TISA

Response by TISA: FCA Dear CEO, we expect you to act to prevent harm to your clients – 12 August 2020

Graham Bateman, Regulation Executive, TISA

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About TISA

The Investing and Saving Alliance (TISA) is a unique, rapidly growing membership organisation for UK financial services.

Our ambition is to improve the financial wellbeing of all UK consumers. We do this by focusing the convening the power of our broad industry membership base around the key issues to deliver practical solutions and devise innovative, evidence-based strategic proposals for government, policy makers and regulators that address major consumer issues.

TISA membership is representative of **all sectors of the financial services industry.** We have **over 200-member firms involved in the supply and distribution of savings, investment products and associated services**, including the UK's major investment managers, retail banks, online platforms, insurance companies, pension providers, distributors, building societies, wealth managers, third party administrators, Fintech businesses, financial consultants, financial advisers, industry infrastructure providers and stockbrokers.

As consumers, the financial services industry and the economy react to and recover from the effects of the pandemic, the importance of the three key pillars of work that TISA prioritises has never been more apparent:

- **Strategic policy initiatives that influence policymakers** regarding the financial wellbeing of UK consumers & thereby enhancing the environment within which the industry operates in the key areas of **consumer guidance, retirement planning, later lifetime lending, vulnerable customers, financial education, savings and investments**.
- TISA is recognised for the **expert technical support provided to members** on a range of operational and regulatory issues targeted at improving infrastructure and processes, establishing standards of good practice and the interpretation and implementation of new rules and regulations covering **MiFID II, CASS, ESG/RSI, operational resilience, Cyber Risk, SM&CR** and a range of other areas.
- **Digital transformation initiatives** that are driving ground-breaking innovation and the development of industry infrastructure for greater operational effectiveness and revenue promoting opportunity for firms. TISA has become a major industry delivery organisation for consumer focused, digital industry infrastructure initiatives – **TISAtech** (a digital marketplace that brings together financial institutions and FinTechs for greater collaboration and innovation) and **TURN** (TISA Universal Reporting Network – a digital platform providing a secure data exchange for financial services using blockchain technology) – alongside projects **Digital ID** and **Open Savings & Investment**. This reflects TISA's commitment to open standards and independent governance.

In response to the expectations on firm's relevant Senior Managers considerations on holding client money balances which are unlikely to be reinvested in the short term or returned back to the client.
A number of our members have expressed significant concern with the continued decline in bank appetite for client money deposits. This includes examples where our members have received notice from their banking counterparties of the intended closure of their accounts, the introduction of fees that make account retention uneconomical and the levying of negative interest rates. As noted by the FCA in PS18/2 in January 2018, there are a number of reasons for this:

- Cost of liquidity requirements for client money deposits, in particular instant access deposits and 30 day term deposits;
- High levels of general liquidity in the banking system; and
- Low interest rates.

Since PS18/2 was published the level of liquidity in the banking system has increased and interest rates have further reduced (0.5% to 0.1%). Adding to this, we are aware of regulatory pressure from both the PRA and FCA targeted at banks and firms respectively, which is resulting in banking appetite for client money deposits decreasing further.

We are aware that a number of firms have been asked to reduce the value of client money they are holding on terms of between 31-95 days. As a result, demand for instant access and 30 day term deposit products has increased. This also at a time where many firms are considering the prospect of increasing the value of client money held in term deposit accounts in an effort to offset the potential impact of negative interest rates e.g. the need to pass on interest rate charges, or increasing the fees charged to consumers .

The PRA, as highlighted in their Statement of Policy on Pillar 2 Liquidity, have expressed concern with the value of deposits held by banks on 30 day notice and the cliff risk this introduces. As a result, a number of our members have been informed by their banks of a need to reduce the value of client money held in these products by year-end. We understand the PRA's concerns around cliff risks, though we are also aware, based on the feedback that we have received, that over the COVID-19 disruption period (March - September 2020) there has been limited notice served on 30 day client money accounts and the value of client money held on deposit has actually increased.

The market in 30 day term deposit accounts developed in part to meet the requirements of firms that hold client money but struggle to find banks willing to accept it on an instant access basis. The options now for our members based on this regulatory pressure is to either increase the value of client money held in longer term deposits, which would likely lead to challenge from the FCA, or to move client money into an instant access account, which many banks have limited appetite for.

We acknowledge the FCA's recent Dear CEO letter urging firms offering non-discretionary investment services to take proactive action to return client money that is unlikely to be reinvested in the short term. Due to the low return currently achievable from low-risk investments, we are however not optimistic that this will lead to a considerable reduction in the value of client money held by investment firms, regardless of the effort made by these firms to engage with clients. It is also likely that this money will simply move from a client money account into a retail deposit account, with no resulting increase in bank appetite for client money deposits.

In contrast to the aims of the FCA's Dear CEO letter, our expectation is that in the short term the value of client money held by investment firms is likely to increase due to market uncertainty relating to the USA Elections, Brexit and COVID-19. Low interest rates, or even the prospect of negative interest rates, may also lead income-seekers to consider higher risk investment alternatives in order to maintain their level of income, resulting in the number of retail investors in the market increasing.

The immediate consequence of all of this is the potential for increases in costs/charges incurred by firms/consumers, the reduction in the level of diversification of client money bank account provision and for client money to be deposited with less financially secure banks. In the short to medium term, if the largest client money bank providers stop offering, or start limiting availability of the client money products they currently offer, it is unclear whether there will be sufficient banking capacity to meet demand.

As a large proportion of client money is held by firms within tax wrappers, or held on an execution-only basis, there are also limited options available to create capacity through the return of client money to clients, or to encourage clients to invest in alternatives to cash.

We outline below a number of options to address these concerns, though it is unlikely that a single course of action in isolation will be enough:

- The FCA and PRA to consider whether asking banks to reduce the value of client money held on 30 day term deposit, whilst at the same time asking for client money to be held on shorter terms (<31 days), is leading to unintended outcomes, including lower levels of client money account diversification and higher costs related to bank account provision.
- The FCA should consider whether the current maximum deposit term allowable under CASS (currently 95 days) should be increased to address the decline in bank appetite for client money deposits.
- The FCA and PRA to review whether the requirement to classify client money as money held on behalf of a 'non-bank financial institution' for the purposes of calculating the Liquidity Coverage Ratio continues to be appropriate (100% outflow rate), or whether in-line with our observations, that it is more appropriate to classify this money as 'non-operational corporate cash' (40% outflow rate) or even as 'retail deposits'.
- The FCA should review the CASS rulebook to consider how the current barriers to the use of Qualifying Money Market Funds as an alternative to bank deposits can be removed.
- The FCA to consider what contingency options are available in the event that firms are unable to obtain sufficient, or appropriate client money account provision. For example, asking the Bank of England to relax the eligibility criteria for opening an account with them in the event that alternative client money account provision cannot be obtained.
- The FCA should consider whether the options available to firms under CASS for the placing of client money (derived from MiFID) could be expanded post-Brexit where equivalent client protection outcomes can be achieved.

There is a real need to take immediate action, both to address the short term challenges currently being faced by our members and to find a long term solution that meets the needs of banks, client money account holders, consumers and both the FCA & PRA.

We would welcome the opportunity to discuss this with you in more detail on behalf of our members.