audit procedures
5(4)	The requirements of sub-paragraphs (2) and (3) shall also apply when the third-party has delegated any of its functions concerning the holding and safekeeping of financial instruments to another third-party.	<p>(XVI) (a) Obtain a listing from the CIF of all clients' financial instruments deposited with a party, as described in Section 5(2), which, however, has delegated any of its functions with regards to holding and safekeeping of financial instruments to another party (the "Delegated Party"). The listing should include reference to the specific functions outsourced, the name of the Delegated Party undertaking the outsourced functions and the total value of financial instruments deposited.</p> <p>(b) From the listing obtained identify Delegated Parties that are operating in a foreign jurisdiction and confirm whether they are regulated. This can be evidenced, for example, by searching the local regulators' web site. If this is not feasible, obtain evidence from the CIF to confirm that the Delegated Parties are appropriately regulated.</p> <p>(c) From the listing obtained identify Delegated Parties operating in a foreign jurisdiction which are not regulated.</p> <p>(d) For jurisdictions not regulating the Delegated Parties identified with regards to holding and safekeeping of financial instruments for the account of another person, obtain evidence from the CIF to support that one of the following conditions is met:</p> <ol style="list-style-type: none"> <li>i. The nature of the financial instruments or of the investment services connected with those instruments requires them to be deposited with such a party in that third country.</li> <li>ii. Where the financial instruments are held on behalf of a professional client, that client requests the CIF in writing to deposit them with such a party in that third country.</li> </ol>

### 3. Depositing client funds (section 1 of 4)

Paragraph	Requirement	Indicative audit procedures
<p><b>6(1)</b></p>	<p>A CIF must, upon receiving any client funds, promptly place those funds into one or more "accounts opened with any of the following:</p> <ul style="list-style-type: none"> <li>(a) central bank;</li> <li>(b) credit institution as defined in article 2(1) of the Business of Credit Institutions Law;</li> <li>(c) bank authorised in a third country;</li> <li>(d) qualifying money market fund.</li> </ul> <p>This shall not apply to a credit institution authorised under the Business of Credit Institutions Law in relation to deposits within the meaning of this Directive, which are held by those credit institutions.</p>	<p>(XVIII) (a) Receive the Company's bank accounts statements and review whether the clients' funds are clearly distinguished from the Company's own funds. Verify that the clients' funds are deposited in bank accounts clearly denoted as "Clients' accounts" whereas Company's own funds are kept in different bank accounts under the Company's name. Examine whether the client accounts at third parties have a "trust status" (this can be checked by obtaining a written confirmation from the third party, stating that: "All money standing to the credit of the account is held by the Company as trustee (or if relevant, as agent) and that the bank/third party is not entitled to combine the account with any other account or to exercise any right of set-off or counterclaim against money in that account in respect of any sum owed to it on any other account of the Company; and (b) the title of the account sufficiently distinguishes that account from any account containing money that belongs to the Company, and is in the form requested by the Company".</p> <p>(b) An exception to the "trust status" mentioned in (a) above is where in the country the cash is deposited for brokerage purposes, the country's legislation does not provide for the concept of nominee (trustee) account holder. In these cases, the auditor should ensure that the CIF correctly communicates this issue to the client (e.g. via the client agreements) and advises him that the client cash is not segregated under MiFID II (since it does not follow MiFID II) so his cash is not protected the same manner as in a MiFID II jurisdiction.</p>

### 3. Depositing client funds (section 2 of 4)

Paragraph	Requirement	Indicative audit procedures
<p><b>6(2)</b></p>	<p>Where the CIF does not deposit client funds with a central bank, the CIF shall exercise all due skill, care and diligence in the selection, appointment and periodic review of the credit institution, bank or money market fund where the funds are placed and the arrangements for the holding of those funds and take into consideration the need for diversification of these funds as part of the required due diligence.</p> <p>In particular, the CIF must take into account the expertise and market reputation of such institutions or money market funds with a view to ensuring the protection of clients' rights, as well as any legal or regulatory requirements or market practices related to the holding of client funds that could adversely affect the clients' rights.</p>	<p>(XIX)(a) Verify that clients' funds are deposited in a central bank, a credit institution, a bank authorised in a third country or a qualifying market fund. Ensure that institutions used by the Company for depositing clients' funds, are properly authorised by obtaining the relevant license/authorisation and review the due diligence procedures followed by the Company.</p> <p>(b) Obtain listing of third parties which hold funds on behalf of clients.</p> <p>(c) Inquire about and obtain listing of all third parties with which client funds are deposited.</p> <p>(d) Obtain the CIF procedures applied in the process of selecting and approving these third parties, as well as the procedures for ensuring adequate diversification of client funds.</p> <p>(e) Review the CIF procedures to determine that due skill care and diligence is exercised in the selection of these third parties. This can be evidenced through the following (<i>list is not exhaustive</i>):</p> <ul style="list-style-type: none"> <li>i. Third party is regulated in a reputable jurisdiction and is licensed to accept client financial instruments.</li> <li>ii. A detailed description of the relevant procedures followed by the third party has been obtained and reviewed by the CIF.</li> <li>iii. The third party carries out independent review of its relevant procedures and makes the report available to the CIF (e.g. ISAE 3402 report).</li> <li>iv. Client rights in the event of bankruptcy or other financial difficulty of the third party have been assessed by the CIF and found to be acceptable and at a minimum in line with the CySEC relevant requirements.</li> <li>v. The expertise of the third party has been adequately assessed by the CIF.</li> <li>vi. The rating of the third party (if applicable) is obtained and assessed.</li> </ul> <p>(f) Review the CIF procedures for monitoring the third party to ensure that this is an on-going process with at least annual updating of the eligibility of each third party used.</p> <p>(g) Select a sample of third parties and perform walk through testing to test whether the above procedures/policies are applied in practice.</p>

### 3. Depositing client funds (section 3 of 4)

Paragraph	Requirement	Indicative audit procedures
<p><b>6(2)</b></p>	<p>The CIF must ensure that clients give their explicit consent to the placement of their funds in a qualifying money market fund. In order to ensure that this right to consent is effective, the CIF should inform its clients that funds placed with a qualifying money market fund will not be held in accordance with the requirements for safeguarding client funds, which are set out in this Directive.</p>	<p>(XX) (a) Obtain a list of the funds in which client money has been placed (if any) and check whether they fall within the definition of a “qualifying money market fund” as provided in paragraph 2 of the Directive.</p> <p>Furthermore, obtain a list of the clients whose money has been placed with the abovementioned funds, and for a sample of these clients containing both retail and professional investors (where relevant), verify that (i) there is evidence that the Company has informed each client in writing, that their money placed in these funds will be held in accordance with the client financial instruments safeguarding rules and not the client money rules, and that (ii) each client gave explicit written consent to the Company for placing his/her money with the specific fund.</p> <p>(b) Review the procedures followed for depositing clients' funds with a qualifying money market fund, if these are in line with the requirements of paragraph 5 of the Directive for holding financial instruments belonging to clients.</p> <p>(c) From the listing of third parties obtained in procedure XIV above, identify third parties operating in a foreign jurisdiction.</p> <p>(d) For each jurisdiction confirm whether the third parties are regulated. This can be evidenced for example by searching the local regulators' web site. If this is not feasible obtain evidence from the CIF to confirm that third party is appropriately regulated.</p> <p>(e) Obtain a listing from the CIF of all client funds deposited with a third party in a third country that does not regulate the holding and safekeeping of financial instruments for the account of another person.</p> <p>(f) Test this listing for completeness by selecting a sample from the listing of third parties obtained in procedure XIV above to ensure that they are correctly excluded from the list obtained in procedure XVI (a) above. This can be evidenced either by searching the local regulators' web site or by obtaining appropriate evidence from the CIF to support the conclusion that the third party is regulated.</p> <p>(g) For jurisdictions not regulating third parties for the holding and safekeeping of client funds for the account of another person, obtain evidence from the CIF to support that one of the following conditions is met:</p> <ol style="list-style-type: none"> <li>i. The nature of the client funds or of the investment services connected with those funds requires them to be deposited with a third party in that third country.</li> <li>ii. Where the client funds are held on behalf of a professional client, that client requests the CIF in writing to deposit them with a third party in that third country.</li> </ol>

### 3. Depositing client funds (section 4 of 4)

Paragraph	Requirement	Indicative audit procedures
<p><b>6(3)</b></p>	<p>Where the CIF deposits client funds with a credit institution, bank or money market fund of the same group as the CIF, then the CIF must limit the funds that are deposited with any such group entity or combination of any such group entities so that the funds do not exceed 20% of all such funds.</p> <p>The CIF may not comply with this limit where it is able to demonstrate that, in view of the nature, scale and complexity of its business, and also the safety offered by the third parties referred to in above, and including in any case the small balance of client funds that the CIF holds, the requirement under the previous subparagraph is not proportionate.</p> <p>The CIF periodically reviews the assessment made in accordance with this subparagraph and notifies its initial and revised assessments to the Commission.</p>	<p>(XXI) Obtain and review:</p> <ul style="list-style-type: none"> <li>a) Analysis of allocation of funds per third party holding client funds, noting whether or not each such party is a Group entity and the nature of the CIF's relationship with each such entity, where applicable;</li> <li>b) Obtain and recalculate the percentage of deposits in each group entity and collectively as a group to the total deposited funds;</li> <li>c) In case the 20% rule is not followed: <ul style="list-style-type: none"> <li>i. Confirm that the CIF has assessed that the limitation of 20% for client deposits with group entities is not proportionate by obtaining supporting evidence for such a conclusion and considering its reasonableness and validity;</li> <li>ii. Obtain and review notifications to the Commission and consider responses of the latter;</li> <li>iii. Ensure that periodical reviews of the assessment are in place and that the Commission is notified accordingly;</li> </ul> </li> <li>d) Inquire the single officer appointed or management regarding future actions to ensure that the 20% rule is maintained (if applicable).</li> </ul>

#### 4. Use of client financial instruments (section 1 of 5)

Paragraph	Requirement	Indicative audit procedures
7(1)	<p>The CIF is not allowed to enter into arrangements for securities financing transactions in respect of financial instruments held by the CIF on behalf of a client, or otherwise use such financial instruments for its own account or the account of any other person or client of the CIF, unless both of the following conditions are met:</p> <p>(a) the client has given his prior express consent for the use of the instruments on specified terms, as evidenced expressly and in writing and affirmatively executed by signature or in an equivalent manner, and;</p> <p>(b) the use of that client's financial instruments is restricted to the specified terms to which the client consents.</p>	<p>(XXII) (a) Obtain from the CIF the list of contracts whereby clients have given their consent to the CIF to use their financial instruments for own account or for the account of another person or client of the CIF.</p> <p>Obtain also the list of transactions relating to the above-mentioned contacts.</p> <p>(b) On a sample basis:</p> <p>i. Review whether the contracts are signed by both parties (CIF and client).</p> <p>ii. Review the specific terms of the contract according to which client's consent has been granted.</p> <p>iii. Test whether the CIF has complied with the contractual terms by:</p> <ul style="list-style-type: none"> <li>- Reviewing a sample of transactions from the above-mentioned list.</li> <li>- Verifying whether the selected transactions are consistent with the terms of the corresponding contract(s).</li> <li>- Confirm that the client receives notice of such transactions performed, for example through separate statements of account sent electronically or other means of notification.</li> </ul>

#### 4. Use of client financial instruments (section 2 of 5)

Paragraph	Requirement	Indicative audit procedures
7(2)	<p>A CIF is not allowed to enter into arrangements for securities financing transactions in respect of financial instruments which are held on behalf of a client in an omnibus account maintained by a third party, or otherwise use financial instruments held in such an account for its own account or for the account of any other person unless, in addition to the conditions set out in subparagraph (1), at least one of the following conditions is met:</p> <p>(a) each client whose financial instruments are held together in an omnibus account must have given prior express consent in accordance with subparagraph (1)(a);</p> <p>(b) the CIF must have in place systems and controls which ensure that only financial instruments belonging to clients who have given prior express consent in accordance with subparagraph (1)(a) are so used.</p>	<p>(XXIII) (a) Obtain from the CIF the list of contracts whereby clients have given their consent to the CIF to use their financial instruments for own account as in 7(1) above.</p> <p>(b) On a sample basis check whether:</p> <ol style="list-style-type: none"> <li>i. Client agreements adequately reflect the provision of the law as per section 17(8) of the Law.</li> <li>ii. Clients asset custody accounts for those clients that have given their consent for the CIF to use their assets are kept separately from those that have not.</li> <li>iii. CIF has a policy on how to compensate clients for use of their assets (even if nil).</li> <li>iv. CIF reflects the amount of securities used on the client statement (or note on the statement that some of the clients' securities may be used, in cases where it is not possible to identify the amount of securities used per client).</li> </ol>

#### 4. Use of client financial instruments (section 3 of 5)

Paragraph	Requirement	Indicative audit procedures
7(2)	The records of the CIF must include details of the client on whose instructions the use of the financial instruments has been affected, as well as the number of financial instruments used belonging to each client who has given his consent, so as to enable the correct allocation of any loss.	(XXIV) For a selected sample of transactions (see subparagraph 7(1) above) verify whether the records of the CIF include appropriate documentation such as: <ul style="list-style-type: none"> <li>(a) Reference to the contract under which consent is granted.</li> <li>(b) Working in relation to the allocation of profits/losses in compliance with the contractual terms.</li> <li>(c) Notification to the client regarding the allocated profits or losses.</li> <li>(d) Evidence of client's acceptance of the allocation, or</li> <li>(e) Reconciliation between client's position and CIF's position regarding the allocation and explanations for reconciling items.</li> </ul>

#### 4. Use of client financial instruments (section 4 of 5)

Paragraph	Requirement	Indicative audit procedures
<p><b>7(3)</b></p>	<p>The CIF takes appropriate measures to prevent the unauthorised use of client financial instruments for its own account or the account of any other person such as:</p> <p>(a) the conclusion of agreements with clients on measures to be taken by the CIF in case the client does not have enough provision on its account on the settlement date, such as borrowing of the corresponding securities on behalf of the client or unwinding the position;</p> <p>(b) the close monitoring by the CIF of its projected ability to deliver on the settlement date and the putting in place of remedial measures in the event that this cannot be done; and</p> <p>(c) the close monitoring and prompt request of undelivered securities outstanding on the settlement day and beyond.</p>	<p>(XXV) (a) Review the terms of the agreements signed for a sample of custody clients to verify that they contain clauses that state, in a clear and unambiguous manner, the measures that the Company will take in the event that the client does not have enough provision on its account on the settlement date of a specific transaction. Look for evidence that the agreement has been accepted by the client (for e.g. this can be evidenced by the client's signature or by the electronic recording of client acceptance via an electronic system maintained by the Company that tracks the acceptance of the terms of the agreement when the client is asked to read the terms and tick a box to indicate his understanding and consent of the terms).</p> <p>(b) Test whether the Company has a procedure to:</p> <ol style="list-style-type: none"> <li>i. Closely monitor the settlement date of each transaction carried out on behalf of its clients.</li> <li>ii. Check its resources in order to estimate whether it will be able to deliver the required cash or financial instruments to the affected clients on the scheduled settlement date.</li> <li>iii. Have in place remedial measures in case it is not in a position to deliver on the settlement date.</li> <li>iv. Follow up, immediately and without delay, on any securities that remain outstanding on the settlement day and beyond (e.g. DvP failures), by contacting the third party that is responsible for delivering the cash or the financial instruments to the client, and enquiring about the delay, and informing the client accordingly.</li> </ol> <p>(c) Review any relevant client complaints and how these were resolved.</p> <p>(d) Inquire the single officer appointed pursuant to paragraph 9 of the Directive about the monitoring procedures and review his/her schedule. Ensure that the CIF promptly requests any undelivered securities outstanding on the settlement day and beyond.</p>

#### 4. Use of client financial instruments (section 5 of 5)

Paragraph	Requirement	Indicative audit procedures
7(4)	The CIF must adopt specific arrangements for all clients to ensure that the borrower of client financial instruments provides the appropriate collateral and that it monitors the continued appropriateness of such collateral and takes the necessary steps to maintain the balance with the value of client instruments.	<p>(XXVI)(a) Consider the arrangements established by the Company to ensure that, where a client's financial instruments are being borrowed under securities financing transactions either by the Company itself or by another person or client of the Company, there are appropriate and adequate controls in place to evaluate whether the type and value of the collateral provided by the borrower is appropriate for the instrument being lent out, both an initiation of the trade and on an ongoing basis.</p> <p>On a sample basis, from the list of contracts whereby clients have given their consent to the CIF to use their financial instruments as in 7(1) above, carry out the following tests:</p> <ul style="list-style-type: none"> <li>i. Check and verify that the value of client financial instruments borrowed from the client is proportionate to the collateral given by the borrower at inception.</li> <li>ii. Test whether there is continuous monitoring to ensure that the value of financial instruments borrowed from the client is proportionate to the collateral given by the borrower.</li> <li>iii. Review communication with borrowers requesting additional collateral to maintain a secured position with the borrower (e.g. margin) relating to the client's financial instruments being borrowed.</li> </ul> <p>(b) Select a sample of securities financing transactions and check whether the type and value of the collateral provided to the client-lender of financial instruments was appropriate both at initiation of the transaction and on an ongoing basis, and that the Company took steps to test this as necessary. Appropriate records of such process should also be maintained by the Company.</p>
7(5)	The CIF does not enter into arrangements which are prohibited under section 17(10) of the Law (i.e. title transfer financial collateral arrangements with retail clients for the purpose of securing or covering present or future, actual or contingent or prospective obligations of clients).	<p>(XXVII) Obtain a list of all the clients with which the Company has entered into title transfer collateral arrangements, together with their retail/corporate classification. Reconcile the retail/corporate classification appearing on the list, for a sample of these clients, with the respective information in the systems of the Company, to verify its accuracy. Make sure that no such arrangements have been made with retail clients.</p>

## 5. Use of Title Transfer Collateral Arrangements (section 1 of 2)

Paragraph	Requirement	Indicative audit procedures
<p><b>8(1), (2)</b></p>	<p>(1) The CIF properly considers and is able to demonstrate that it has done so, the use of title transfer collateral arrangements in the context of the relationship between the client's obligation to the CIF and the client assets subjected to title transfer collateral arrangements by the CIF.</p> <p>(2) When considering, and documenting, the appropriateness of the use of title transfer collateral arrangements, the CIF takes into account all of the following factors:</p> <p>a) whether there is only a very weak connection between the client's obligation to the CIF and the use of title transfer collateral arrangements, including whether the likelihood of a clients' liability to the CIF is low or negligible;</p> <p>b) whether the amount of client funds or financial instruments subject to title transfer collateral arrangements, far exceeds the client's obligation, or is even unlimited if the client has any obligation towards the CIF; and</p> <p>c) whether all clients' financial instruments or funds are subject to title transfer collateral arrangements, without consideration of what obligation each client has to the CIF.</p>	<p>(XXVIII) (a) Obtain from the CIF the list of clients whose assets are subject to title transfer collateral arrangements (e.g. client name, client ID, client categorization, type of asset or funds under TTCA, amount of asset or funds, reference to the contract under which consent is granted, etc.)</p> <p>(b) Obtain also a list of respective clients' liabilities in relation to the above assets.</p> <p>(c) On a sample basis:</p> <ol style="list-style-type: none"> <li>i. Confirm that the clients on the list are only professional clients.</li> <li>ii. Review contracts signed by the CIF and the client, more precisely the specific terms and clauses governing the TTCA arrangement.</li> <li>iii. Review documentation of the CIF to assess whether the client's assets subject to TTCA are reasonable/proportionate to the client's obligations to the CIF (e.g. consider if the amount of client's funds or financial instruments subject to TTCA far exceeds the client's obligation or is even unlimited if the client has any obligation to the CIF). Also consider whether the CIF has sufficiently documented the evaluation process it applied in order to conclude on the above.</li> <li>iv. In addition to the above, review documentation of the CIF in order to conclude whether the use of the client's assets under TTCA is in line with the contract signed and is appropriate/suitable taking into consideration the likelihood of a client's liability to the CIF (i.e. whether it is low or even negligible). Also consider whether the CIF has sufficiently documented the evaluation process it applied in order to conclude on the above.</li> <li>v. Review documentation of the CIF to ensure that in each case the CIF prior to using the client's assets subject to TTCA, considers what obligation the client has to the CIF, and that it sufficiently documents this evaluation process as well as the conclusions drawn.</li> </ol>

## 5. Use of Title Transfer Collateral Arrangements (section 2 of 2)

Paragraph	Requirement	Indicative audit procedures
<p><b>8(3)</b></p>	<p>Where the CIF uses title transfer collateral arrangements, it shall highlight to professional clients and eligible counterparties the risks involved and the effect of any title transfer collateral arrangement on the client's financial instruments and funds.</p>	<p>(XXIX) For a sample of professional clients and eligible counterparties with which the Company has entered into title transfer collateral arrangements, obtain the contract of the said arrangement, as well as any other relevant communication, to check whether the Company has informed such parties, in writing and in a clear and unambiguous manner, of the risks that arise from the use of such arrangements and the effect these may have on their funds and financial instruments.</p> <p>In this context, the Company should clearly state that any funds and financial instruments that are being transferred from the client to the Company under one such arrangement, shall not be treated as client assets for the duration of the arrangement and as such, they shall not be safeguarded based on the client asset requirements, nor will they be included in the client asset reconciliations performed by the Company.</p> <p>Look for evidence that this information has been viewed and understood by the affected clients, and that they have nevertheless consented to proceed with the use of title transfer collateral arrangements (e.g. either by signature or the electronic tracking of their consent).</p>

## 6. Governance Arrangements (section 1 of 1)

Paragraph	Requirement	Indicative audit procedures
9	<p>The CIF appoints a single officer of sufficient skill and authority with specific responsibility for matters relating to the CIF's compliance with its obligations regarding the safeguarding of client financial instruments and funds.</p> <p>The CIF decides, by ensuring full compliance with this Directive, whether the appointed officer is to be dedicated solely to this task or whether the officer can discharge responsibilities effectively whilst having additional responsibilities.</p>	<p>(XXX) (a) Obtain the internal organizational structure of the Company and check whether a separate function exists for dealing with client asset issues. Obtain also, the Company's policies and procedures on the responsibilities of this function.</p> <p>(b) Enquire as to which person or persons within the Company have been assigned with responsibilities relevant to the safeguarding of client funds and financial instruments and interview those persons about their responsibilities and day to day tasks, to ensure that they reflect the relevant policies and procedures and that adequate time is devoted to ensure the proper safeguarding of client assets.</p> <p>(c) Consider whether the person(s) assigned with the specific responsibility to ensure compliance with the Company's obligations regarding the safeguarding of client assets, has sufficient skill and authority to properly carry out the assigned tasks (consider his/her work experience, academic/professional qualifications, any relevant seminars attended, other).</p> <p>(d) Where a single officer exists with client assets responsibility, and that officer is not solely dedicated to this task, consider whether the necessary actions are being carried out by that person in a timely manner, to ensure the ongoing compliance of the Company with client asset requirements (obtain information on what other tasks and in what frequency these are performed by the officer).</p>