14 October 2013

Our ref: ICAEW Rep 148/13

Your ref: CP 13/05

The Client Assets Policy & Risk Team
Client Assets Unit – Markets Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

Via email: fca-cp13-05@fca.org.uk

Dear Sirs,

ICAEW Rep 148/13: Review of the client assets regime for investment business

ICAEW is pleased to respond to your request for comments on consultation paper *13/05: Review of the client assets regime for investment business*.

We support the FCA's endeavours to clarify the client assets rules for investment businesses and the consideration of how to make administrations more efficient for firms that hold client money with the insolvent business where they have lengthy waits under the current regime.

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

ICAEW Rep 148/13: Review of the client assets regime for investment business

Memorandum of comment submitted in October 2013 by ICAEW, in response to the Financial Conduct Authority (FCA) consultation paper 13/05 Review of the client assets regime for investment business published in July 2013.

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *13/05: Review of the client assets regime for investment business* published by the Financial Conduct Authority (FCA) on 12 July 2013, a copy of which is available from this link.

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. 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 and a monthly magazine, *FS Focus*.

MAJOR POINTS

Additional reporting by auditors

5. We note that the consultation introduces an increasing number of reporting requirements. We are concerned about the perceived increase in reliance on the CASS reporting accountant for oversight and detection in the new rules.

6. The wording of the aforementioned requirements consistently refers to 'adequately designed'. We would like to point out that ICAEW's current technical guidance on similar reporting by accountants and auditors refers to 'suitably designed' (for example the AAF 01/06 framework). In order for an auditor to be able to report, there must be suitably defined criteria against which to form a conclusion, as such the criteria against which auditors are required to report should be in the rules. If a conclusion as to adequate design is to be required, this must be further articulated by the FCA, and the profession would be pleased to assist in exploring what this would look like. However, if this is simply an overlooked subtly of language, we would suggest that the wording is changed to 'suitably designed'.

7. It should be emphasised that in order to provide an assurance conclusion, there need to be, in the areas where an ad hoc special assurance opinion is being requested, an obligation on the firm to have documented the process and procedures for the auditor to consider.

8. We have previously emphasised to the FSA and FCA that the client assets report is not an audit report, but an assurance report signed by an authorised auditor. Where additional reports are required by the new rules it must be clarified whether the statutory Companies Act auditor must provide the report, or the reporting accountant for client assets purposes.

9. Under the proposed rules, auditors or reporting accountants lack clear guidance as to the point in time at which they should obtain comfort on the effectiveness of a firm's non-standard method of reconciliation or alternative approach to segregation before issuing the auditor's letter as required under the rules. It is unclear whether the auditors should give a

view at the design stage or after the firm has implemented the method [But the wording of the reports implies at the design stage?]. The operational effectiveness of controls can be covered by the year end CASS assurance opinion.

Banking exemption

10. We view the change to the banking exemption wording as an improvement, but additional clarity is required. We accept that the application of the banking exemption has caused some difficulties but we are not convinced that the change in the 'default' basis provides a better approach for investors. Additional clarity is also needed as to how the exemption interacts with others such as DvP, and what constitutes a deposit or holding on the balance sheet for these purposes.

Cleared funds

11. Many of the proposals refer to the status of cleared funds at a bank. We have concerns that this requires firms to operate their business based not on internal records but those of a third party. We understand that 'cleared funds' and their value can have multiple meanings and work on multiple time scales. It is our understanding that banks have the right to 'reserve' such funds for a period of time, thought to be six banking days. Given the strict interpretation of the rules for funding and value which are proposed, we are concerned that firms are not sufficiently able to control this process and the significant funding that UK regulated firms may have to do in comparison to similar EEA passported firms.

Significant change to the regime

12. While compiling our response to this consultation we have spoken with parties who would be impacted by future changes to the rules. Overall it is felt that the rules are a substantial re-write, and we emphasise that there will be some very significant impacts for fund managers, brokers and banks (especially custodians). As with any significant regime change, progress, and ultimately success, will take time. We would encourage the FCA to work with the industry, both in the period from when the new rules are published, to implementation, and following implementation as there may be elements of the rules where issues take time to become manifest.

RESPONSES TO SPECIFIC QUESTIONS/POINTS

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

13. We agree that following the Lehman Brothers collapse that there is political will to change the regime, but are conscious that any changes may seem potentially dangerous as they are untested. We urge the FCA to acknowledge that the speed proposals in the distribution rules may not be practical given the realities of major insolvencies.

14. The number of insolvencies qualifying for the speed proposals will be directly linked to the cost benefit of the new rules. We do not think it is unrealistic to assume that as a firm gets nearer to a possible insolvency, the records it maintains may deteriorate. We believe accuracy should remain a paramount aim of any rules – inaccurate returns may take longer to resolve than a slower, but more accurate regime in the first instance.

15. We are concerned by the level of responsibility that will be placed on the insolvency practitioner (IP) under the proposed rules. The decision as to whether the books and records of the insolvent entity relating to client assets are sufficiently accurate to enable the IP to make a first pool payment based on them is likely to be incredibly onerous.

16. In such circumstances, we believe the IP will need confirmation from the FCA that the decision they make is appropriate, or will be 'held harmless' from legal action should their assumptions about the accuracy of the records prove incorrect.

17. We note the suggestion that a distribution based on CMP 1 would be made within a matter of weeks. We believe that while this may be possible, if any maximum timescale is set for such a distribution we suggest it is a month at minimum.

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

18. Yes – as long as the conditions are carefully articulated, they could allow more commerciality. Clients should be considered holistically in terms of service continuity from the business, not simply client money return. However, we are concerned that the timescale of 14 business days may be too short a period to be fully effective, and suggest that consideration be given to extending this period to either 25 business days or one month.

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.

19. While there are potential disadvantages to adopting a 'hindsight' approach to the valuation of cleared margin position, on balance we support the proposal 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.

20. We agree with the proposals in principle, but would seek further clarification around the timing. Twenty eight days could appear arbitrary, and it should be clarified whether this is days or business days, as elsewhere in the proposals timings are referred to in business days.

21. If the proposed 28 day limit is adopted, we would consider advertisement a slow way of making unclaimed money known to potential claimants.

22. We encourage the FCA to clarify the position in the situation where, if such unclaimed money was not used to fund CMP shortfalls would it have to be maintained indefinitely, or could a similar arrangement as in place for other unclaimed amounts (donation) be applied by the IP? Any clarification should be consistent with other proposals.

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.

23. Yes, reasonable steps should be in place for trivial amounts. However, we think £10 is an arbitrary figure and in some cases it would cost more to return to money to the client in transfer fees than the sum being returned. Fifty pounds is unlikely to be more material to the individual in the case of retail deposits and would increase efficiency. We would argue that if the individual has not 'chased' such amounts, it seems fair to pool them to meet the claims of individuals who have maintained contact. For wholesale customers, we would suggest a threshold of £500.

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

24. We agree that interest earned post a primary pooling event should reduce any shortfall in the client money pool, however would raise the following:

- The number and nature of balances should be considered.
- In a low rate environment this is likely to be immaterial to all involved, however, if rates rise, the consumer perspective on interest 'their' money is earning may change.

25. We are unsure why client money should be converted into 'the most prevalent currency'. Where a client has specifically agreed or allowed amounts to be held in another currency, the cost of conversion must be taken into account. Depending on how long someone has been invested this could have a more profound effect on some clients than others.

26. If the purpose of the requirement is to provide 'one' basis for entitlements, guidance may be required on conversion rates. There is likely to be a number of days between the PPE and conversion of underlying currency, which could affect client's holdings.

27. Practically speaking, we noted that the rules do not seem to allow pre and post administration money to be co-mingled so, to allow post-administration interest to reduce any shortfall, the rules would need to be amended. We also understand that the Insolvency Act requires currency balances to be converted in a different way to the CASS rules and we'd suggest the two should be aligned where possible.

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

28. The proposed approach seems practical. In general, we would support it.

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

29. We consider the extension to exchanges and central counter parties (CCP) reasonable. However, it needs to be clarified whether accounts which are impacted by an exchange or CCP would also be pooled. If this is not intended to be the case we are unsure how apportionment of losses would be established.

30. We do not currently understand what is gained from deleting the notification requirements and would welcome explanatory text on this.

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

31. We believe that implementation in the first half of 2014 does not give affected parties very long if work on systems and controls is needed. We encourage the FCA to allow sufficient time for appropriate structures to be put in place.

32. Limiting multiple pools to firms with more sophisticated systems and control environments seems sensible if the assumptions made are correct. The proposals around segregation and record keeping also seem sensible.

33. There are several points around optionality which we feel need further clarification or consideration, namely, will it be used? Is it likely to help sell products? What is considered 'a good likelihood that porting will be achievable' in reality?

34. With regard to the disclosure document and the wider regulatory requirement to 'know your customer' we do not currently understand how the FCA will check this is provided before client money is passed over to the firm. We question whether the template will be suitable for business and customer where we are placing value on judgement.

35. We do not object to the requirement for two months written notice regarding amendments. Where the FCA is requiring to be notified we would seek to understand what they propose to do with this information when it is collected, and see a clear plan and benefit for its use.

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

36. Clarification in this area is seen as a positive. We believe that the changes are helpful.

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

37. We accept that the application of the banking exemption has caused some difficulties but we are not convinced that the change in the 'default' basis provides a better approach for investors. We question whether reversal of the burden in the banking exemption is consistent with the FCA's wider consumer protection stance. It would seem easier to treat client money as client money throughout the process, rather than automatically remove CASS protection for such funds.

38. Although the majority of retail customers may generally have less than £85,000 on deposit with any one deposit taker (or group) arguably those potentially larger deposits that sit within some form of collective trust arrangement (such as SIPPs, stockbrokers and lawyers client money accounts and other similar arrangements) are potentially most exposed. A further potential complication may also arise with the protection of cash deposits held within offset mortgage accounts.

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.

39. We agree that any rules proposed by the regulator should not set themselves up to do battle with trust law which IPs will likely be familiar with, and should not create injustice or confusion for beneficiaries.

40. The option for application in entirety will reduce confusion, but may add complexity for some, and will require individual cost benefit analysis.

41. We believe the documenting decisions proposed seem sensible.

42. We would seek to understand how common the wavier where seeking to hold in accordance with the trust requirements (ie in a single institution) is, as we feel there could be a lot of letters and mix of trusts applying and not applying within the same firm which causes confusion about 'best practice'.

Q13: Do you agree with the proposals relating to the TTCA provisions? If not, please provide reasons.

43. We would urge the FCA to consider the benefit of making detailed rule changes in view of the developing EU position. It may be more efficient and effective to wait until this is settled.

44. We are of the view that the points made regarding documentation are sensible, but the mechanisms will need practical consideration.

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

45. We would encourage the FCA to be more ambitious than three business days for clearing in the current environment. The time period needs to be set more clearly and we agree that commercial settlement system needs more precise definition, especially as technology continues to rapidly evolve. We would urge the FCA to give consideration to listing those settlement systems which they believe meet the requirements of a 'commercial settlement system' and for which the DvP exemption could be applied.

46. While accepting that clients should be made aware of the implications of use of a DvP window we are concerned that it may prove difficult to get specific agreement to such use, especially if it is a separate agreement to the main client agreement. The customer should be informed when they drop out of protection and this should be highlighted in the terms of business.

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 (Chapter 4).

47. We would support the requirement for cheques issued in respect of redemption proceeds to be protected as client money until they are presented.

48. However, we have concerns over the removal of the DvP exemption in respect of units in regulated collective investment schemes. While we would expect those in the industry to comment on specific details, we understand that the removal of the DvP arrangement could lead to a significant funding requirement for managers of such schemes, particularly those who may run a 'box' arrangement.

49. We would suggest that the FCA consult further with the industry to clarify the implications of the removal of the DvP exemption. If the exemption is removed, we suggest an extended transitional period of 12 to 18 months to allow firms and their administrators time to amend systems and procedures, many of which are significantly reliant on IT systems.

50. We understand that sales and repurchases of units will generally be dealt by the manager as principal. If the negative add-back/bank account method of reconciliation (CASS 7.6A.14) is not available to unit trust managers/ACDs we suggest the FCA clarify how this will work for redemptions as technically the cash would become due to the client before the liquidation money is received from the trustee/depositary (see 7.6A.22 – item B).

51. If FCA intends simply that the manager segregates the money at T4 this should be clarified.

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 (Chapter 4).

52. Yes, clarification would be helpful but we have two concerns here – firstly whether it is achievable in all cases to allocate within one business day. Secondly it seems inconsistent with the allocation timeframe elsewhere – e.g. 7.4.28A which gives 5 days (Q25), though we have noted that this may still prove challenging in some circumstances.

Q17: Do you agree with these proposals on money ceasing to be client money? If not, please provide reasons (Chapter 4).

53. Yes – but the extent of what is a legal (or constructive) obligation may need refining. In 7.2.15(3) it seems odd to say that a client's instruction is necessary to pay money which belongs to them into their own bank account. We assume that this is a technical legal point trying to square away the discharge of fiduciary duty, but from a risk point of view it would not seem to be an issue to pay the client their own money.

Q18: Do you agree with our proposals in relation to the transfer of client money to a third party? If not, please provide reasons (Chapter 4).

54. We are not sure how, as set out in 7.2.17B (3)(b)(ii), another firm can take on the client money if it does not have protection in place. We have assumed that this covers the circumstances where client money is transferred to an entity outside the scope of the FCA's client money rules but covered by another regulator's similar rules, within the EEA for example. This also raises the question of how 'best endeavours' is to be interpreted as it seems very weak from a client protection point of view.

55. We would like to point out that 'ensure' is a strong, absolute word and we cannot see how a transferring firm is expected to ensure what happens at another firm, especially if and when they are becoming insolvent. We believe all they can realistically do is instruct so it should be

considered if this is enough, and how would it be proved. Use of the word 'will' also poses similar problems.

56. As previously noted, a limit of £50 for retail and £500 for wholesale customers may be more appropriate as £10 seems low in today's market.

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

57. We agree with the restriction of payments of unclaimed money to registered charities. We think it would be sensible for there to be a minimum level at which the board must approve charitable payments.

58. The prescription of the reasonable steps checklist seems sensible; it may add a data burden if this was to be kept indefinitely for future people trying to claim. Along with record keeping the proposals are sensible, but all comes at a cost so a time limit needs to be applied.

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.

59. Yes, but maybe the board doesn't need to be involved. Ten pounds seems like a small figure to use and we would suggest a higher figure given the costs involved in meeting the more stringent requirements for large amounts, and have suggested £50 for retail customers and £500 for wholesale customers elsewhere in this document for similar purposes.

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

60. In principle yes. However, we note that basic principle seems to be that firms need to give more consideration to diversification, which is sensible, but adds cost.

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

61. We agree with the proposal.

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

62. Yes, in principle we would support the clarification. We would like to note however that this may attract certain operational complexities on transition.

63. This could significantly impact firms who use PayPal™ and/or merchant accounts. Such firms models currently operate on the basis that client money is paid into a client account 'promptly' (within 24 hours) of receipt. We are also aware that a lot of such firms also keep a buffer in their client account to act as a safety net. We would recommend that before this rule change is implemented, it would be of value of the FCA to establish how many firms would be affected, and to carry out a cost benefit analysis. The potential implication of this is that the firm may need to provide considerable funding in respect of certain types of payments.

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.

64. Clarification to remove ambiguity is thought to be beneficial, but we are aware that the proposals have caused some confusion as to why units held in a fund and which are held under CASS 6 are taken into account as client money and included in the client money reconciliation. It may be appropriate to provide further guidance on what is envisage.

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

65. As noted in the introduction to our response, we have concerns regarding many of the proposals which refer to the status of cleared funds at a bank. The implication is that at these proposals require firms to operate their business based not on internal records but those of a third party.

66. We understand that 'cleared funds' and their value can have multiple meanings and work on multiple time scales. It is our understanding that banks have the right to 'reserve' such funds for a period of time, thought to be six banking days. Given the strict interpretation of the rules for funding and value which are proposed, we are concerned that firms are not sufficiently able to control this process and the significant funding that UK regulated firms may have to do in comparison to similar EEA passported firms. We believe it would be useful for the FCA to further articulate their expectations in this area, and whether any further alignment can be expected from banks on clearing times.

67. These concerns aside, we agree that firms should record amounts immediately upon (cleared) receipt and theoretically they should be able to deposit no later than one business day but there could be practical difficulties in some circumstances. It also makes sense to practice segregation whilst trying to identify unknown receipts.

68. It is however important to note that the changes proposed may require a number of firms to re-engineer processes. A sufficient transitional period should be allowed in order to manage this and may need to be in excess of six months. We are concerned that a firm must not only record when it receives client money, but also when 'the bank' gives value for that money. As noted above, there are different definitions of when value is received and circumstances where it can been rescinded within a certain period.

69. We have some concerns over the five day allocation rule, especially in respect of the amount of time some fund managers and administrators take to provide an analysis of the amounts they send across.

Q26: Do you agree with our proposals to clarify the proper use of prudent over-segregation of client money? If not, please provide reasons (Chapter 4).

70. In principle, the idea behind a buffer arrangement for 'over segregation' is an appropriate response in the circumstances. We believe a specific requirement for a firm to keep its over segregation policy under review on a regular basis could be made more explicit in 7.4.21C.

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.

71. We suggest that if the FCA expect only 'the largest investment banks' to use this approach, it would be helpful to prescribe as such, avoiding ambiguity and delegating appropriateness decisions to auditors.

72. Restriction of this approach seems sensible, but when a firm documents and sends into the FCA its rational for using the alternative approach we would like further information about how will it be judged as to what is appropriate.

73. We would like to further understand the rational for a three month buffer. This will not necessarily be the most accurate amount if there is any seasonality in the business or for businesses that are building up or new. Where an assurance report is requested on the appropriateness of the buffer calculation sufficiently articulated criteria would need to form part of the rules. An annual suitability review seems sensible, and timing this with the audit cycle to be most effective would make sense. Six months for changes does not seem unreasonable.

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.

74. Yes, where the firm is still responsible for such client money transferred to a third party we would agree with keeping it on the reconciliation.

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.

75. We do not disagree with this proposal.

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.

76. We believe that external and internal client money reconciliations are already performed on a daily basis by many firms who consider daily reconciliations as best practice.

77. We would question why the FCA should limit the use of the negative add back method. While recognising the benefit to an IP of having individual client information available we are concerned that the act of removing the negative add back method may lead to significant cost implications for firms and in due course investors. Immediate benefit may not be obvious other than prompter repayment in the unlikely event that their fund manager goes into administration. We would urge the FCA to further consider cost benefit in this area.

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

78. Paragraph 4.132 refers to removing the 20 days grace for acknowledgment letters; if a firm has to open an account in order to deposit the money (say it receives a foreign currency for which there is no account for example) it is automatically in breach**.** We would like to know how the FCA proposes to practically deal with this situation if the firm is prohibited from putting the money in its client account. There could also be a practical impact on a firms business model if, through a lack of compliance by a bank in an overseas territory, a firm would strictly no longer be permitted to hold client money in that location.

79. With regard to the detailed guidance notes on acknowledgment letters (point 20), we would like to point out that getting evidence of authority of bank signatories will be problematic in practice. Where the firm is still waiting for evidence of a signatory's authority it should be clarified whether they can still use the account. Outside of the UK there may be additional issues, similar to those experienced by auditors getting a bank confirmation letter from foreign jurisdictions. Twenty business days may not be enough time.

80. We believe there may be more education needed at third parties and banks as to what firms will need from them. There may be sensitivities around the details required to be released by banks.

81. As before, we would seek clarification of expectation around use of the phrase 'reasonable endeavours'.

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

82. We agree that the FCA should keep this guidance up to date with the relevant CFTC provisions.

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

83. We agree that clarification in this area would be beneficial.

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

84. In principle, we agree with the proposals and note the broad consistency with unclaimed money, however 12 years is a long time, especially depending on the nature of the asset (it may impact the value) and would like to know what the precedent for this is. We believe judgement would be required with regard to donation, depending on the type of asset (how liquid the market is, and the ease of any potential sale) and the change in value. It would be useful if the FCA were to provide further guidance in this area so as to avoid diverging practice with regards to asset sales.

85. We agree with the restriction of payments of unclaimed assets to registered charities.

86. As with client money prescription of the reasonable steps checklist seems sensible; it may add a data burden if this was to be kept indefinitely for future people trying to claim. Along with record keeping the proposals are sensible, but all comes at a cost.

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.

87. We are not aware of any material impact that this will have on UK regulated firms but accept that those in the industry are in a better position to indicate any difficulties. In principle we would support this proposal.

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.

88. We concur that there should be a formalised agreement; however provisions of further terms may in some situations prove confusing. If over prescribed, terms will be hard to tailor to different circumstances. We suggest the form of the agreement should be left to the judgement of the firm.

Q37: Do you agree with our proposals to provide the two different methods for the internal custody assets reconciliation? If not, please provide reasons (Chapter 5).

89. We have some concerns as to whether this proposal on internal reconciliations for custody assets recognises and takes into account current market practice as we understand many firms have a single record of entitlements.

90. Hence we believe that many asset managers will be using the internal systems evaluation method, and would need to evaluate their processes in accordance with CASS 6.5.4ER and all the work and cost involved. Overall the proposals should strengthen custody reconciliations but at a cost.

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.

91. The request for assurance in this area seems reasonable, however there would need to be sufficient, clearly stated criteria, and agreement on what the most suitable framework would be. These proposals imply that the FCA is going to place a lot of weight on the judgement of the auditor, rather than drawing their own conclusion. It is the firm's responsibility to comply with the rules and care needs to be taken that the FCA and the firm do not rely on a third party to say that the rules have been complied with. We further note that auditors cannot necessarily opine on the fact that the internal evaluation method provides equivalent degree of protection as that is a legal question.

92. From a conceptual point of view, we would need to consider whether a reasonable assurance opinion can be issued on a system that has not operated or could even still be at the design stage, and whether the fact that many firms already operate such systems must be incorporated into the transitional provisions.

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

93. We agree that separate reconciliations would add clarity in certain circumstances.

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.

94. A physical count is sensible for assets held, but a total count would potentially be quite onerous to do as often as a monthly reconciliation and we question if this would be necessary. Given that holding physical share certificates is now quite niche outside of private equity firms the cost benefit of this proposal would have to be considered carefully.

95. We believe that most firms operating physical custody should be able to carry out reconciliation on a total count method. We would suggest that if required there be such a count at least every three months but accept that in cases where small amounts of assets with little movement, every six months may be adequate.

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.

96. We agree with setting minimum frequencies, but perhaps a month is more appropriate than 25 business days.

97. We believe that at least monthly external reconciliations would be appropriate and daily CREST reconciliations.

98. We would suggest that there should normally be a count of physical custody at least every three months, but accept that in cases where small amounts of assets with little movement, every six months may be adequate. Our concern is that if something went missing the day after a count it could be six months before the 'loss' is identified.

99. We agree with the requirement to segregate assets to cover a shortfall that that has not been resolved by the time of the reconciliation, particularly as, if monthly reconciliations are done, the shortfall may have existed for a month.

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.

100. We do not disagree. Significant effort has been put in by firms to document client money procedures and processes and documentation behind custody assets procedures has to some extent taken a lower priority. It is appropriate to make sure that firms are adequately documenting processes.

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

101. We believe written agreement and a mechanism seems sensible, but note that this area may have to be revisited depending upon the extent of MIFID recommendations.

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

102. We agree clarity of protection should be paramount. This should be kept under review as the IOSCO recommendations are not yet known. The requirements are congruent with COBS and should support the possibility of clients requesting more frequent statements.

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.

103. If solely regarding provision of information, this should not be problematic.

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

104. The need to update the Disclosure Document and send out to all clients annually is a potentially significant additional cost, even if sent in electronic form. There are concerns over whether clients who do not currently take an interest in their arrangements will actually look at this document and be better informed. We would also seek to understand how the accuracy of the document is going to be ensured, and whether this is through FCA review or otherwise.

105. There is also the potential issue that customers would not be aware that they require a disclosure document, so therefore do not know to request one or complain if they have not been sent one on an annual basis.

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

106. We agree that this sounds sensible given then trend towards consumers relying less on formal written communication (both physical and electronic) and with the use of technology increasing (apps, online platforms etc.). The problem arises when considering the next step, how these mandates from other sources are recorded and an appropriate trail of evidence established. We would urge the FCA to consider these matters as they progress.

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

107. Our response to this question was submitted in August 2013 in line with the response date set out in the consultation paper. It can be viewed here.

Q49: Do you agree with the approach of replacing the existing client assets sourcebook with a new sourcebook? If not, please provide reasons Chapter 9).

108. The changes proposed in this consultation paper are significant and could be seen as warranting a new sourcebook. However, it should be recognised that staff at both firms and the regulator have got used to the structure of the current rule book. A complete change brings with it an increased risk of error in implementation of the new rules. Many firms would also need to significantly increase the effort needed to update their current internal compliance manuals and monitoring programmes should a wholly new rule book be put in place.

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 (Annex 1).

109. The costs of the proposals will be significant, and will have a dramatic impact on many firms.

110. The cost benefit analysis as performed seems to greatly underestimate the cost to businesses. We would emphasise that these costs are not solely attributable to auditor letters and funding, but in many cases repapering of client agreements and trust letters; system changes (especially where cash flows were previously exempt) and changes to reconciliation methods on money and assets.

111. Where we do not feel the costs and benefits of proposals have been sufficiently explored or justified, we have highlighted these within the relevant question. Our concerns regarding the

costs and benefits of the additional auditor reporting which may become required is explored in our major points section also.

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