Review of the client assets regime for investment business
TISA Response to FCA CP13/5

Q1: Do you think we should implement the speed proposal or codify the existing regime? Please explain the reasons for your response.

We support the proposal in principle, but we are concerned that the proposals are based on the accuracy of the defaulting firm's records. But firms in such positions may well not have accurate or reliable records. And IP practitioners may well prefer to satisfy themselves that there are no corporate assets mixed in with client assets, before distributing money to clients. What happens to clients, which do have valid claims but are incorrectly excluded from the distribution? Would their claims fall on the FSCS?

We recommend that the existing regime should be codified.

Q2: Do you agree that, where used, this transfer proposal will be beneficial to clients? If not, please provide reasons.

We support the proposal but believe 14 days to be too short a time frame. 28 days would be more realistic.

Q3: Do you agree that 'hindsight' should be applied to the valuation of clients' cleared open margined positions to determine their entitlements to the relevant CMP? If not, please provide reasons.

We agree that hindsight should be applied.

Q4: Do you agree that where a firm takes these reasonable steps, it should be able to use unclaimed client money entitlements to make good any CMP shortfalls? If not, please provide reasons.

We agree that where a firm takes these reasonable steps, it should be able to use unclaimed client money entitlements to make good any CMP shortfalls. Our members suggested that rather than making payments to charity, with the invidious responsibility to choose an appropriate charity, payments should be made to the Treasury.

Q5: Do you agree that these less onerous 'reasonable steps' should apply where a client's entitlement is less than £10? If not, please provide reasons.

We agree that these less onerous 'reasonable steps' should apply where a client's entitlement is less than £10.

Q6: Do you agree with the proposals regarding treatment of interest and currency conversion? If not, please provide reasons.

We agree that any interest earned on pooled client money after a 'Primary Pooling Event' should be used to reduce any shortfall in that client money pool.

We do note that the rules on currency conversion may adversely impact on some customers and would like more clarification from the FCA.

Q7: Do you agree with the proposals regarding the treatment of client money received after a PPE? If not, please provide reasons.

We agree with this proposal.

Q8: Do you agree with the proposals regarding a secondary pooling event? If not, please provide reasons.

We agree with the proposals.

Q9: Do you agree with the amended proposals to allow clearing firms to operate multiple client money pools? If not, please provide reasons.

We agree with the amended proposals.

Q10: Do you agree with our proposal to clarify the application of the client money rules in this way? If not, please give reasons.

We agree with the proposals.

Q11: Do you agree with our proposals in relation to the banking exemption? If not, please provide reasons.

We agree with the proposals.

Q12: Do you agree with our proposals in relation to how trustee firms should hold client money when they are acting as such? If not, please provide reasons.

We agree that the client money distribution rules should not apply to client money held by a trustee firm e.g. the trustee bank account for a SIPP.

Platforms will often include a SIPP as part of their proposition. Typically, they will operate a number of transactional accounts for the receipt of money onto and off of the platform, including for the purchase and sale of investments for several product wrappers. We are not sure how FCA envisages the rules working for Platforms who operate a SIPP and would appreciate clarification. We assume that even though the client money distribution rules will not apply to the money in the trustee bank account, this does not preclude a firm reconciling all of its platform accounts in one exercise.

In these circumstances, would FCA expect such firms to opt to comply with the requirements set out in CASS7.4, 7.6 and 7.8 in their entirety?

Q13: Do you agree with the proposals relating to the TTCA provisions? If

not, please provide reasons.

Q14: Do you agree with the proposal of clarifying the requirements around the DvP window? If not, please provide reasons.

Please could it be confirmed that a 'commercial settlement system' would also incorporate recognised payment schemes including, but not limited to, CHAPS, Bacs, Faster Payments and SEPA? Many institutions will settle transactions by making payment to a custodian, trustee, depositary or other appropriate counterparty by a payment from a bank account held by them to an account held by the relevant counterparty.

Q15: Do you agree with the proposal to remove the DvP window for delivery versus payment transactions for the purpose of settling transactions in relation to units in a regulated collective investment scheme? If not, please provide reasons.

No, we do not.

For UK domiciled funds it is typical, but not necessary, that the manager acts as the principal in the dealing process with investors. This means that the manager is buying/ selling units with the fund and also buying and selling units with the investor. The manager's trading activity with the investors is netted together with any required movement for the Manager's account (box) to determine the manager's trade with the fund. Trades are performed at the next valuation point (VP) with investor cash settlement due on the contractual settlement date (generally T+4) with the units being retained by the manager until investor cash is received. The manager also deals with the fund at the same VP for settlement on the same contractual settlement date.

The proposed removal of the delivery versus payment (DVP) exemption for fund managers has led to a number of interpretations of what is client money at the various stages of the dealing process. For illustration in the example below it is assumed that the fund's contractual settlement period is T+4 and that the manager is dealing as the principal.

Where ***<u>the investor is redeeming</u>*** and from the table in 7.6A.22 the individual client balance is the ***<u>proceeds due to the client once the client has delivered the asset</u>***. The delivery of the asset will be considered fulfilled when the units are renounced (on receipt of the documentation from the investor) and the payment to the investor is due 4 days after renunciation. It would be consistent with this view that cash receipts from the fund are received into the firm's account since the liquidation proceeds are the firms' money. In this view the fund itself may have paid liquidation proceeds to the manager but where the underlying investor has not renounced title to the asset the fund is at risk to the failure of the manager.

Where ***the investor is buying*** and from the table in 7.6A.22 the individual client balance is the ***receipt from the investor pending delivery of the asset to the client.*** Where the manager has dealt prior to the receipt of cash (this being the general case) the receipt of cash from the investor is the firm's money and should be received directly into the firm's bank account. On this understanding the manager might receive the cash as the firms' cash prior to settling the associated creation with the fund leaving the fund at risk to the failure of the firm. This is exactly the position that exists today with DVP where the manager is acting as the principal.

On the understanding set out above the impact of the removal of DVP could be limited to the requirement to hold the balance of uncashed cheques as client money. Understanding the impact of the removal of DVP is central to the understanding the impact on fund managers since it impacts the working capital requirements of fund managers, the payment flow between the bank accounts and the reconciliation methodologies.

The view set out above would require managers to hold uncashed cheques as client money. The alternative views mentioned are likely to require greater balances of client money. To date managers have used the balance representing uncashed redemption cheques to fund creations when the proceeds from the underlying buying investors have been received late. Whilst the practice of using the balance of redemption uncashed cheques is inconsistent with the aims of investor protection that are set out in the consultation paper it has shielded the fund from the impact of late settlement. By removing this source of funding, fund managers will need to consider whether their requirements for working capital are within their financial capacity to deliver and, where this is not so, will have to explore the alternative of removing themselves from the payment chain altogether.

A manager could remove themselves from the payment chain by operating as an agent and arranging the payment flows directly between the fund and investors. This is a significant change to common UK market practice and one that we suspect will lead to many other issues not restricted to the protection of client assets so should not be implemented in haste. There are benefits to consumers of the manager acting as a principal in the dealing activity.

It is difficult to estimate the impact on systems and processes (and with it the cost and time scale) without understanding the precise requirements for those systems from the consultation paper. However we believe that the primary requirement from the consultation paper is for fund managers to maintain a holistic client money balance in real time. This would be huge undertaking and in our view both unnecessary and disproportionate. The vast majority of fund managers systems whether in-house or outsourced do not do this in the way envisaged by the FCA. Such a requirement, which would be unique to the UK, could reduce the competiveness of UK funds and lead to the UK losing ground as a fund domicile – an aim of the UK Government's Investment Strategy report. We also understand that a similar client money regime is being implemented in Ireland where the industry is giving serious consideration to arranging the

payment flows directly between the fund and the investor. We believe it is important to assess the respective merits of these and similar models to maintain the competiveness of UK funds.

It is common practice that that the fund manager acts as a principal in the dealing process with investors. This means that the fund manager is buying and selling units with the fund and is also buying and selling units with the investor. The proposed removal of the DvP window for authorised fund managers has led to a number of interpretations of when money is client money at the various stages of the dealing process if the authorised fund manager is dealing as principal. For example, if the authorised fund manager has acted on client instruction and bought the units from the fund before receiving a cheque from the client, when should the uncleared funds from the investor be protected as client money? The publication of the CP has created a lively industry debate about how the cash flows should work in the absence of a DvP window but there is a wide divergence of opinion and little consensus.

Some interpretations of the required cash model indicate that the absence of the DvP model will significantly increase the working capital requirements of authorised fund managers (since they will no longer be able to use the balance presenting uncashed redemption cheques as working capital). These funding requirements may extend beyond the means of all but the largest authorised fund managers. If this were the case, some authorised fund managers would be forced to consider the alternative option of acting as an agent in the trade with the investor and arranging for the payment flows to take place directly between the investor and the fund (thereby eliminating the need for the authorised fund manager to hold client money). Such a significant change to market practice will create other risks and should not be contemplated without considering the broader impact on the market and investors.

The implications of the proposals are as follows:

Current operating model - intraday funding:

In the current DVP model the funds on the corporate account act as a buffer to the day's activity on the premise that everything will be good by the end of the day.

Thus, BACS payments being made in the morning will buffered by (rightly or wrongly) any corporate money held within the bank account, unpresented cheques, creditors, early settled subscriptions, BACS receipts, and also by the Daytime Exposure Limit (DEL) for that particular account. The Daytime Exposure Limit is an intraday limit that the bank grant a firm based on a risk assessment performed by the bank.

All of this will cease when the DVP exclusion is removed, and all this activity is paid through client money accounts and no intraday shortfall is allowed.

BACS are an obvious issue, as they will pay from the bank account immediately at the beginning of the day. However, BACS are also one of the cleanest forms of payment for the client as it's fully automatic i.e. no requirement to manually key into a banking system and no unclaimed balances as the payment has been made. Moving away from this payment method would not be in favour of the industry or the individual client.

We estimate that the industry pays **£8bn of redemptions via the BACS method per month.**

The impact is not limited to BACS. If there are any redemptions due, firms may not be able to fund these from their DEL, or have sufficient liquidity to pay until liquidation proceeds have been received.

The result would be a complex reconciliation process, as liquidation proceeds will be received per fund so could result in numerous receipts of liquidation proceeds. If a large multi-funded deal takes place, it would require an incredibly complex reconciliation to ensure receipt of liquidation proceeds for each fund prior to making the onward payment.

We estimate that the industry pays **£170bn of redemptions per year in CHAPS payments**.

For all these practical reasons, we believe that the proposals around removal of the fund manager exemption, coupled with the interpretation of the rules on intra-day settlement are impracticable, expensive and, as they stand will have a significant adverse impact on the market for little practical increase in protection for customers.

These comments on intra-day funding apply with equal force to platforms. The current banking model does not permit for real time intra day balance monitoring. The issue around intra day funding remains whether or not the fund manager exemption is retained.

Q16: Do you agree with our proposal to clarify the rule in relation to the payment of interest and introduce guidance setting out the segregation and allocation requirements of interest? If not, please provide reasons.

Yes we agree with the proposal to clarify the rule. We understand that the FCA has accepted during industry forums that 7.2.14 A R requires redrafting to permit the firm to pay interest to clients in accordance with the terms and conditions agreed.

There is also uncertainty about the typical situation where terms and conditions provide that interest is payable on, say, first of the month and interest is received by the firm throughout the month. Is it client money when received, or only when due to the client?

Q17: Do you agree with these proposals on money ceasing to be client money? If not, please provide reasons.

The proposed rule 7.2.15 R does not allow for situations where unidentified funds cannot be allocated to a client and the firm returns them to the sender within the specified timeframe. We would request that the rule is amended to reflect this.

We recommend that the policy statement should provide clarification around the *requirement to instruct or consent to any payment of client money into a bank account in the name of the client,* as this would assist firms in the prevention of fraud.

Q18: Do you agree with our proposals in relation to the transfer of client money to a third party? If not, please provide reasons.

We agree with the proposals.

Q19: Do you agree with our proposals in relation to allocated but unclaimed client money? If not, please provide reasons.

We agree with the proposals. However the general consensus of members is that £10 is too low, and a figure of £100 would be more sensible.

Q20: Do you agree that unclaimed sums of less than £10 should cease to be client money if they are paid away to charity in accordance with the proposals above? If not, please provide reasons.

We do not agree with the FCA's proposals under 7.2.19R (2) where the reasonable steps to trace a client to return unclaimed client money are too extensive and impractical (e.g. local media). Firms will be inclined not to take these extra measures in order to cease treating unallocated funds as client money
We do welcome however, the FCA's proposals, which will reduce the cost of administering small amounts of unclaimed client money. We would however, request that the proposals went further than those outlined in the paper and in particular, would ask the FCA to consider an additional category between £10 and £100, where the firm would be permitted (but not required) to pay the proceeds to charity with one attempt to contact the client but where the firm ***would*** be required to make good any valid future claims.

Q21: Do you agree with our proposal to clarify the requirements around client bank accounts? If not, please provide reasons.

We support the FCA's *intention* to clarify the rules for client bank accounts and diversification requirements. Rule 7.4.9A R is still unclear however, in terms of to whom the 20% rule applies to. It would be helpful for the FCA to set out more clearly in 7.4.9B R what is meant by a "relevant group entity."

For client money that is held by the firm and where the balance is stable then diversification is both desirable and practicable. Where the client money is transactional in nature then the requirement to diversify over more than one bank would create considerable logistical challenges, cost and execution risk. We would welcome explicit clarification from the FCA that a firm would be permitted to take into account the practical issues of execution in determining an appropriate diversification policy.

We are most concerned about diversification of operational bank accounts. These are usually embedded in regular payments systems, for settlement and are often specified in customer literature. Diversification, or even stand by arrangements, for operational/transactional bank accounts is deeply problematic in conception. They can't just be switched on as is possible with client balances accounts. We appreciate that events such as the Nat west imbroglio can occur, but they are extremely rare, and we do not see how a standby account would have been a particular help in the interim.

For transactional/operational client money balances, diversification may result in increased operational risk associated with the transfer of these monies to/from clients. These balances are typically held for a short period of time and linked to inward receipts from clients or outward payments to clients. A firm will usually make payments to clients via a recognised payment scheme, to which, access will be provided by the bank they hold operational accounts and associated banking systems with. It would be expected that monies be held on the bank accounts to settle any payments the firm has submitted on the debiting date for those payments. In the event that these balances had been diversified, and there is an issue in the funds being returned from the counterparty used for diversification to the operational banking provider on the payment debiting date, it is likely to result in payments not being processed and monies failing to be paid to clients.

The extent of the difficulties in undertaking risk assessments of a bank that is being proposed for firms' client money accounts should not be underestimated. We understand that competition and EU law would preclude the FCA of identifying suitable institutions for these accounts but the requirements placed on each firm to risk assess the banks must be realistic and practicable. The additional requirements set out in 7.4.9 are very broad and are open to interpretation without any certainty that they achieve any more than the existing rules. For example, specific guidance on what the FCA believes to be "financial soundness of the third party" would be helpful.

Q22: Do you agree with our proposal to prohibit the use of unbreakable term deposits? If not, please provide reasons.

No, we do not.

We accept that the use of long term unbreakable deposits is inappropriate for client money balances but disagree that there should be an outright prohibition on unbreakable deposits irrespective of the term and irrespective of the terms of the investment with the investor. The difference in interest rates between cash on call and on deposit can exceed 100 basis points (bps) and any general prohibition would have a significant detrimental impact to investors.

Under current market conditions the banks advise us that that moving from call to say 95 day or longer can mean up to 50 to 60bps. On UK client money balances of £100 bn a prohibition on deposits other than on call (and that is what a ban on unbreakable deposits would mean) would come at a potential annual cost of £500 to £600m. In the longer term, when normal yield curves re-appear we could see greater differences. This is a very high price for customers and firms to pay. The proposals would also adversely affect banks, as call money has little value on the balance sheet.

We understand from the banks, that in the interest of not placing further stress on the banking system, that they would break term deposits in the circumstance of a primary pooling event. Given the cost of the proposals and the attitude taken by the banks, we urge that this proposal is dropped or radically recast.

Moreover, under current proposals, we suspect that only banks would be able to offer clients a cash ISA product that is competitive.

As we explained when we met, many firms do not consider that where a customer instructs that client money be placed in a FTD that this should continue to be treated as client money under CASS 7, provided equivalent protection has been put in place through other means.

In addition, as FTDs are a permitted investment for SIPPs under HMRC rules, we understand that the FCA prohibition on investing in FTDs will not apply to SIPPs although we cannot see this reflected in the draft rules. However, if SIPPs are required to include interest earned on such investments in daily internal and external client money reconciliations then the effect of the extra work involved could have the same effect as prohibition.

As requested we set out a legal view on the proposal:

Fixed term deposits as an asset class

A number of platforms, fund managers and other intermediaries provide a cash management service to their clients. For example, a provider of a General Investment Account or a SIPP may facilitate investment into fixed term deposits acting on the instructions of their client or their investment adviser. Equally, a fund manager may be given a mandate that specifically permits investment of cash into fixed term deposits as part of a wider investment mandate.

In both cases it will be impracticable (if not impossible in the case of a SIPP) to place the deposit in the client's own name as that would require the bank to carry out KYC and other checks before accepting the deposit. The only practicable option will be to place the funds on deposit whether in the name of the firm or a nominee of the firm or an outsourcing service provider or its nominee. In almost all cases, the client will select specifically the deposit-taker(s), the maturities and the interest terms that should apply to such deposits, and will have agreed to their money being held until maturity without the possibility of an earlier return. Firms will generally consider their Principle 10 obligations in protecting such monies in the event of a primary pooling event and will seek to ensure that the risks involved are adequately disclosed to clients requesting this service.

It is the view of many firms that such a service falls outside the scope of the client money rules under CASS 7 (as this does not relate to MiFID business or designated investment business), and it would be extremely helpful if the FCA could confirm this. Due to the FCA's comments, some firms are under the misapprehension that any money placed on deposit by a firm for its clients that is not held in the client's own name, must be subject to the provisions of CASS 7 and so unbreakable fixed term deposit products are unacceptable under any circumstances.

Q23: Do you agree with our proposal to clarify the existing requirements around the immediate segregation of client money? If not, please provide reasons.

No, we believe that the alternative approach could still be appropriate in some circumstances.

There are a number of industry interpretations in defining what is client money in the absence of the DvP window. If, for example, the fund manager (dealing as principal) has acted on client instruction and bought the units from the fund before receiving a cheque from the client, when the cheque has been received from the client, should the uncleared funds be protected in the client money account? Arguably, this is money owed to the fund manager and therefore not client money. In this scenario, should funds be transferred directly into the operations account?

Until there is further clarity from the FCA about how the cash model should operate without the DvP window, we are of the view that the immediate segregation of client money is not always appropriate for a fund manager dealing as principal. It would be helpful for the FCA to clarify in its rules, the scenarios where immediate segregation of client money is not necessary, so that there are not widely diverging interpretations of the rules across the industry.

Q24: Do you agree with our proposed clarification of how client money

segregated into units in a QMMF should be treated? If not, please provide reasons.

We agree with the proposed clarification.

Q25: Do you agree with our proposals in relation to physical receipts and the allocation of client money? If not, please provide reasons.

Again, we support the principle that firms should segregate physical receipts of client money promptly in a client money bank account and should not use client money that belongs to other clients when they enter into transactions for a client whose funds have not yet cleared into a client bank account.

There is a risk that where a cheque is banked into a client money account, withdrawing against that amount before the cheque has cleared results in a risk to other client money balances, should the cheque subsequently bounce. The risk would arise if the cheque bounces and the firm fails.

For a fund manager the receipt of a cheque is most common after the deal was executed. If the manager's role in the trade is as a principal and the asset is delivered to the investor at the time of receipt, there is no client money requirement as a result of the cheque. This example is set out in the response to question 23. For this reason the cheque should be banked into a non-client money account. Similarly for a manager acting as an agent in the trade (e.g. an ISA Manager,) the firm's own money will be used for the onward remittance before the cheque has cleared and for this reason, it would be appropriate to bank the cheque in a non-client money account.

The monitoring of when a cheque clears will prove to be a significant challenge. We understand that there are different meanings of the word 'cleared" in use by the banks (e.g. for interest or cleared for onward transmission). For example we are informed that T+2 is cleared for interest (that is, firms can start earning interest on deposited cheques), T+4 is cleared for credit (that is, firms can draw against the balance) and T+6 is cleared for fate. In many cases firms find that the information provided by banks is inconsistent and frequently incomplete. For the banks "cleared" refers to the end of the business day and not intraday. If the proposal is to determine when a cheque has cleared, the uncertainty caused by poor quality information from the banks might encourage the use of an extensive "safe" period by firms to avoid criticism or sanction. This period then intensifies the financing requirements of authorised investment managers.

Cheques remain a popular means of payment, particularly for retail investors where the amount of each cheque is relatively small. As such it would be extremely unlikely that the aggregate balance of cheques bouncing would have any material impact on the overall client money resource available, if the firm were to fail. It would be a shame if the result of these proposals were to deny retail clients the availability of cheques as a valid means of payment for trading in funds because managers were unable to finance the requirement.

We agree with the 5 day requirement for the allocation of client money to an individual client on the basis that, where it is not possible for the firm to allocate client money, it is free to determine itself whether to continue with the investigation or return the money back to the sender.

For example there are often cases where advisers send money for a client without giving sufficient detail to identify the client. Although firms know that this money is client money, until the adviser gives sufficient detail firms cannot allocate the money. The new 5 business day rule will result in many firms recording breaches for this reason, even where they have made every effort to resolve the matter. In these circumstances, firms would not want to have to return the cheque after 5 business days.

Similarly, firms allocate distributions on receipt, except in un-reconciled positions. These, typically, are caused by transfers and this is unlikely to improve until standard industry messaging is introduced. Reducing the timeframe to 5 days would therefore mean that many firms would have breaches every month

We would also appreciate FCA's confirmation that where firms receive the money before we have received sufficient supporting information from the fund manager to enable the distribution to be posted accurately, then the 5 day clock start from the date of receipt of adequate information.

Upon completion of any reconciliation, monies are always credited to the client with good value. Whilst unallocated client money held in a client bank account is protected, we recognise there is the need to credit receipts to the clients' accounts as soon as possible, we would ask that the FCA consider a framework that allows a firm to resolve discrepancies with receipts to permit the correct allocation of client money as required by CASS 7.6.1R, where additional information is required.

In the circumstances we recommend a 10 day time frame with a commitment to review as automation progresses in the industry.

Again, we support the principle that firms should segregate physical receipts of client money promptly in a client money bank account and should not use client money that belongs to other clients when they enter into transactions for a client whose funds have not yet cleared into a client bank account.

However, we have a number of concerns over the proposals as drafted:

- a firm receiving a cheque from a client may often have to carry out AML and other KYC checks before conducting business with that client. Is the FCA suggesting that a firm must bank a cheque before a client has passed such checks? If so, and the client fails to pass such checks subsequently, firms will be left in a very difficult position from an AML perspective.

- the proposed wording of these provisions could create doubt as to whether it remains permissible for a firm to enter into a transaction on behalf of a client

before the client's funds have cleared, provided that the firm will fund the transaction from its own funds (and not from client money) if the client's funds subsequently fail to clear.

- many firms received cheques from both clients and providers that are made out to incorrect or even non-existent legal entities, or where it is not clear what the cheque relates to. It would be useful if the FCA could provide some guidance on whether such cheques should also be deposited promptly into a client money bank account or whether it would be permissible for firms to (a) make further enquiries before depositing the cheque, and/or (b) take the view that such cheques should be returned to the sender.

Q26: Do you agree with our proposals to clarify the proper use of prudent over-segregation of client money? If not, please provide reasons.

We agree with the proposals.

Q27: Do you agree with our proposals in relation to the use of the alternative approach to client money segregation? If not, please provide reasons.

As mentioned in responses to questions 15 and 25, we believe there might be circumstances when money received from clients is not always client money. We would welcome discussions with the FCA about the typical scenarios for which the usage of this approach would still be valid.

Q28: Do you agree with our proposal to clarify the requirements around how a firm should treat client money transferred to a third party? If not, please provide reasons.

We do not see how including these amounts in firms' own reconciliations would work. We would welcome clarification from the FCA on this point.

Q29: Do you agree with our proposal to allow firms to hold client money in client transaction accounts at custodians? If not, please provide reasons.

We agree with the proposal. But firms would like clarification on whether cash is deemed to belong to the firm before they physically receive it.

Q30: Do you agree with our proposals in relation to internal and external client money reconciliations and notification and recordkeeping requirements? If not, please provide reasons.

At present fund managers will usually receive cash into and pay cash out to clients from non-client money accounts. In conjunction with this, managers have been using method 2 for reconciliation (sometimes referred to as the "negative add-back method").

Method 2 permits the client money requirement/reconciliation to be performed with respect to each bank account and was, as the Consultation Paper states, introduced into the FSA rules in 2002 to accommodate firms whose internal ledger systems and business practices were arranged on a bank account by bank account basis rather than on a client by client basis. Prior to the introduction to the FSA rules in 2002, the bank account by bank account method had previously existed for firms regulated by IMRO or the PIA that adhered to the SIB rules (SIB 4.08 (1) (b)). It should be noted that around 80% of the fund manager industry uses method 2 so a change would have a dramatic impact.

Most fund managers systems remain organised on a bank account by bank account basis. Whilst the paper recognises the importance of continuing the availability of this method to such firms, there seems limited value in the requirement for an audit report or of notification to the FCA, both of which undermine the integrity of the reconciliation approach. If the FCA has observed some inappropriate practices of method 2 such as firms not providing a client by client total, the restrictions on the use of the method 2 should be targeted more closely to where the abuse originated without extension to firms that are, and continue, to operate the method appropriately.

Where systems and processes are designed on a bank account by bank account basis a lengthy redesign of these would be required to accommodate the proposed change. It would also restrict the ability to operate ***different*** systems across the scope of the firm (possibly due to different products or different administrators) since the requirement to operate a client by client total becomes impracticable across different systems/ locations & products.

We therefore urge that use of either method be permitted and that if FCA are concerned about abuse that they discuss this further in more detail with the industry.

Q31: Do you agree with our proposals for the exchange of acknowledgment letters? If not, please provide reasons.

The introduction of standard template wording is a welcome proposal, but the removal of the 20 day period might expose clients to additional risk if it were it to result in no client money account being available for use.

Although we believe that if the standard wording is on anyone's letter head it should be the banks, the proposal for the letter to be on the firms note paper for counter signature by the bank is inconsistent with the purpose of the letter, which is the bank's acknowledgement that the firm is acting as trustee with respect to the account. Furthermore it is unclear how firms will be able to ensure that any signature from the bank is actually that of someone authorised to sign the letter. The production of an authorised signature list from the banks seems to introduce an additional risk of payments fraud. The proposal might also lead to disputes about the authentication of the letter.

Ensuring that client money accounts are set up correctly is fundamental to protecting client assets, yet the Consultation Paper proposes the continuation of a letter process, which has been problematic in the past. The changes to the process will in our view make the situation worse despite the use of standard wording and it continues to require large volumes of documents to be properly executed and stored/retrieved efficiently and effectively.

The introduction of standard wording facilitates an alternative, less risky and less costly method of achieving the FCA's objective through the use of technology that would permit the accounts to be identified accurately and certainty that the bank's acknowledgement was properly authorised (through access controls). We discussed this in principle when we met.

Such a solution would also provide easy accessibility to the Insolvency Practitioner of a register of client money accounts belonging to a firm.

Furthermore amendments to the template wording could be introduced quickly and efficiently also facilitating an annual update. In such a solution there would be no requirement for paper letters to be sent, filed or retrieved. We recommend that the FCA, in drafting the rules, leaves open the possibility of the adoption of such a system by the industry.

In the absence of a technology solution the requirement to "re-paper" all client money accounts will be a significant logistical challenge for firms that could not be performed within the 6 months' timescale without risking administrative chaos at the banks. An annual update to the letter will also be a cumbersome and long-winded process with limited benefit to the client.

In summary:

- We welcome the principle of standardized wording
- We have grave concerns about the account opening process and re-papering the back book
- We would like to explore new options that don't just perpetuate lots of paper flying around the market, but take advantage of current technology

Q32: Do you agree with our proposed guidance on the Part 30 Exemption Order and LME Bond Arrangements? If not, please provide reasons.

We have no comment on these proposals.

Q33: Do you agree with the proposal of clarifying the requirements around the DvP window? If not, please provide reasons.

See our earlier comments.

Q34: Do you agree with the proposal relating to unclaimed custody assets? If not, please provide reasons.

Review of the client assets regime for investment business
TISA Response to FCA CP13/5

TISA leads a cross industry group looking at Data Quality, which liaises regularly with FCA. The following sets out their comments.

1. The need within the recommendations to apply any de-minimis at client level is likely to give the firms with multiple systems considerable difficulty ***as assets are probably being reported at policy level. Note this will only apply to Product Providers rather than Funds or Investment Management firms***

2. The costs of effective client tracing and verification has not been taken into account within the recommendations. Effective tracing for live customers is likely to cost firms £20 to £30 per case and for deceased clients £250 per case. ***This should be reflected in the de minimis applied.***

3. ***The use of tracing agencies and the higher level of success they can obtain has not been highlighted in the recommendations for 'Reasonable Steps' and we feel they should be.*** Use of a tracing agency as a replacement to the 3 further attempts after the initial 28 days. Success rates of between 50% and 85% have been achieved using tracing agencies.
When firms are taking reasonable steps, we think it is important for the regulators to know what is possible with tracing. i.e. typical success rates with good data and typical success rates with poor data. That way when they are judging whether a firm has taken reasonable steps they can measure based on their achievements. ***The reference to reasonable steps is no stronger than terminology in previous rules and therefore goes no further to protect client's money. We know from what we see in the industry, that reasonable steps to one is completely difference to another and in our opinion leaves consumers without a fair and reasonable approach.***

4. ***It is not practical to 'place an advertisement in local media' as part of 'Reasonable Steps'.*** Would this advertisement be a generic one or specific to the client? If it was generic we can't see what benefit it would bring and if specific to client, we can see that it would open the doors to 'ambulance chasers' and potential fraudsters. Suggesting firms use media advertising, seems to me like an entirely inadequate means to solving this problem, this is evidenced in the comparatively low levels of effectiveness of other reunification campaigns that have focused on advertisements. This method is also not suited to deceased people. Evidence of the ineffective nature of this is NS&I activities and my lost accounts. High cost, high operational requirements and very low levels of reunification.

5. ***The recommendations do not include any indication as to an acceptable level of success in tracing clients with unclaimed assets and we feel this would be helpful.***
The recommendations do not include any MI requirements for reporting unclaimed assets, but from my industry group work, this should follow at a later date. Timescales here are unclear.

6. ***It is concerning that there is no reference or consideration given to the fact that assets owners may be deceased and are therefore unable to respond to letters and media adverts.*** As we know a straightforward and

low cost solution to this is mortality screening, followed by proactive action to trace the legal heirs.

Q35: Do you agree with our proposal to limit the circumstances where a firm may register or record legal title to its own applicable assets in the same name as that in which legal title to client safe custody assets are registered or recorded? If not, please provide reasons.

At the TISA meeting with the FCA on 23rd September, we were led to believe that company assets registered in the same nominee as client's assets but under a different designation would not be acceptable (5.19). We fail to see the logic in this, as a separate designation should be sufficient to allow the firm's assets to be clearly distinguishable from any clients. For a firm to establish a relationship with an additional custodian or open and maintain a different nominee company to satisfy this rule is neither cost nor time effective. We would urge you to consider the use of designations to satisfy this requirement.

Q36: Do you agree with our proposals for requiring written custody agreements and clarification on the terms and details, which ought to be included? If not, please provide reasons.

We support the proposals in principle, but would like further clarification.

Q37: Do you agree with our proposals to provide the two different methods for the internal custody assets reconciliation? If not, please provide reasons.

We agree that it is important that the rules accommodate firms that operate an integrated system and those that do not.

We believe an integrated approach is the less risky of the two methods and as a result, see no purpose in the requirement for an audit report or of notification to the FCA when the least risky approach is adopted. Proposing an additional requirement to the less risky approach is illogical and serves only to undermine the integrity of this approach. If the FCA has observed some inappropriate practices with the "evaluation" methodology then these should be addressed directly in the rules.

The internal system evaluation method does not deal with the situation where a firm deposits all of its assets with a third party under CASS 6.3, whilst still being responsible to the client for those assets, and both parties share the one integrated record. In this situation then the firm would still be in breach of CASS 6.5.6A. We are not sure how common this situation arises in practice.

Q38: Do you agree with our proposals in relation to the provision of an auditor's report before a firm can use the internal evaluation of custody records system method? If not, please provide reasons.

No, we do not. We believe that it the firm's responsibility to ensure adequate systems and controls and for the auditor to give an opinion.

Q39: Do you agree with our proposals in relation to physical custody reconciliations? If not, please provide reasons.

We agree with the proposals.

Q40: Do you agree with our proposals in relation to the provision of an auditor's report before a firm can use 'the rolling stock' method? If not, please provide reasons.

No, we disagree on the grounds we set out above. It a firm's responsibility to have adequate systems and controls, which should be documented. It should be the auditor's responsibility to give an opinion to you on whether the controls are adequate and draw your and the firm's attention to any problems.

Q41: Do you agree with our proposals for frequencies of custody reconciliations and those relating to the handling of discrepancies? If not, please provide reasons.

The clarification of the requirement to perform custody reconciliations re-introduces the requirement to reconcile custody positions to the fund manager registers in circumstances where a firm does not use a sub-custodian. The wording of the rule refers to the third party responsible for the registration of title to safe custody assets. This definition includes both MiFID instruments and other designated investments e.g. life policies. We are not sure whether insurance companies would be able to meet these requirements. Similarly, there may be other contractually based investments where the providers could not provide the required information.

Many firms, particularly platforms, will carry out transactions in units in CIS on a daily basis. However unlike CREST, we cannot get daily feeds of information from CIS Third Party Administrators, currently there is not even a common format across administrators for providing this information. Does FCA acknowledge this limitation on firms' ability to conduct external reconciliations on CIS funds more frequently than once every 25 business days?
Under current FCA rules, firms are only required to make good a shortfall where there are reasonable grounds for concluding that the firm is responsible. Although it would not appear that it is FCA's intention to change this, the new rule 6.5.10B requires a firm to make good the shortfall and makes no provision for exceptions. This is only mentioned in the guidance at 6.5.12G.
We would also appreciate confirmation that although firms are required to make good a shortfall immediately, they will be able to re-check the reconciliation to establish that there is indeed a shortfall before they do this.

Q42: Do you agree with our proposals to require firms to document their own internal policies and procedures for their custody reconciliations? If

not, please provide reasons.

We agree with the proposals.

Q43: Do you agree with our proposals in relation to TTCA? If not, please provide reasons

We agree with the proposals.

Q44: Do you agree with our proposed requirements on reporting to clients on their holdings of client assets? If not, please provide reasons.

No. See our response to Q45

Q45: Do you agree with our proposals around the information that firms should be required to provide to clients about their holdings of client assets? If not, please provide reasons.

Some firms will hold client money as part of their product offering. Other firms e.g. fund managers hold client money in a purely transitory and temporary manner pending the successful transmission of those funds to the client. Through the removal of the DvP exemption, fund managers will hold client money balances for more clients in respect of fund transactions and the implication here is that such balances would be reported to clients on the statement envisaged to provide greater transparency. However, we suspect that the requirement will create more confusion with clients, particularly if there are a number of temporary balances to fund transactions. There is also the challenge of incorporating client money balances that are cleared/uncleared funds. We would appreciate some guidance on how this requirement could be delivered in a manner that is fair, clear and not misleading.

Q46: Do you agree with our proposals for the introduction of a Client Assets Disclosure Document? If not, please provide reasons.

We do not agree with the proposals for the introduction of a Client Asset Disclosure document, particularly the requirement to re-issue this each year. Appropriate detail should be provided in the customer terms and conditions. In addition, we could add further wording into the statements that we issue signposting to where customers can get further information e.g. on a website. We do agree that customers should be informed of any changes to their Terms and Conditions in this area.

We support the aim for clarity and communication. However the costs of introducing further documentation that is stand alone, delivered prior to any transaction being conducted and on an annual basis thereafter, is disproportionate to the value that investors will extract from it.

Some firms, e.g. fund managers, only have client money as a result of transactions and only hold client money pending payment. We can see limited value in extending the requirement to this group.

Platform members strongly opposed this proposal. They already give regular reporting to clients and this would likely be more expense and confusion with little benefit for clients.

Q47: Do you agree with our proposal to bring 'non-written' mandates into the scope of CASS 8? If not, please provide reasons.

We agree with this proposal.

Q48: Do you agree that our proposed changes will ensure that CASS is compatible with the EMIR RTS? If not, please provide reasons.

We do not know if this is the case.

Q49: Do you agree with the approach of replacing the existing client assets sourcebook with a new sourcebook? If not, please provide reasons.

In principle, it would be desirable to have a new sourcebook with all the rules in one place. However, a number of members expressed concern about the implications for customer literature where existing rules are referred to by number. There are still some significant areas where we believe the FCA should withdraw the proposals pending further consultation, or where they need further discussion. In these circumstances, we believe a decision can wait.

Q50: What are your views on the benefits and costs of the proposals? Please provide explanations and qualitative evidence to support your response where appropriate.

We do not believe the Cost Benefit Analysis has adequately captured the costs in the following areas:

1. Unbreakable deposits, where the proposals as they stand could cost the industry several hundreds of millions of £.
2. The funding costs on fund managers consequential on the removal of the fund manager exemption,
3. The implications of potential changes to the ways fund managers, funds and their customers will inter-act if the proposals are implemented
4. The cost of implementing the proposals on reconciliations.

TISA would be pleased to help the FCA obtain a better understanding of the costs and implications of their proposals.