



04 October 2013

Our ref: ICAEW Rep 142/13

Your ref:

Banking Reform Bill Team  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

Dear Sir or Madam

**Banking Reform: Draft Secondary Legislation**

ICAEW is pleased to respond to your request for comments on *Banking reform: draft secondary legislation*.

We have significant reservations about the proposed certification regime for 'high net worth' individuals. ICAEW is doubtful whether the regime, as currently specified, is capable of working in practice.

We would like to meet with you to explore how our concerns might best be addressed. In the meantime, please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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Manager, Risk and Regulation

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## ICAEW REPRESENTATION

### **BANKING REFORM: DRAFT SECONDARY LEGISLATION**

**Memorandum of comment submitted in October 2013 by ICAEW, in response to HM Treasury and the Department for Business, Innovation and Skills' consultation paper 'Banking reform: draft secondary legislation' published in July 2013**

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## INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *Banking reform: draft secondary legislation* published by HM Treasury and the Department for Business, Innovation and Skills in July 2013, a copy of which is available from this link [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/223566/PU1488\\_Banking\\_reform\\_consultation\\_-\\_online-1.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/223566/PU1488_Banking_reform_consultation_-_online-1.pdf)

## WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 140,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
4. This representation has been prepared jointly by the Audit and Assurance Faculty and the Financial Services Faculty. The Audit and Assurance Faculty is a leading authority on external audit and other assurance activities and is recognised internationally as a source of expertise on audit issues. It is responsible for technical audit and assurance submissions on behalf of ICAEW as a whole. The faculty membership consists of nearly 8,000 members drawn from practising firms and organisations of all sizes from both the private and public sectors. Members receive a range of services including the monthly Audit & Beyond newsletter.
5. The Financial Services Faculty was established in 2007 to become a world class centre for thought leadership on issues facing the financial services industry acting free from vested interest. It draws together professionals from across the financial services sector and from the 25,000 ICAEW members specialising in the sector and provides a range of services including a monthly newsletter FS Focus.

## MAJOR POINTS

6. ICAEW has significant doubts about the conceptual basis for the certification regime for 'high net worth' individuals and about whether it is capable of being put into practical effect.
7. We are of the view that the most appropriate 'cut off' to define 'high net worth' is a threshold considerably above the proposed figure of £250,000.
8. The paper does not make clear why declarations of high net worth need to be countersigned by a third party (an accountant) rather than evaluated by the bank at which an individual wishes to make a deposit outside the ring fence.
9. It is most unlikely that accountants or other professionals would be willing positively to attest that an individual meets the definition of 'high net worth'. That is because in the case of some individuals a great deal of work would be needed to establish to a high level of confidence whether or not that was the case.
10. However, if it were clarified that the primary responsibility for making a declaration would lie with the person making it, accountants might be able to provide a degree of assurance regarding the veracity of the declaration made.

11. Even so, it would need to be clarified how much work an accountant would typically be expected to do in order to support their opinion. This is important as for people with complex affairs extensive procedures undertaken by an accountant would be expensive.
12. Limiting counter signatories to 'chartered accountants' looks unreasonably restrictive.
13. The definition of 'net worth' to be used in establishing whether an individual exceeds the specified threshold does not look fit for purpose.
14. In our opinion, the proposed extension of high net worth status to a range of family members looks overly broad, and in our view should be limited to – at most – spouses and civil partners who manage their financial affairs substantially in common. However, it is arguably dangerous to base policy on assumptions about family relationships, which vary enormously.

## **RESPONSES TO SPECIFIC QUESTIONS**

### **Q4: Do you agree with the proposed threshold of £250,000?**

15. Any threshold used to define who is a 'high net worth' individual is bound to be somewhat arbitrary, and there is no 'right' answer.
16. In the present context 'high net worth' appears to be used as shorthand to refer to someone of reasonable financial knowledge who is capable of evaluating the risks and rewards of depositing outside the ring fence. We are concerned that the threshold of £250,000 may be too low for that purpose. Particularly in view of the level of house prices in parts of the UK, it is quite possible that some people will have bank deposits in the region of £250,000 as a result of 'down-sizing' their accommodation, or as a result of a legacy, without being at all knowledgeable about financial matters.

### **Q5: Do you agree with the proposed method of certification for high net worth individuals?**

17. We do not agree, and have strong concerns about the proposals.
18. The paper does not make clear why the Government is not proposing that verification of high net worth status should be undertaken by the banks themselves. This could be done as an adjunct to the 'know your customer' due diligence which they have to undertake.
19. However, if the Government considers that certification from a party other than the banks is required then the points below should be taken into account in designing the regime.

### **Respective responsibilities of persons claiming high net worth status and accountants**

20. We believe that it should be made clear in the Statutory Instrument that the primary responsibility for assessing whether or not the definition of high net worth is met lies with the individual concerned. The fact that their declaration is required to be countersigned by an accountant should not be allowed to obscure that responsibility. This is relevant to the kind of opinion an accountant is likely to be able to offer.

### **Form of opinion**

21. Accountants (and other professionals) are unlikely to be comfortable signing a categorical statement along the lines of 'I am satisfied that [someone is] a high net worth individual'. This suggests a very high level of certainty as to the position, which in the case of individuals with complex financial affairs may be difficult – or at least very costly – to obtain.
22. Assuming it will be made clear that the primary responsibility for declaring high net worth status lies with the person making the declaration, it might be possible for accountants to offer

a 'limited assurance' opinion along the lines of 'nothing has come to my attention to cast doubt on the declaration made'.

### **Work to be undertaken**

23. The proposed report states that the countersigning chartered accountant has 'investigated' the assets of a person so as to be satisfied that they are properly claiming to be 'high net worth'. But no definition of 'investigate' is provided. While some people have straightforward affairs such that this process should present few difficulties, those of others can be highly complex. Clarification would be needed as to how far an accountant would normally be expected to carry their investigation.
24. For instance, it might not always be clear whether a broker's statement related to assets over which an individual has absolute ownership as opposed to acting, for example, in a trustee capacity. Material holdings of assets which cannot readily be valued, such as investments in unquoted equities or jewellery, would present difficulties. And there could be privacy concerns if there was a sense that an accountant was required to undertake an exhaustive investigation.

### **Who should be able to countersign a declaration**

25. As generally understood, the expression 'chartered accountant' excludes the members of some accountancy bodies, such as ACCA and many overseas accountancy bodies. We assume that this is unintentional.
26. We also note that not all individuals who meet the proposed definition of 'high net worth' will have a business relationship with an accountant. However, they may have such a relationship with another professional with financial expertise, such as a financial adviser, stockbroker, or a solicitor practising in areas requiring financial knowledge.
27. Costs for those seeking to have their high net worth declarations countersigned are likely to be minimised if this can be done by any appropriately qualified person. It is, however, of paramount importance that only people who are independent of the person making a declaration are permitted to countersign.
28. Taking the points in paragraphs 25-27 together, we recommend that the Statutory Instrument specifies who can countersign along the following lines:

'The declaration must be countersigned by a person who: (a) is independent of the individual to whom the declaration relates; and (b) can evidence the financial skills and knowledge required to assess whether that individual is 'high net worth', having regard to the complexity of that individual's financial affairs.

The relevant financial skills and knowledge may be evidenced, for example, by membership of a professional accountancy body'.

### **The definition of 'high net worth'**

29. While the definition proposed appears to be similar to one already used by financial services regulators (for example in the context of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005), we do not regard it as fit for the present purpose.
30. The principal problems are that it includes no definition of 'free and investible' assets, and that it takes no account of liabilities.
31. There is considerable scope for debate as to meaning of 'free and investible'. Some might construe this concept narrowly, and count only cash and near cash assets. Others might argue that almost any kind of asset for which there is a reasonably deep and liquid market is

potentially 'free and investible'. Thus they might include assets such as residential property held for investment purposes ('buy to let').

32. The apparent lack of account taken of liabilities obscures the point that someone could have gross financial assets in excess of £250,000, but little net worth, for example if they had significant mortgage debt and little equity in their home.
33. It is also not clear how contingent liabilities should be taken into account – for example where a parent has provided a guarantee for a mortgage loan advanced to one of their children, or in the case of someone involved in divorce proceedings where it is expected that a significant share of assets will pass to a (former) spouse.
34. A further challenge concerns small businesspeople, given that the boundary between their personal and business finances is often permeable.
35. We also note that the requirement to measure net worth at the end of each month, and then to average the results to obtain an annual figure, has the potential greatly to increase the costs of the process, especially for individuals who re-allocate their assets frequently. The proposal amounts to saying that a balance sheet for the individual should be prepared monthly, which is an onerous requirement.

**Q6: Do you agree that family members of certified high net worth individuals should be able to bank outside the ring-fence? Do you have any views on the proposed method of certification for family members of high net worth individuals?**

36. The Government's proposal appears to be that where an individual is 'high net worth' a reasonably wide range of members of their family should also be allowed to bank outside the ring fence. We believe that to be appropriate in only limited circumstances.
37. We can see the logic of the proposal in the case of spouses and civil partners who genuinely operate their finances on a joint basis. In such circumstances if one partner is 'high net worth' then the other must be as well. That said, we do not think it would be reasonable to expect an accountant (or other professional) to come to a view about whether a couple did, in fact, operate their finances substantially in common, not least as this is something about which it would be challenging to assemble formal evidence.
38. However, the proposal is not compelling if each partner manages their assets on a largely separate basis. Pre-nuptial arrangements and any other agreements which could limit the access of one partner to the resources represented by 'high net worth' could also be relevant.
39. We question the idea that where an individual is 'high net worth', that should allow such a person's parents and children to bank outside the ring fence. There is no necessary relationship between a person's wealth and that of their parents. As regards children, it is generally accepted that special care should be taken to protect the assets of minors from loss.
40. The consultation paper refers (p10) to high net worth individuals being prepared to support (certain classes of) relatives. While that may be the case as regards children, for wealthy families in particular the picture may be complicated by factors such as trust arrangements. And we certainly do not think such support can necessarily be relied upon by the parents of a high net worth individual.

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