

Estonian Financial Supervision and Resolution Authority

Advisory Guidelines

AUDITOR'S REPORT ON THE OPERATION OF THE PRINCIPLES OF SAFEGUARDING AND HOLDING CLIENT ASSETS

These advisory guidelines were established by Decision No. 1.1-7/163 of the Management Board of the Estonian Financial Supervision and Resolution Authority of 17 October 2022 under subsection 57 (1) of the Financial Supervision Authority Act.

1. COMPETENCE

Pursuant to section 3 of the Financial Supervision Authority Act (hereinafter the FSAA), financial supervision is conducted in order to enhance the stability, reliability, transparency and efficiency of the financial sector, to reduce systemic risks and to promote prevention of the abuse of the financial sector for criminal purposes, with a view to protecting the interests of clients and investors by safeguarding their financial resources, and thereby supporting the stability of the Estonian monetary system.

Pursuant to subsection 57 (1) of the FSAA, the Estonian Financial Supervision and Resolution Authority has the right to issue advisory guidelines to explain legislation regulating the activities of the financial sector or to provide guidance to subjects of financial supervision.

2. PURPOSE AND SCOPE OF THE GUIDELINES

2.1. According to subsection 88 (7) of the Securities Market Act (hereinafter the SMA), an investment firm shall ensure that its auditor's report regarding compliance with the principles for holding and safeguarding client assets, as established by the internal policies of the investment firm, including regarding compliance of the activities of the investment firm with the provisions of sections 88 and 88¹ through 88⁴ of the SMA, is submitted to the Estonian Financial Supervision and Resolution Authority at least once a year (hereinafter the Report).

2.2. The purpose of these Guidelines is to explain the requirements for the preparation and content of the Report, the manner of and deadline for submission of the Report, and the liability for failure to submit or non-compliance with the requirements of the Report to be submitted to the Estonian Financial Supervision and Resolution Authority. These Guidelines have been prepared in line with the relevant requirements of the SMA and other legislation and regulations.

2.3. According to Article 16 (8) and (9) of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, an investment firm shall, when holding financial instruments belonging to clients, make adequate arrangements so as to safeguard the ownership rights of clients, especially in the event of the investment firm's insolvency, and to prevent the use of a client's financial instruments on its own account except with the client's express consent. An investment firm shall, when holding funds belonging to clients, make adequate arrangements to safeguard the rights of clients and, except in the case of credit institutions, prevent the use of client funds for its own account.

2.4. The following persons having the right to provide services relating to holding client assets shall submit a Report to the Estonian Financial Supervision and Resolution Authority:

2.4.1. Investment firms registered in Estonia;

2.4.2. Fund managers referred to in section 307 of the Investment Funds Act¹;

2.4.3. Credit institutions providing investment services or ancillary services to investment services within the meaning of the Securities Market Act²;

2.4.4. Branches of third country persons providing investment services in Estonia³.

¹ Subsection 309 (8) of the Investment Funds Act

² Subsection 2 (4) of the Credit Institutions Act

³ Subsection 230¹ (1) 3) of the Securities Market Act

All of the above are referred to as investment firms in these Guidelines.

2.5. Client assets are understood as clients' funds and securities within the meaning of section 2 of the SMA.

3. PREPARATION OF REPORT

The Report shall be prepared in line with the following principles:

3.1. The auditor of the investment firm shall prepare the Report on the basis of a limited assurance engagement conducted according to the International Standard on Assurance Engagements (Estonia) 3000 (hereinafter the Standard). During the assurance engagement, the auditor shall follow all the requirements of the Standard relevant to the engagement.

3.2. The auditor shall plan and conduct the following procedures, amongst others, in all the structural units of the investment firm, including branches in foreign countries:

3.2.1. In the planning phase of the engagement, examine the relevant legal rules regulating the holding and safeguarding of client assets by an investment firm, these Guidelines of the Estonian Financial Supervision and Resolution Authority and other relevant regulations;

3.2.2. Map the investment services provided and the investment activities pursued by the investment firm;

3.2.3. Assess the compliance with the applicable regulations of the internal policies of the investment firm concerning the safeguarding and holding of client assets;

3.2.4. Interview the management board member of the investment firm in charge and other relevant persons to assess the operation of and actual compliance with the internal policies;

3.2.5. Interview the compliance officer at the investment firm to identify any problems with compliance with the requirements for holding and safeguarding client assets at the investment firm;

3.2.6. Examine any customer complaints recorded at the investment firm and the measures taken to solve them, so as to identify any violations of the requirements for holding and safeguarding client assets;

3.2.7. Check the accounts of client assets, their separation from the assets of other clients and the investment firm, the operation of relevant registers and the consistency of accounting during the reporting period;

3.2.8. Check the procedures for reconciling data from the investment firm's accounting system with data from third parties with whom client assets are held, and the outcome of these procedures;

3.2.9. Check compliance with the procedures and principles for selecting and monitoring depository institutions/account providers (in whose accounts client assets are held) and the compliance of the selected partners and the contracts with them with the relevant requirements of the SMA;

3.2.10. Check the availability of reports to clients on holding their assets and the compliance of such reports to the internal procedures of the investment firm and the relevant requirements of the SMA;

3.2.11. Check the exercise of the rights arising from the client's ownership of their assets (exercise of voting rights, right to interests/dividends on the assets) in line with the internal procedures of the investment firm;

3.2.12. Interview the person responsible appointed under subsection 88 (6¹) of the SMA to assess whether the person has sufficient capacity (including time, authority, etc.) to perform their tasks with regard to the auditor's objectives;

3.2.13. Assess whether the person responsible appointed under subsection 88 (6¹) of the SMA has sufficient skills and competence to perform their tasks;

3.2.14. Check the compliance of the investment firm's activities with the requirements set out in section 88⁴ of the SMA in all events of using and disposing of a client's assets.

3.3. The submission requested by the auditor of the management of the investment firm under sections 56–59 of the Standard shall, amongst other things, include a confirmation by the management of the investment firm on the compliance of the investment firm's operations with the internal policies regulating the holding and safeguarding of client assets at the investment firm, or the Report shall explain why such a confirmation was not available from the management.

3.4. The Report shall follow the structure and contain the main elements specified in the Standard. The conclusion of the limited assurance engagement shall be formulated in a manner that indicates whether, based on the procedures conducted and the evidence gathered, any circumstances have been identified suggesting that the investment firm has failed (in any of its structural units) to comply with the principles of safeguarding and holding client assets or that there are material non-compliances with the provisions of sections 88 and 88¹ through 88⁴ of the SMA in the activities of the investment firm (in any of its structural units).

3.5. Further to the above, the Report shall contain the following information concerning each of the structural units of the investment firm:

- 3.5.1. The areas inspected by the auditor during the engagement;
- 3.5.2. A description of the nature, timing and extent of the procedures conducted to reach the conclusion presented in the engagement Report;
- 3.5.3. If the investment company has the right to hold client assets, the auditor's opinion on the following:
- i Whether the investment firm had sufficient internal policies and systems in place during the reporting period to meet the requirements for holding and safeguarding client assets throughout the period covered by the Report;
 - ii Whether the operations of the investment firm were in line with the internal policies for holding and safeguarding client assets throughout the period covered by the Report;
- 3.5.4. If the auditor identified an insufficiency in the internal policies and systems for holding and safeguarding client assets at the investment firm or a non-compliance of the operations of the investment firm with these internal policies, the auditor's opinion on which requirements were violated, including a description of the insufficiency or violation and a reference to the relevant legal provision;
- 3.5.5. If the auditor is unable to present an opinion as specified in section 3.5.4 above, a description of the area in which an opinion cannot be presented and the reasons for not presenting an opinion.
- 3.6. If the Report presents a modified conclusion, the engagement Report shall contain a description of the circumstances that led to the modification and the modified conclusion.

3.7. If the persons referred to in section 2.4 of these Guidelines do not hold client assets due to their business model, the Report will be prepared in line with the standard ISRS 4400 (Revised), Agreed-Upon Procedures Engagements. The Report shall contain a statement to the effect that the management of the investment firm has confirmed to the auditor that the investment firm does not hold client assets, and the auditor's confirmation of having conducted the necessary procedures and obtained assurance that the investment firm has not held client assets during the reporting period.

4. REPORTING PERIOD AND SUBMISSION OF REPORT TO THE ESTONIAN FINANCIAL SUPERVISION AND RESOLUTION AUTHORITY

- 4.1. The Report shall be submitted at least once a year according to subsection 88 (7) of the SMA.
- 4.2. The investment firm defines a reporting period, which shall not be longer than one year, in its internal policies. The investment firm may submit a Report on a shorter period. The first Report may cover a shorter period during which the provision of the relevant services began, and further annual Reports may be submitted together with the other reports due to the Estonian Financial Supervision and Resolution Authority. If the Report is submitted to the Estonian Financial Supervision and Resolution Authority together with other reports, the Report under subsection 88 (7) shall be clearly distinct from the other reports. The Report shall be submitted to the Estonian Financial Supervision and Resolution Authority within four months of the end of the reporting period.
- 4.3. The Report shall be prepared in Estonian or, by prior agreement with the Estonian Financial Supervision and Resolution Authority, in English. The investment firm shall e-mail the Report, bearing the digital signature of the auditor, to the Estonian Financial Supervision and Resolution Authority at aruandlus@fi.ee with a cover letter by a representative of the investment firm. If the Report contains the auditor's remarks on any insufficiencies or violations identified at the investment firm, the investment firm shall present the measures and an action plan for rectifying the insufficiencies or preventing repeated violations in the cover letter, if the investment firm agrees to the auditor's remarks. If the investment firm disagrees with the remarks in the Report, the investment firm shall present their reasoned position to the Estonian Financial Supervision and Resolution Authority.
- 4.4. Although the Report is prepared by the auditor of the investment firm, the investment firm shall be liable for compliance with the reporting requirement.

5. IMPLEMENTATION OF THE GUIDELINES

These Guidelines will take effect on 1 December 2022.

These Guidelines apply to reporting periods ending on 30 November 2022 or later.