



29 June 2010

Our ref: ICAEW Rep 54/10

Your ref:

Ric Wilding
Prudential Banking and Investment Business Policy
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Dear Mr Wilding

CP 10 / 09 Enhancing the Client Assets Sourcebook

ICAEW is pleased to respond to your request for comments on consultation paper 10/09
Enhancing the Client Assets Sourcebook.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

ENHANCING THE CLIENT ASSETS SOURCEBOOK

Memorandum of comment submitted in June 2010 by the ICAEW, in response to the Financial Services Authority's consultation paper 10/09 Enhancing the Client Assets Sourcebook published in March 2010

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper 10/09 *Enhancing the Client Assets Sourcebook* published by the Financial Services Authority.

WHO WE ARE

2. ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure these skills are constantly developed, recognised and valued.

MAJOR POINTS

Support for the initiative

4. We note that some firms may need to put additional procedures in place to complete the CMAR on a regular and timely basis. While we would expect the information to be available it is possible that changes to procedures may need to be made to obtain the information in the format requested by the CMAR. We would thus suggest that a reasonable period of time is set between the finalisation of the revised rules as a Policy Statement and the date of the first submissions of the CMAR. We would hope these submissions would also be appropriately incorporate into the GABRIEL reporting system.
5. We note the desire on the part of FSA to make a number of elements of CASS which are currently guidance into rules. While in principal we have no major concerns over this we note that in many cases the wording of the guidance may need to be suitable amended and that this is not just a process of changing a 'G' to an 'R'. While FSA's recent fines in respect of client Assets breaches is a clear indication of the concerns FSA has in this area the opportunity should also be taken as part of these changes to emphasise FSA's future expectations of firms and the reasons for these changes.

RESPONSES TO SPECIFIC QUESTIONS/POINTS

1: Do you agree that existing CASS record-keeping requirements are sufficient? If not, please outline where you consider these could be enhanced.

6. We would support maintaining the current CASS record keeping requirements in respect of client money and custody assets.

2: Do you agree with our proposed glossary definitions regarding prime brokerage as stated above?

7. No comments.

3. Do you agree that we should introduce a requirement that the re-hypothecation clauses be summarised in a separate annex to the PBA and/or other relevant contractual documentation which contains such provisions?

8. We understand the desire to make clients better aware of the implications of the details set out in the prime brokerage agreements they enter into and accept that the requirement to 're-paper' agreements and include an annex on the effects of re-hypothecation is a means of achieving this. We would suggest that for the avoidance of doubt appropriate cross reference is included in the rules between CASS and the sections of COBS dealing with client agreements.

4: Are there any other transparency and/or disclosure issues we should consider?

9. None.

5: Do you agree that we should introduce a requirement that prime brokers offer daily reporting to all clients?

10. If daily reporting is now being carried out by many Prime Brokers as 'market practice' then we see no reason not to incorporate this as expected practice within the rules.

6: Do you agree that we should require that the daily report contain at the least, the cash value of the following:

- cash loans and accrued interest;
- securities to be redelivered by the client under open short positions;
- current settlement amount to be paid under any futures contracts;
- collateral held by the firm in respect of securities transactions, including if the firm has exercised a right of use in respect of safe custody assets;
- short sale cash proceeds held by the firm in respect of the short positions;
- cash margin held by the firm in respect of open futures contracts;
- mark-to-market close-out exposure of any OTC transaction secured by safe custody assets or client money;
- total secured obligations;
- all other safe custody investments held for that client;
- the location of all safe custody assets, including the sub-custodian where the assets are held; and
- a list of the institutions at which the firm holds or may hold client money including money held in client bank accounts and client transaction accounts.

It is unclear to us why a daily report of institutions where the firm 'may' hold client money is required but accept that for completeness this may be appropriate.

7: Do you consider that the content of the report provides clients with enough information to manage their exposures?

11. Whether the proposed contents set out in question 6 would provide a client with enough information to manage their exposures depends on the transactions the client undertakes and the form of records they maintain. However, we note that the contents in question 6 is set out as a minimum and would expect a client to be in a position to request such information as they consider necessary to manage their exposures.

8: Do you agree that this report should be made available to clients on a daily basis?

12. We are unclear whether the intention is to introduce a rule in CASS which requires prime brokers to send client a daily report or a rule which requires than to offer clients a daily report, the clients then having the option to request less frequent reporting. We support the approach that a report should made available on a daily basis to the client but believe that the client should have an option of choosing to receive such reports on a less frequent basis

9: Do you agree that we should impose a 20% maximum limit on intra-group client money deposits in client bank accounts and that we should change existing guidance into a rule? Do you have views on alternative limits?

- 13.** We accept the possible contagion risk created by holding client money intra-group and recognise FSA's desire to reduce this risk. In principle we support the approach of spreading the holding of client money. We are concerned, however, by the limit of 20%. It is less than the large exposure limit under the current rules and we would have expected to see a similar limit. In theory with 20% held at intra-group banks then a firm could place 80% or more with a third party bank which may or may not be of greater risk. Is it FSA's intention to set an overall restriction on the percentage of client money that may be held with any one non-group bank or banking group? If so then such a requirement should also be included within these rules at this stage so as to avoid firms having to revise their client money systems more frequent than necessary.
- 14.** We also have some concerns over the operation of this limit. If it is 20% then is this 20% of the client money held according to the cash book (the firm's records) or is it the amount held according to the bank statements (the banks' records). We would assume the former as this is the amount which the firm has control over, but clarification would be helpful.
- 15.** We are also concerned with two other aspects of the operation of this requirement. First, is this an 'end of day' limit or is it intended to apply 'intra-day'. Second, consideration should be given to the implications where a firm receives a significant sum of client money into an intra-group client money account as part of its normal day to day business and which is then applied appropriately in accordance with the clients' wishes, which may happen before the end of the day or may take a day or two to complete. What is the implication of such 'temporary' breaches of the limit? We could see a situation where a strict interpretation of the limit could result in a firm being expected to transfer such amount to a non-group client money account and then back a day or so later to make payment for the appropriate investments and all the additional (client?) costs this may involved. It may be that the proposals re 'transaction' accounts referred to in question 11 below could cover such circumstances.
- 16.** We would suggest that FSA consider whether there should be the opportunity for clients to elect to allow a firm to keep their money with an intra-group bank if the additional risks are appropriately explained to them.

10: Will a 20% limit impact on your firm's liquidity. If so, how?

17. No comments.

11: Do you consider it is appropriate to exclude client money held in client transaction accounts?

18. In principle, yes, as a firm will often need to have funds in a specific bank account to settle a transaction. The inference is that to qualify for this 'exemption' the firm would need to operate both a 'transaction' client money accounts and a 'free' client money account and make appropriate transfers into the transaction account. It may be that to ensure this operates as expected further rules are required around when transfers can / should be made to and from the transaction account.

12: We also invite your views on amending all the guidance currently contained within CASS 7.4.9G into a rule.

19. If CASS 7.4.9G is to become a rule then consideration may need to be given to redrafting certain aspects. For example the phrase "a firm should also consider, together with any other relevant matters..." is fine for guidance but is somewhat open ended for a rule. Otherwise we would have no objection to CASS 7.4.9G becoming CASS 7.4.9R. We would, however, ask FSA to consider whether some of the current guidance may be better emphasised as 'Evidential' provisions in the rule book.

13: Do you agree that we should introduce a rule prohibiting the use of general liens in custodian agreements and amending existing guidance to clarify our requirements?

20. It would be helpful to see more detail of the FSA's analysis around client transaction accounts before commenting on this issue. However, in principle, it seems appropriate to exclude transaction accounts from the limits.

14: Do you think that we should go further and prohibit all liens in custodian agreements?

21. No, see response to question 13 above.

15: Do you foresee any unintended consequences in implementing this proposal?

22. No.

16: Do you agree that we should establish the CASS oversight controlled function?

23. We support the creation of a CASS oversight controlled function. It is often difficult for the auditor to identify someone within a firm who has an overall view of the client money and custody assets operations of the firm and we believe this proposal will assist in this matter.

17: Do you agree that one person within the firm holding the controlled function should have ultimate oversight and control?

24. Yes and be supported by and have access to, the Board in that oversight and control.

18: Do you agree with our stratification of firms as small, medium and large with regard to client money and/ or asset holdings? If not, please provide us with your thoughts as to an appropriate method of stratification.

25. We accept that some form of stratification is appropriate. We have concerns over whether the three tiers of small, medium and large is necessary. We would suggest that in some cases FSA may wish more frequent reports from small firms and that a basic quarterly reporting requirement for all firms that hold client money and / custody assets irrespective of size should be the basic reporting requirement. This would be in line with reporting for large exposure purposes at present. FSA should have the option for requesting more frequent reports as necessary.

19: Do you consider an assessment based on the previous calendar year is appropriate? If not, why?

26. We assume 'calendar year' here to refer to the year to the firm's accounting reference date, in which case this seems reasonable as in many other areas of FSA's rules the previous accounting year is used as the basis of a requirement. If the true sense of the calendar year to 31 December is meant then we have concerns that some firms will need to implement additional systems to monitor this where their yearend is not 31 December. The proposals in response to Question 18, namely to use a standard quarterly reporting, could alleviate this problem.

20: Do you agree with our proposal for the CMAR?

27. If this provides information which is of benefit to the regulator then the re-introduction of a client assets return to FSA is a reasonable process. We assume this will be incorporated into the GABRIEL reporting system.

21: Would you experience any difficulty in supplying the information requested in the CMAR? If so, please provide us with examples to illustrate.

28. Certain aspects of the information requested on the CMAR form are we believe likely to be quite difficult and time consuming for a firm to obtain on a regular basis at present. For example, a firm will often receive a statement of the number of stocks and shares held but not

always a statement of the specific value each time. Section 2b of the CMAR request value and an analysis of such value by each legal jurisdiction, a process which we believe a number of firms may find quite time consuming on a monthly basis.

- 29.** Section 3 of the form refers to the client money requirement calculation. This is effectively the calculation of the amount of the clients' entitlement compared to the firm's cash book records for client money – effectively the internal reconciliation. Yet the table suggest that unpresented cheques should be shown here. While this may be relevant for a firm using the alternative approach we would not expect unpresented cheques to form part of the internal reconciliation for the normal approach. Unpresented cheques will of course be a timing difference on the external reconciliation to the bank statement.
- 30.** Section 4a and 4b ask firms to identify 'discrepancies' arising from the custody assets reconciliation and the internal and external client money reconciliations. While the timescales should exclude most pure 'timing differences', we believe that guidance may be needed to clarify that pure timing differences should not be included here as discrepancies.
- 31.** We are puzzled by certain contents in the client assets return. For example, the question as to whether the firm controls client money. Such money would not normally be considered as client money of the bank or other regulated entity which has the primary relationship. We would not normally expect such money to fall under the CASS rules nor to be included in the firm size calculation of small, medium or large. Indeed, as the rules stand at present where a firm only controlled client money it is unlikely the firm would expect to be caught by these CASS rule changes. We would further question the need for including the line 'Name of CASS audit firm.'

22: Do you consider monthly reporting for large and medium firms and bi-annual reporting for small firms appropriate frequencies?

- 32.** As noted above, our preference would be for all firms to be required to report on a quarterly basis and for FSA to have the option to request more frequent RMAR report should it have any concerns. Whichever format is eventually chosen we would suggest the process is reviewed by FSA after the system has been in use for a period of say two years.

23: What are your views on the benefits and costs of the proposed policy measures?

- 33.** No specific comments.

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