

**Interpretive Document**

# Markets in Financial Instruments Directive – Annual submission by Category 1 and Category 2 firms

## **Agreed-upon Procedures**

This document outlines the agreed-upon procedures to perform the audit required by Regulation 75 of the Financial Services (Investment Services) Regulations 2020 as it applies to 730,000 Euro firms and 125,000 Euro, otherwise referred to as Category 1 and 2 firms.

The GFSC expects the procedure and tests set out in this document to be the basis of the testing by auditors to the GFSC for the purposes of the Regulation 75 report.

The auditor's report does not constitute an assurance engagement; it does not need to express a conclusion or provide recommendations; and it is solely for the benefit of the firm and GFSC. The report will be shared with the GFSC in accordance with the firm's responsibility set out by Regulation 75 of the Financial Services (Investment Services) Regulations 2020.

The details set out in Appendix 1 below are the procedures and tests for the necessary requirements. The report should be completed by an external auditor.

We expect the report to list all of the AUPs performed (essentially relevant AUPs the GFSC publishes) and state any exceptions noted.

The agreed process should constitute the extent of the testing, unless agreed separately.

## **Glossary**

*Sample Sizes:* Sample sizes may be too big for some firms e.g. only have three relevant clients and therefore testing should apply to all three clients. Sample sizes should be taken randomly

*Custodian/Custody:* The terms custody and custodian are used throughout the document, this can be a credit institution for an investment firm or a custodian bank holding client portfolios for a credit institution, please use the most relevant for the firm.

*External Auditor:* A statutory auditor approved by the GFSC.

*Frequency:* We are asking for frequency to be applied as per firm's policy on frequency of reconciliations.

## Appendix 1 - Findings and observations in relation to the adequacy of arrangements under Regulations 30 – 34, 52 (15) and (16), and 55 of the Financial Services (Investment Services) Regulations 2020

In accordance with the terms of our engagement letter dated [date], we have performed those procedures agreed with the directors of the Company and set out below relating to the arrangements of [Company name] (“the Company”) under Regulations 30 – 34, 52 (15) and (16), and 55 of the Financial Services (Investment Services) Regulations 2020.

Our report has been prepared for the Company solely. It has been released to the Company on the basis that our report shall not be copied, referred to or disclosed, in whole (save for the Company’s own internal purposes) or in part, without our prior written consent.

Our report was designed to meet the agreed requirements of the Company determined by the Company’s needs at the time. Our report should not therefore be regarded as suitable to be used or relied on by any party wishing to acquire rights against us other than the Company for any purpose or in any context. Any party other than the Company who obtains access to our report or a copy and chooses to rely on our report (or any part of it) will do so at its own risk. To the fullest extent permitted by law, **xxx** Limited will accept no responsibility or liability in respect of our report to any other party.

Our engagement was undertaken having regard to International Standard on Related Services 4400 *Engagements to Perform Agreed-upon Procedures Regarding Financial Information*.

*The procedures performed were as follows:*

***[Insert confirmation that procedures were consistent with those contained in the “Scope of our work” section of the accompanying engagement letter.]***

*[Other than as noted in the following paragraph, no / No] exceptions were noted from performing the procedures set out above.*

***[Where exceptions are being noted insert the following paragraph.]***

*[The exceptions noted were as follows:]*

***[Insert details of exceptions in the column below]***

Because the above procedures do not constitute either an audit or a review in accordance with International Standards on Auditing or International Standards on Review Engagements, we do not express any assurance on the adequacy of the arrangements of [Company name] (“the Company”) under Regulations 30 – 34, 52 (15) and (16), and 55 of the Financial Services (Investment Services) Regulations 2020.

Note that, as agreed with the Financial Services Commission, this report does not specifically cover regulations 30(2), 30(3), 31(5), 33(5), 33(6), 33(7), 34 and 55.

Had we been engaged to perform, and had performed, additional procedures, an audit or a review in accordance with International Standards on Auditing or International Standards on Review Engagements, other matters might have come to our attention that would have been reported to you.

Yours faithfully

xxx Limited

[Address]

[Date]

Relevant MiFID II regulations	Agreed procedures	Findings
<b>Regulation 30 – Safeguarding of client financial instruments and funds</b>		
30 (1)(a) keep records and accounts enabling 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	1) Obtain a list of clients to include all clients transacted with during the audit period, included on and off-boarded clients. Verify completeness of list by obtaining revenue report or transaction listing for the audit period. Select 10 client transactions and agree clients selected on transaction listing back to original list'.	
	a) For each client, check that the name of the custody account on the firm's system states the client name or unique client identifier.	
	b) For each client, check that the name of the cash account on the firm's system states the client name or unique client identifier.	
30.1 (b) maintain its records and accounts in a way that ensures – (i) they are accurate and, in particular, correspond to the financial instruments and funds held for clients: and (ii) they may be used as an audit trail.	1) Obtain a list of all clients. Select a sample of 10 clients.	
	a) For each client, detail confirmation should check that client accounts details and client instructions match.	
	b) Check that all information obtained from the client is stored for use as audit trail.	
	c) For each client, obtain a sample of the client statements for a specified date. Check that the amounts on the statement match the amounts on the accounts for	

	the given date. Where a third party custodian is used to handle client assets, their statements should be used to check.	
30. 1 (c) conduct regular reconciliations between its internal accounts and records and those of any third parties by whom assets are held;	1) Select sample of 3 external custodians (this can be a credit institution for an investment firm or a custodian bank holding client portfolios for a credit institution) reconciliations for 15 dates for each custodian and check that:	
	a) the external reconciliations conducted by the firm identify specific transactions which are for clients;	
	b) the frequency of when the reconciliation is performed is in line with the firm's policy (daily, weekly or monthly) Firm to state frequency of reconciliations in Appendix 2 below.	
	c) the reconciliation is performed using internal and external records (i.e. firm's own records and those of a third party)	
	d) All external reconciliation breaks are recorded in the firm's breaches log.	
	e) there is segregation of duties between the preparer and the reviewer and there is evidence of review performed for each completed reconciliation (documented evidence of review in line with firm policy and sufficient for an audit trail)	
30. (1) (d) take the necessary steps to ensure that any client financial instruments deposited with a third party in accordance with regulation 31 are identifiable separately from financial instruments belonging to the firm or that third party, by means of differently titled accounts on the books of the third party or other equivalent measures that achieve the same level of protection;	1) Obtain list of third party custodians used by the Firm. Select 15 client transactions that use third party custodians and check that it is clearly labelled.	
	a) For each account, check the name of the account held at a third party states the client name or that it is a custody account - this can be viewed from statements or online account access.	
	b) For a sample of 3 third party custodians, check that the 'custodian agreement' explicitly refers to 'custody arrangements' or other equivalent term and ensures the requirement of 30 1 (d) is met i.e. the third party agrees to hold client assets by means of differently titled accounts on their books.  c) Obtain list of firm's assets held at year end with third party custodians - Select Sample of 10 separate financial instruments and agree these to firm accounting records.	
	1) Select a sample of 10 of your client accounts holding monies.	

30(1) (e) Take the necessary steps to ensure that client funds deposited in accordance with regulation 32 in a central bank, a credit institution, a bank authorised in a third country or a qualifying money market fund are held in an account identified separately from any account used to hold funds belonging to the firm .	a) For each account, check the name of the account held at a third party states the client name or that it is a cash account held on behalf of clients and that the account is recorded in this name in the institution's system. This can be viewed from statement or online account access.	
	b) For each of your third party arrangements, check that there is a corresponding agreement.	
30. (1) (f) introduce adequate organisational arrangements to minimise the risk of the loss, or diminution of client assets or rights in connection with those assets, as a result, of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence. f	1) Obtain a list of any committee and any subcommittees that form part of the firm's asset oversight and accountability structure. This can be provided by the firm directly to the auditor.  (i) Obtain all committee minutes during the period. (ii) Confirm if meetings were held in line with Firm policy or Terms of Reference for committee (Monthly, quarterly) and explanations if meeting not held. (iii) Confirm if list of employees with 'key asset roles' - (2) below attended meetings. Document instances and explanations of non-attendance. (iv) Confirm if client asset specific MI was presented and discussed to the committee. (This includes total number of clients on and off boarded, total value of assets held per most recent reconciliation, number of recorded 'breaks' or 'breaches (failure to reconcile in line with policy), instances of fraud, number of customer complaints over client assets issues, and changes to client asset handling arrangements (number or change in number of custodians used)). (v) Confirm if custodian and bank due diligence was carried out at least once during the audit period per 31 (1)	
	2) Obtain 'Employee key client asset register' demonstrating list of employees with 'key asset roles' showing all employees with a key client asset role during the period.	
	3) Obtain 'Employee key client asset register' demonstrating list of employees with 'key asset roles' showing all employees with a key client asset role during the period (including leavers and joiners). Confirm with management register is as at year-end is up to date with a management representation that the staff on the register were employed with the firm as at year-end or left the firm at the date recorded on the register..  Obtain MiFID II 'Breaches log'.	

	<p>4) (i) Document if Firm kept Breaches log in line with FSC requirements with headings 'Breach description, legislation reference, reasons for breach, date breach occurred, date breach recorded, date breach resolved, person recording breach, root-cause analysis'</p> <p>(ii) Document number of recorded instances of breaches</p> <p>(iii) Document breaches log owner or person responsible for maintaining breaches log</p> <p>5) Obtain a copy of the Firm's complaints register as already described below</p>	
	<p>a) Select a sample of 10 relevant breaches or complaints with client asset impact. Check that the breaches/ complaints were investigated, explained and resolved in a timely manner (according to the firm's policy) and with an audit trail. These should have been processed as per the firm's process. Firm's process on resolving breaches should be disclosed to the FSC as an appendix.</p>	
	<p>4) If the Firm holds physical assets, Select a sample of 5 certificates and check the following;</p> <p>i) that the firm has performed a physical asset reconciliations frequently (as per their policy)</p> <p>ii) the assets counted correspond to the records on the system</p> <p>iii) the name on the certificates correspond to the records on the system</p> <p>iv) check asset registered is in the name of the client and if not obtain a rationale from the firm</p>	
30. (4) An investment firm must not enter into any arrangement which creates a security interest, lien or right of set-off over a client's financial instruments or funds that enables a third party to dispose of the client's financial instruments or funds in order to recover debts that do not relate to the client or the provision of services to the client.	<p>1) Obtain a sample of 3 relevant third party agreements/contracts which covers custody arrangements</p> <p>Inspect custodian agreements tested above (Ref) for arrangements stated in 30 (4).</p>	
	<p>a) Check that no rights of lien or set off clauses have been included. Where clauses have been included, proceed to test (b)</p>	
30. (6) Where an investment firm – (a) grants a security interest, lien or right of set-off over client	<p>b) Obtain relevant details of the sample of third party agreements identified in (a) above</p>	

<p>financial instruments or funds; or (b) has been informed that an interest, lien or right of that kind has been granted, the firm must record it in client contracts and the firm's own accounts to make the client's ownership of assets clear, such as in the event of an insolvency.</p>	<p>c) Select a sample of 5 clients using these identified third parties. Obtain the client contracts and check that the lien information has been included.</p>	
<p>30. (7) An investment firm must make information relating to clients' financial instruments and funds readily available to – [certain parties] in the format set out in 30. (8).</p>	<p>d) for the sample of clients selected, check the corresponding client accounts for records of lien arrangement</p> <p>1) Obtain details of any such requests from a relevant party and check how the firm responded and whether the response was in line with 30. (7) and 30. (8).</p> <p>(i) Obtain details of any such requests from a relevant party and check how the firm responded and whether the response was in line with 30. (7) and 30. (8).</p>	
<p>30. (8) The information which must be made available under sub-regulation (7) includes–  (a) related internal accounts and records that readily identify the balances of funds and financial instruments held for each client;  (b) where client funds are held by an investment firm in accordance with regulation 32 details of the accounts in which client funds are held and of the relevant agreements with the firm;  (c) where financial instruments are held by an investment firm in accordance with regulation 31, details of the accounts opened and relevant agreements with those third parties, as well as details of the relevant agreements with the firm;</p>	<p>Testing as above - to procedure 1) - 30. (7).</p>	
<p><b>Regulation 31 – Depositing client financial instruments</b></p>		
<p>31.(1) An investment firm may deposit financial instruments held by it on behalf of its clients into an account opened with a third party provided that the firm exercises all due skill, care and diligence in the selection, appointment and</p>	<p>1) Obtain a list of the Firm's 3rd Party custodians from the firm and select a sample of 5 custodians. Verify the completeness of the list: Obtain revenue report or transaction listing for the audit period. Select 15 client transactions that use third party custodians and agree clients selected on transaction listing back to original list.</p>	



<p>periodic review of the third party and of the arrangements for the holding and safekeeping of those financial instruments.</p> <p>31. (2) In applying sub-regulation (1), an investment firm must take account of the expertise and market reputation of the third party and any legal requirements related to the holding of those financial instruments that could adversely affect clients' rights.</p> <p>31. (3) An investment firm must only deposit financial instruments with a third party if it is in a jurisdiction where the safekeeping of financial instruments for the account of another person is subject to specific regulation and supervision and the third party is subject to that specific regulation and supervision.</p>	<p>(a) Initial Due diligence was performed and approved by the relevant committee as per above, before assets were deposited with the Custodian.</p> <p>If a new custodian was opened during the period, obtain custodian statements from date account was opened and confirm that no assets were deposited before initial Due diligence was performed and approved by the relevant committee.</p>	
	<p>(b) (i) Check that the initial due diligence review documented the expertise &amp; market reputation (in the form of Credit rating agency ratings, recent news publications &amp; internet search results), legal requirements related to the holding of those financial instruments.</p> <p>(ii) Check that the firm has documented reasons why these are acceptable to the firm and in line with their policy.</p> <p>(iii) All DD performed periodically - e.g. Obtain Due diligence performed on all custodians used during the period and confirm due diligence has been approved by the relevant committee.</p> <p>Only include below to address sub custodians but it also should be applicable to custodians per the legislation.</p>	
	<p>For the sample of selected sub custodians, (3 samples of sub custodians.)</p> <p>c) Check that each annual due diligence review documents considerations pertaining to legal requirements/market practices related to the holding of client assets that could adversely affect clients' rights including:</p> <p>i) whether the third party is in a jurisdiction where the safekeeping of financial instruments for the account of another person is subject to specific regulation and supervision</p> <p>ii) whether the third party has the appropriate regulatory permissions</p> <p>iii) whether the third party has had any negative press relating to its service</p>	
	<p>d) Check that each review for due diligence has been reviewed and signed off</p>	
	<p>e) Check that a due diligence review was performed and approved and signed off by the relevant oversight committee as determined above</p>	
	<p>f) Inspect the policy documents of the firm and check that they contain procedures for determining the expertise and market reputation of sub custodians, as well as the presence of required regulatory permissions, depending on the jurisdiction.</p>	

<p>31. (4) An investment firm must not deposit financial instruments held on behalf of clients 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 except where—</p> <p>(a) the nature of the financial instruments or the investment services connected with those instruments requires them to be deposited with a third party in that third country; or</p> <p>(b) the financial instruments are held on behalf of a professional client and the client has requested in writing that the firm deposit them with a third party in that third country.</p>	<p>1) If sub-custodians are identified from the due diligence review above that operate in countries which do not regulate the holding and safekeeping of client assets, perform the following:</p>	
	<p>a) Check that the custodians have been further reviewed by the firm and a rationale obtained as to why the firm is comfortable with using the third party</p>	
	<p>b) Check that the clients using the third party custodian are all classified as professional clients</p>	
	<p>c) Check that a request in writing has been made by the client to deposit assets with a third party in that country.</p>	
	<p>d) Select a sample of 10 clients and check that the risks of using the third party custodians have been articulated in the contracts</p>	
<p><b>Regulation 32 – Depositing client funds</b></p>		
<p>32. (1) An investment firm must promptly place any client funds it receives into an account opened with – [certain parties]</p>	<p>Not applicable for credit institutions. For a sample of 10 client funds received in the period, obtain details of the date of receipt and the date of placement in accordance with 32. (1), commenting on any exceptions noted. [Note that 32. (2) provides an exception to the requirement for credit institutions]</p>	
<p>32. (3) An investment firm which does not deposit client funds with a central bank must—</p> <p>(a) exercise all due skill, care and diligence in the selection, appointment and periodic review of the credit institution, bank or money market fund where those funds are placed and the arrangements for the holding of those funds; and</p> <p>(b) as part of its due diligence, consider the need for diversification of those funds. [Note also the requirements of 32. (4)]</p>	<p>Not applicable for credit institutions Inspect the policy documents of the firm and check that they contain procedures for determining the expertise and market reputation of sub custodians, as well as the presence of required regulatory permissions, depending on the jurisdiction.</p>	
	<p>Not applicable for Credit Institutions. Select a sample of 10 credit institution, bank or money market funds , check that each risk assessment questionnaire for periodic due diligence contains responses obtained on questions pertaining to legal requirements/market practices related to the holding of client funds that could adversely affect clients' rights.</p>	

	Not applicable for Credit Institutions Obtain the licensee's diversification policy and for a sample of 5 dates during the period verify that the policy has been complied with.	
32. (5) An investment firm may only place a client's funds in a qualifying money market fund where – (a) the firm has informed the client that funds placed with a qualifying money market fund will not be held in accordance with the requirements for safeguarding client funds set out in regulations 30 to 34; and (b) the client has given explicit consent for the funds to be placed in the qualifying money market fund.	Not applicable for Credit Institutions  For a sample of 5 clients for which client funds have been placed in a qualifying money market fund, check compliance with rules (a) and (b)	
32. (6) An investment firm that deposits client funds with a credit institution, bank or money market fund which is part of the same group as the investment firm, must not deposit more than 20% of the firm's client funds with any entity or combination of entities within the group. [Note the exceptions in 32.(7) and 32.(8)]	Not applicable for Credit Institutions  1) Check a sample of 5 dates during the year that the 20% limit within 32. (6) was not breached.	
<b>Regulation 33 – Use of client financial instruments</b>		
33.(1) An investment firm must not–	1) Confirm with the firm if they offer Securities Financing products from a discussion with management.	
(a) enter into arrangements for securities financing transactions in respect of financial instruments held by the firm on behalf of a client; or	a) Obtain current template agreements used in the audit period and i) check that they do not allow arrangements prohibited under 33(1). ii) check that the agreements contain the risks of using an omnibus account including use of one client's asset to settle another	
(b) otherwise use those financial instruments for its own account or the account of any other person or client of the firm, unless the conditions in sub-regulation (2) are met.	b) For a sample of 10 relevant client agreements, check that the template agreements have been used.	
	2) If the firm allows Securities Financing (including activities such as prime brokerage and rehypothecation);	

<p>(2) The conditions are that–  (a) the client has given express prior consent to the use of the instruments, on specified terms which are–    (i) evidenced in writing; and  (ii) affirmatively executed, by signature or equivalent means;</p>	<p>a) Obtain 5 sample agreements with specific clauses on the Financing arrangements and check that it contains;  i) consent clauses and note if there are specific conditions (e.g., the type of securities that can be loaned, rehypothecation rates etc.)  ii) measures to be taken by the firm 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) Confirm if client has provided consent evidenced in writing and affirmatively executed, by signature or equivalent means</p>	
<p>33. 2 (b) the use of the client’s financial instruments is restricted to the specified terms to which the client has consented.</p>	<p>d) Obtain a sample of 10 client's account statements and check that e.g., the instruments held are in line with the terms of the relevant agreement.</p>	
	<p>e) Obtain a sample of the firm's monitoring report for 10 dates within the period and check that the firm has assessed the following:  i) projected ability to deliver on the settlement date  ii) remedial measures if the firm cannot deliver on the settlement date  iii) close monitoring and prompt requesting of undelivered securities outstanding on the settlement day and beyond</p>	
<p>33. (3) An investment firm must not–    (a) 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    (b) otherwise use those financial instruments for its own account or the account of any other person, unless, in addition to the conditions in sub-regulation (2), the conditions in either or both of sub-regulation (4)(a) or (b) and in sub-regulation (4)(c) are met.</p>	<p>1) Obtain a list of omnibus accounts in use as at period end (audit period year end). Select a sample of 10 registered assets:</p>	
	<p>(a) obtain a listing of registered owners of those assets from management;  Obtain revenue report or transaction listing for the audit period.  Select 15 client transactions that use third party custodians.  Agree registered owners for selection above to transaction list / revenue report.</p>	
	<p>b) check, from the client agreements, which clients have agreed to re-hypothecate their assets;</p>	
	<p>c) check the relevant report as at period end ((audit period year end) for details of which clients have had their assets re-hypothecated to verify that only those assets belonging to clients who have agreed to rehypothecate their assets, have been re-hypothecated.</p>	
<p><b>Regulation 52 – Organisational requirements: investment firms</b></p>		

<p>52 (15) An investment firm must make adequate arrangements–  (a) when holding financial instruments belonging to clients–  (i) to safeguard the ownership rights of clients, especially in the event of the investment firm’s insolvency; and</p>	<p>1) Obtain relevant policies/ procedure documents prepared by the firm as at period end (31 December 2019) and check that they contain details covering the following areas in the event of the firm’s insolvency:  (i) To check that there is clear identification of clients details in firm’s system, test a sample of 10 clients  (ii) Process sets out time frame for conducting reconciliation of client’s financial instruments This should be set out in report to GFSC.  (iii) clients holdings clearly identified in firms system (separate instruments in separate client accounts) – testing of 10 instruments from firm system and check whether they belong to a client or not.</p>	
<p>52 (15). (a) (ii) to prevent the use of a client’s financial instruments on own account other than with the client’s express consent;</p>	<p>See test for regulation 33 above.</p>	
<p>52 (15) (b) when holding funds belonging to clients–  (i) to safeguard the rights of clients; and  (ii) to prevent the use of client funds for its own account (except in the case of credit institutions).</p>	<p>See test for regulation 33 above.</p>	
<p>52 (16) An investment firm must not conclude 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>	<p>1) Obtain a list of clients from the firm with title transfer collateral arrangements (“TTCA”)</p>	
	<p>a) Select a sample of 10 clients. For each client check that the clients have not been categorised as retail clients as per process set out by MiFID II</p>	

Appendix 2 (For Management)

- Per 30.1 (c) procedure 1b) The Firm's policy on reconciliations is that they are to be performed \_\_\_\_\_.
- Per 30.1 (f) procedure 4a) The Firm's policy for resolving breaches and client complaints is \_\_\_\_\_.