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RE: CP133 – Consultation on enhancements to the Central Bank Client Assets Requirements, as contained in the Central Bank Investment Firms Regulations

I refer to the above matter and the request from the Central Bank of Ireland ('the Bank'), for views from relevant stakeholders, in particular those relating to the Client Asset Requirements ('the CAR'). The ICCL recognises the key priority focus that the Bank places on the protection of client assets, seeking to minimise the risk of loss or misuse of client assets by investment firms, particularly given the very significant consequences that arise for clients in such circumstances. In this regard, the ICCL welcomes the proposals from the Bank to enhance the CAR and the opportunity to share its views on this matter, particularly in the context of the close alignment of the objectives of the CAR and the role and objectives of the ICCL.

While not explicitly raised in CP133, one of the many challenges arising from investment firm failures encountered to date has been the difficulty for an insolvency practitioner to extract promptly, a clear register of clients and their associated client assets held by the firm, to enable the efficient and cost-effective return of those client assets. While the ICCL recognises that enhancements have been delivered through MiFID II and the CAR in the period since our submission to CP71, the ICCL continues to advocate for investment firms to be required to produce a Single Customer View ("SCV"), without delay, to support an insolvency practitioner with identifying clients, returning their client assets and establishing a right to compensation promptly. An SCV could at a minimum include, the legal name and status of the client, the details and value of client money and client financial instruments entrusted ("client assets"), and eligibility or otherwise for straight through compensation pay-out. It is the view of the ICCL that a requirement for firms to maintain an SCV could significantly enhance the outcomes for investors in an insolvency scenario.

The submission of the ICCL to CP133 as enclosed at Appendix 1, is informed by our experiences in dealing with the aftermath of a number of investment firm failures. The ICCL is open to meeting with the Markets Policy Division and/or Client Asset Specialist Team, as appropriate, to discuss or clarify any aspect of the attached submission.

Yours sincerely,

Alan de Lacy
Funding and Policy Manager

Directors: J. Marshall (Chairperson), G. Treacy (Deputy Chairperson), R. Breheny, R. Clarke, C. Miles, D. Jewell, V. Bowens, C. Gill, C. Foley, A. Smith, S. Madden, P. Fitzgerald.
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APPENDIX 1

Question 1: Do you agree with the proposal to extend the scope and application of the CAR to credit institutions undertaking MiFID investment business? If not, please explain why.

The ICCL expressed the view that the CAR should be extended to credit institutions in its submission to CP71 and continues to support the extension of the CAR to credit institutions undertaking MiFID investment business. The ICCL is seeking clarification as to whether the proposed CAR extension also includes investment business as defined in the Investment Intermediaries Act 1995.

Question 2: Are there any elements of the CAR (existing provisions or proposed enhancements) that should not apply to credit institutions? Please provide a clear rationale as to why credit institutions should not be required to comply with a particular existing or enhanced provision, and/or set out an alternative provision that may be more appropriate.

This is principally an issue for the institutions to advance, however, the ICCL would anticipate that any derogation from the proposals should not interfere with the CAR objectives of minimising the risk of loss or misuse of client assets by investment firms, and, in the event of insolvency of an investment firm, enable the efficient and cost-effective return of those client assets to clients.

Question 3: Are there any unintended consequences that might arise as a result of extending the scope and application of the CAR to credit institutions?

The ICCL welcomes the extension of scope to apply the CAR to credit institutions authorised/licenced pursuant to section 9 of the Central Bank Act of 1971. However, the ICCL believes that a future-proofing of the CAR could be achieved with the extension being applied to credit institutions authorised pursuant to section 9(a) of the Central Bank Act of 1971 as a Third Country Branch credit institution, at a minimum in circumstances where such credit institutions are permitted to provide investment services to retail clients and where the credit institution has been required by the Central Bank to join the Irish Investor Compensation Scheme in accordance with section 29A(2) of the Investor Compensation Act, 1998. Further, the ICCL would also recommend that the CAR is extended to include firms seeking authorisation under Part 6 of EU (Markets in Financial Instruments) Regulations 2017 (SI. No. 375 of 2017), and where the Third Country Branch investment firm is permitted to provide investment services to retail clients, and has been required by the Central Bank to join the Irish Investor Compensation Scheme in accordance with section 29A(2) of the Investor Compensation Act, 1998.

Question 4: Do you agree with the Central Bank's proposal to provide a 12 month transitional period, from the date of publication of the third edition of the Investment Firms Regulations, for credit institutions to comply with the CAR? If not, please explain why.

Given the role and objectives of the ICCL, it would be preferential to implement the proposals at the earliest possible opportunity and the ICCL would hope that the transitional period is not extended beyond 12 months.

Question 5: Do you agree with the proposal to introduce additional disclosure requirements in the CAR for credit institutions undertaking MiFID investment business on behalf of clients, in order to provide clarity to clients as to how their money will be held and protected? If not, please explain why.

The ICCL welcomes the recognition of this issue by the Central Bank of Ireland and the proposal that additional disclosure requirements emphasise the importance of credit institutions being able to clearly understand and communicate to clients the circumstances under which their money is held and depositor protections apply, and, the trigger event(s) whereby depositor protections cease and investor protections apply. The converse is also true to ensure that clients of credit institutions concluding or exiting an investment service or activity with a credit institution are clear as to when investor protections cease and depositor protections are recommenced, subject to the prevailing legislative eligibility provisions.

The ICCL observes that circumstances may arise during an insolvency event relating to an investment firm within the scope of the CAR, whereby an insolvency practitioner determined (or was minded to determine) that a client is subject to investor protections instead of depositor protections, as a consequence of some unintended ambiguity between the CAR and the legislation underpinning the depositor and investor protection schemes. In that context the matter should be determined by the Central Bank of Ireland in accordance with the provisions of section 35(8) of the Investor Compensation Act, 1998.

Question 6: Please provide details of any circumstances under which a credit institution may cease to hold money on behalf of clients as deposits (i.e. avail of the 'banking exemption') and would instead hold that money as client funds.

The ICCL is not immediately aware of such circumstances and awaits the feedback from relevant respondents to determine if it has any further views in this regard.

Question 7: In your view, are there other implications of extending the scope and application of the CAR to credit institutions that the Central Bank should consider?

The ICCL is not immediately aware of any other implications of extending the scope and application of the CAR to credit institutions that the Central Bank should consider.

Question 8: Do you agree with the Central Bank extending the application of the existing PCF-45 role (HCAO) to credit institutions holding client assets? If not, please explain why.

The ICCL supports the extension of the PCF-45 role (HCAO) to credit institutions holding client assets.

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Question 9: Do you agree with the Central Bank's proposal to require investment firms to maintain, for a period of 6 years, a copy of all relevant material in order to evidence that express consent has been obtained from a client prior to the investment firm entering into arrangements for securities financing transactions, or otherwise using the client's financial instruments? If not, please explain why.

The ICCL supports the proposal by the Central Bank of Ireland to require investment firms to maintain a copy of all relevant material in order to evidence that express consent has been obtained from a client prior to the investment firm entering into securities financing arrangements, or otherwise using the client's financial instruments. However, the ICCL is minded to observe that it would envisage that all relevant material should be maintained for, the greater of 6 years, or the duration for which transactions continue associated with the prior express consent. The ICCL also observes that, with regard to retail clients, it may be appropriate to have a time-bound consent and also to ensure that the investment firm clearly documents, through examples, how the best interests of the client are achieved, and, the implications for the client in an insolvency event where the investment firm may not be able to return the clients financial instruments and the collateral is no longer appropriate or available to meet the clients claim, for whatever reason.

Question 10: Do you agree with the Central Bank's proposal to require that TTCAs be the subject of, or form part of, a written agreement between an investment firm and a client? If not, please explain why.
Question 11: Do you agree with the proposed information that should be included in the written agreement in respect of TTCAs? If not, please explain why.
Question 12: Do you agree with the proposal that the written agreement containing the TTCA provisions be maintained by investment firms for a period of 6 years? If not, please explain why.

Question 13: Do you agree with the Central Bank's proposals relating to record-keeping requirements following a client's request for the termination of a TTCA? If not, please explain why.

Question 14: Do you agree with the Central Bank's proposals relating to a written notification by an investment firm to clients following the termination of a TTCA? If not, please explain why.

Question 15: Do you agree with the Central Bank's proposal to require investment firms that provide prime brokerage services to make available to clients a daily statement covering client asset holdings in the context of prime brokerage business? If not, please explain why.

Question 16: Do you agree with the Central Bank's proposal to require investment firms that provide prime brokerage services to include an annex to a relevant client agreement, summarising the key terms of the prime brokerage business that relate to client assets? If not, please explain why.

The ICCL is not responding to questions 10 to 16 inclusive.

Question 17: Do you agree with the Central Bank's proposal to require an investment firm to notify the Central Bank of its intention to effect a material transfer of client assets at least three months in advance of the transfer taking place? If not, please explain why.

The ICCL supports the Central Bank's proposal to require an investment firm to notify its intention to effect a material transfer of client assets at least three months in advance of the transfer taking place, however, the ICCL believes that this minimum notification period should apply in circumstances where the transfer does not result in an additional flow of assets into the jurisdiction or into the scope of the ICCL operated Investor Compensation Scheme ("ICS"). In circumstances where the transfer would result in an in-flow of client assets from another jurisdiction into Ireland, and notably within the scope of the ICS, the ICCL believes that it may be necessary to require a longer notification period to ensure that, among other matters, adequate ICS capacity is either available or can be prepared.

Question 18: Do you agree with the Central Bank's proposal to include a reference to transfer of business in Regulation 59(1)(d)(iv) of the CAR, thereby requiring investment firms to include information in respect of transfer of business arrangements, in so far as they relate to client assets, in the terms of business? If not, please explain why.

The ICCL supports the Central Bank's proposal to include transfer of business arrangements in the terms of business for all investment firms subject to the CAR.

Question 19: Do you agree with the Central Bank's proposals to enhance the CAR guidance in order to support investment firms in respect of the orderly transfer of client assets? If not, please explain why.

The ICCL supports the Central Bank's proposal to enhance the CAR guidance in order to support investment firms in respect of the orderly transfer of client assets for all investment firms subject to the CAR.

Question 20: Are there other aspects of the transfer of business process, as relating to client assets that require clarification? If so, please provide details.

The ICCL observes that, subject to the matter not being addressed elsewhere either now, or in the future, that investment firm' terms of business specifically provide for the unconsented transfer of client assets to another investment firm(s) subject to the CAR either by the Resolution Authority or an insolvency practitioner appointed by the High Court at the request of the Central Bank of Ireland.

Question 21: Do you agree that CAR guidance could support investment firms in managing the approach to uncontactable clients during a transfer of business? If not, please explain why.

The ICCL agrees that CAR guidance could support investment firms in managing the approach to uncontactable clients during a transfer of business, particularly where an investment firm subject to the CAR no longer has, or is unlikely to be able to maintain the personnel, skills and infrastructure necessary, due to the actual or likely absence of a critical mass of clients, potentially resulting in increased risks to the client assets of uncontactable or unconsented clients.

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Question 22: Do you agree with the Central Bank's proposal to clarify in the CAR guidance the expectation that client funds should be deposited directly into a third party client asset account? If not, please explain why.

The ICCL supports the Central Bank's proposal to clarify in the CAR guidance the expectation that client funds should be immediately segregated through a requirement to ensure funds are deposited directly into a third-party client asset account.

Question 23: Do you agree with the Central Bank's proposal to require investment firms to perform an 'internal' client financial instrument reconciliation? If not, please explain why. Responses should include details of any barriers an investment firm may face in performing this process. Details of any suggested alternative processes that could address the risk of loss/misallocation of client financial instruments and meet the objective of the proposed enhancement should also be included.

The ICCL supports the Central Bank's proposal to require investment firms to perform an 'internal' client financial instrument reconciliation.

Question 24: Do you agree with the proposed frequency (i.e. monthly) for performing the 'internal' client financial instrument reconciliation? In responding, please refer to instrument types, e.g. those that could be checked more or less frequently than on a monthly basis, and set out the applicable rationale.

The ICCL is strongly of the view that all investment firms should be in a position to present an 'internal' client financial instrument reconciliation process at least monthly, and ideally at more frequent intervals and on short notice in order to ensure that the CAR objective of enabling the efficient and cost-effective return of those assets to clients in the event of the insolvency of an investment firm can be achieved at all times. The ICCL has formed this view as the time delays and costs incurred from the reconciliation processes associated with client assets in past failure cases have been significant and in the main, borne by the client asset estate.

Question 25: Do you agree with amending Regulation 57 to require investment firms to conduct an 'external' reconciliation of client financial instruments not deposited with a third party, using statements obtained from those entities responsible for maintaining the record of legal entitlement to those client financial instruments? If not, please explain why.

The ICCL supports the Central Bank's proposal to require investment firms to conduct an 'external' reconciliation of client financial instruments not deposited with a third party, using statements obtained from those entities responsible for maintaining the record of legal entitlement to those client financial instruments. The ICCL is interested to understand what additional safeguards could be introduced in circumstances where the entities responsible for maintaining the record of legal entitlement to those client financial instruments are controlled by, connected to, or, a related party of the investment firm.

Question 26: Do you envisage any barriers to conducting this reconciliation on at least a monthly basis? If so, please explain these barriers.

Please see response to Q.24 above.

Question 27: Do you agree with the Central Bank's proposal to enhance Regulation 57 to expressly require investment firms to conduct a reconciliation of physical client financial instruments?

The ICCL supports the Central Bank's proposal to require investment firms to conduct a reconciliation of physical client financial instruments.

Question 28: Do you agree that the reconciliation of physical client financial instruments should be conducted on at least a monthly basis? If not, please explain why.

Please see response to Q.24 and Q.26 above.

Question 29: Do you agree with the Central Bank's proposal that investment firms should follow the process as set out in Regulation 57(7) of the CAR in order to address a reconciliation difference or discrepancy identified through any reconciliation process? If not, please explain why.

The ICCL supports the Central Bank's proposal that investment firms should follow the process as set out in Regulation 57(7) of the CAR in order to address a reconciliation difference or discrepancy identified through any reconciliation process. The ICCL observes consideration could be given to expanding Regulation 57(7)(c) to explicitly require that, in addition to identifying/resolving the cause of any reconciliation difference, the investment firm is required to document in detail the cause on a real-time investigatory basis. The ICCL believes this would be extremely beneficial to an insolvency practitioner in the event of a failure event to ensure the CAR objective of enabling the efficient and cost-effective return of those assets to clients in the event of the insolvency of an investment firm could be achieved at all times. The ICCL has formed this view as the time delays and costs incurred from the reconciliation processes associated with client assets in past failure cases have been significant and in the main, borne by the client asset estate.

Question 30: Do you agree with the Central Bank's proposal to require investment firms to place money, financial instruments or a combination of both from the investment firm's own assets into the relevant third-party client asset account to address a client financial instrument shortfall identified through the performance of an 'internal' reconciliation of client financial instruments? If not, please explain why.

The ICCL supports the Central Bank's proposal to require investment firms to place money, financial instruments or a combination of both from the investment firm's own assets into the relevant third-party client asset account to address a client financial instrument shortfall identified through the performance of an 'internal' reconciliation of client financial instruments. The ICCL observes that any such transfer from the firm's own assets to the client assets should be made in such a manner that once the transfer is effected, the transferred company assets move beyond the reach of the investment firms own creditors should an insolvency event arise.

Question 31: Do you agree with the Central Bank's proposal to require investment firms to address shortfalls identified through the performance of an 'internal' reconciliation of client financial instruments where that shortfall has not resolved itself in three working days? If not, please explain why.

The ICCL supports the Central Bank's proposal to require investment firms to address shortfalls identified through the performance of an 'internal' reconciliation of client financial instruments where that shortfall has not resolved itself in three working days. The ICCL observes that any such transfer from the firm's own assets to the client assets should be made in such a manner that once the transfer is effected, the transferred company assets move beyond the reach of the investment firms own creditors should an insolvency event arise.

Question 32: Do you agree with the Central Bank's proposal to require investment firms to address excesses identified through the performance of an 'internal' reconciliation of client financial instruments, where that excess has not resolved itself in three working days? If not, please provide details of any barriers that an investment firm may face in removing the excess.

The ICCL recognises the intent of the Central Bank's proposal to require investment firms to address excesses identified through the performance of an 'internal' reconciliation of client financial instruments, through withdrawal from the relevant third-party client asset account, where that excess has not resolved itself in three working days. The ICCL has concerns in this regard, particularly where the excess to be removed from the client asset account may be material. The ICCL is keen to understand if the Central Bank has considered whether additional independent safeguards can be deployed to verify the underlying reason for the difference for any material withdrawal from client assets prior to the actual withdrawal given the potential risks posed to a client assets estate in an insolvency event, or, whether it would be preferable to retain the excess client assets in a segregated account/area pending resolution of the reconciliation difference/discrepancy to mitigate the risk of any potential shortfall in the client asset estate in a failure event.

Question 33: Do you agree with the Central Bank's proposal for investment firms to maintain a record of the actions it has taken in respect of the remediation of a reconciliation difference or discrepancy? If not, please explain why.

The ICCL supports the Central Bank's proposal for investment firms to maintain a record of the actions it has taken in respect of the remediation of a reconciliation difference or discrepancy. See also our response to Q.29 above.

Question 34: Do you agree with the Central Bank's proposal to align process for the remediation of client fund differences or discrepancies identified through the performance of the daily calculation with the process for remediating reconciliation differences as set out in Regulation 57(7)? If not, please explain why. Details of any suggested alternative processes to ensure that the internal records used in the performance of the daily calculation are accurate to (i.e. meet the objective of the proposed enhancement) should also be included.

The ICCL supports the Central Bank's proposal to align the process for the remediation of client fund differences or discrepancies identified through the performance of the daily calculation with the process for remediating reconciliation differences as set out in Regulation 57(7).

Question 35: Do you agree with the Central Bank's proposal to enhance the CAR to require investment firms to develop and maintain a Client Asset Applicability Matrix within the CAMP? If not, please explain why.

The ICCL supports the Central Bank's proposal to enhance the CAR to require investment firms to develop and maintain a Client Asset Applicability Matrix within the CAMP. The ICCL observes that when setting guidance, consideration could be given to including guidance that extends to listing depositor and / or investor protections applicable to each product line or service offered by the investment firm supported by an appropriate rationale where no such protection exists.

Question 36: Do you agree with the Central Bank's proposal to enhance existing requirements to include a section in the CAMP that identifies all entities to which an investment firm outsources any activity relating to the safeguarding of client assets and details of how the investment firm proposes to exercise oversight of the activities? If not, please explain why.

The ICCL supports the Central Bank's proposal to enhance existing requirements to include a section in the CAMP that identifies all entities to which an investment firm outsources any activity relating to the safeguarding of client assets and details of how the investment firm proposes to exercise oversight of the activities.

Question 37: Do you agree with the Central Bank's proposal for investment firms to include a reference to the location of its internal client asset breach and incident log in the CAMP? If not, please explain why.

The ICCL supports the Central Bank's proposal for investment firms to include a reference to the location of its internal client asset breach and incident log in the CAMP. The ICCL observes that the CAR should specify that the log should be available for inspection, including in circumstances where there are no breaches or incidents recorded in the log.

Question 38: Do you agree with the Central Bank's proposal to require investment firms to include the information set out in Paragraph 1(9) of Schedule 3 to the MiFID Regulations in the CAMP? If not, please explain why.

The ICCL supports the Central Bank's proposal to require investment firms to include the information set out in Paragraph 1(9) of Schedule 3 to the MiFID Regulations in the CAMP.

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Question 39: Do you agree with the proposed enhancements to the CAR guidance as set out above as they pertain to:
a. Client Asset Risk Matrix;
b. Client asset account flows;
c. IT systems and controls;
d. Access to critical systems;
e. Operational and governance structure;
f. Books and records;
g. Compensation schemes; and
h. Reconciliation and daily calculation processes?
If not, please explain why.

The ICCL supports the proposed enhancements to the CAR guidance as set out in paragraphs 145 to 162 of the CAR Consultation Paper.

Question 40: In your opinion, is there any additional information which should be included in the CAMP?

The ICCL believes that it is important that the guidance proposed in relation to paragraph 156 is generally accepted as meaning that for an insolvency practitioner to reconcile and distribute the assets of clients efficiently and without delay, the books and records should readily facilitate the insolvency practitioner establishing the overall client asset position pertaining to each client. Any outcome below this standard, may not in the view of the ICCL, enable the efficient and cost-effective return of those assets to clients.

The ICCL also observes from experience, that in the context of the proposal to strengthen the CAR guidance as set out in paragraph 158, investment firms are currently required pursuant to Article 47 of the MiFID II Delegated Regulation, to provide summary details of any relevant Deposit and/or Investor Compensation Scheme's operating in a jurisdiction. The ICCL is strongly of the view that if CAR guidance is being strengthened, it could clarify an expectation that the investment firm should, and, in the context of the Client Asset Risk Matrix proposal, clearly establish through their own legal analysis, and communicate to its clients, whether the Deposit and/or Investor Compensation Scheme's operating in each jurisdiction are in fact <u>applicable</u> to their clients in the context of each investment service being provided to the client.

Question 41: Do you agree with the Central Bank's proposed approach for the CAR guidance on the structure of the CAMP? If not, please explain why.

The ICCL supports the Central Bank's proposed approach for the CAR guidance on the structure of the CAMP, notably as in the ICCL's view it would be preferable for a uniformity of CAMPs to aid and assist insolvency practitioners.

Question 42: Do you agree with the Central Bank's proposal to grant a 12-month transitional period following the publication of the third edition of the Investment Firms Regulations for investment firms to comply with the revised CAR? If not, please explain why.

Given the role and objectives of the ICCL, it would be preferential to implement the proposals at the earliest possible opportunity to help deliver better outcomes for clients in insolvency scenarios. The ICCL would hope that there is no significant delay to the intended timeline for the publication of the third edition of the Investment Firm Regulations, or indeed that the transitional period is not extended beyond 12 months from that date.

Question 43: Do you foresee any challenges in reporting the information referenced in the paragraph 171, on a monthly basis? If so, please explain why.

The ICCL is not responding to question 43.

Question 44: Have you identified areas of the client asset regime that warrant consideration, in particular in light of new or evolving business practices, financial innovation or advancements in technology?

The ICCL is not responding to question 44.