Grant Thornton

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Central Bank of Ireland

Grant Thornton response to Consultation Paper CP71 Client Asset Regulations and Guidance

Contents

Executive Summary

This paper includes Grant Thornton's comments on Consultation Paper CP 71 Client Asset Regulations and Guidance.

We welcome the proposed changes which include a client asset framework based on seven Client Asset Core Principles with a once off Transitional Regulation ('the Regulation') in respect of a firm's initial Client Asset Management Plan ('CAMP'). We note that the Central Bank of Ireland ('CBI') has produced draft Guidance to assist firms in the interpretation of the draft Regulation which sets out what firms holding client assets are required to comply with.

We note and welcome the introduction of the requirement to have a key individual take responsibility and ownership of this subject by introducing the Client Asset Oversight Role appointing a pre-approved controlled function under Part 3 of the Central bank Reform Act 2010. We agree that this role should be occupied by a director/senior manager with direct access to the Board.

We agree with the majority of the proposals as outlined in your consultation paper. However based on our audit and regulatory client asset experience we have suggested some additional enhancements as outlined further in the next section. Our responses should be read in conjunction with Consultation Paper CP71.

Responses to individual requirements

Q1. Do you agree that the Client Asset Core Principles encompass the key fundamental principles in protecting and safeguarding client assets? If not, please explain why.

We agree that the Client Asset Core Principles encompass the key fundamental principles in protecting and safeguarding client assets. We note that Regulation 4 (1) requires a firm to reconcile at least monthly the balance of all client funds held as recorded by third parties whilst Regulation 4(1) requires that client asset accounts which hold client funds and have daily transactions should be reconciled daily. Core Principle 3 in relation to 'Reconciliation' states that a firm should conduct, on a regular basis a reconciliation between its internal records and those external records of any third party with whom client assets are held. We would suggest that the language in Core Principle 3 in relation to frequency of reconciliation be aligned to the requirements of the Regulation to ensure clarity of understanding and consistency of approach.

Q2. Do you agree with the proposed wider scope in respect of 'client funds'? If not, please explain why.

We agree with the proposed wider scope in respect of 'client funds' which proposes that all client funds received by a firm irrespective of whether for investment in a regulated or unregulated product shall be deposited in a client asset account until invested as per the client's instructions.

Q3. Do you agree with the approach proposed to deal with instances where client funds are received but the firm has not identified the client or the necessary client paperwork is not complete? If not, please explain why.

We agree with the principle that in instances where client funds are received but the firm has not identified the client or the necessary client paperwork is not complete that funds should be returned within a specified time period. However a period of 2 days may in some circumstance be too short time period in which to resolve such an issue. The CBI might consider a requirement to take all steps to resolve the matter/obtain necessary paperwork as soon as reasonably practical, subject to the requirement to do so within 5 working days.

Q4. Do you agree that the Regulations should apply to funds that have been lodged into a Collection Account? If not, please explain why.

We agree in principle that the Regulations should apply to funds that have been lodged in a Collection Account. However we suggest that the CBI considers the circumstances for FSPs in relation to this requirement given the potential additional operational requirements involved. An appropriate transition period should be put in place to enable FSPs to prepare for implementation.

Q5. Do you agree for the purpose of segregating client assets and determining which clients are impacted if a third party fails, a firm should be able to identify where each individual client's assets are held? If not please explain why.

We do not agree that for the purpose of segregating client assets and determining which clients are impacted if a third party fails, a firm should be able to identify where each individual client's assets are held. We note that the CAR aims to protect client monies in the event of the insolvency of the investment firm to which it applies not the underlying bank counterparty.

This requirement as framed appears to impose a record keeping requirement designed to deal with the potential risk associated with the insolvency of the underlying counterparties. We would suggest that to implement this requirement in this way would lead to a significant additional and onerous administrative burden for the firms to which it applies. It has the potential to lead to unintended and inequitable consequences in some circumstances e.g. one or more clients may lose monies deposited with Bank X in the event of its insolvency in circumstances where they did not specify their monies should not be deposited with Bank X, whilst other clients do not suffer a loss by virtue of being deposited with Bank Y either by request or otherwise. In both circumstances the investment firm itself has not failed. This may be inequitable where all clients are sharing the benefit of pooling monies vis a vis the interest rate applied to their respective accounts.

Q6. Do you agree that a client's required margin should be better protected under the client asset regime? If not, please explain why. If you agree, please outline how this could be best achieved.

We agree that a client's required margin should be better protected under the client asset regime. We also agree with the proposed solution of holding the required margin in a designated client asset margin bank account where the firm would only have use of this money for the purpose of hedging the client's position. Therefore in the event of liquidation the money would flow back into that same designated client asset margin bank account and would be there for the client.

Q7. Do you agree that the records should be retained for six years? If not please explain why.

We agree that the records should be retained for six years. We note that where records are held in soft copy, a firm should be in a position to produce these records without delay but in any event within one business day. It would be useful to clarify the CBI's expectations regarding when a firm should be in a position to produce these records should such records be held in hard copy.

Q8. Do you agree with the new approach proposed in respect of Facilities Letters and Confirmations? If not please explain why.

We agree with the new approach proposed in respect of Facilities Letters and Confirmations.

Q9. Do you agree that in the interest of protecting client assets, where a third party has not designated a client asset account/Collection Account as requested by the firm, these client assets should be withdrawn from the third party without delay? If not, please explain why.

We agree that in the interest of protecting client assets, where a third party has not designated a client asset account/Collection Account as requested by the firm, these client assets should be withdrawn from the third party without delay.

Q10. Do you agree with the approach for reconciling client asset accounts that hold client funds? If not please explain why. If there are other types of accounts that do not readily conform to the frequency of reconciliations cited above, please provide details of same.

We agree with the approach for reconciling client asset accounts that hold client funds. However we would request further clarification in relation to the treatment of fixed term deposits. Is it intended that 4(1) include or exclude fixed term deposits? In our view there is no value to the monthly reconciliation of fixed term deposit accounts other than at the fixed period on which they roll over or are broken.

We would also request the CBI provide guidance in relation to the criteria to be applied in determining whether an account is 'subject to a greater risk of misappropriation'. We also suggest that the firms' directors determine the approach and frequency of reconciliation for client asset accounts that hold client funds based on risk. e.g. for a fixed term deposit maturing in 6 months it may be deemed sufficient to reconcile this fixed term deposit upon maturity or upon relevant coupon dates.

Q11. Do you agree that client financial instruments should be reconciled at least monthly or should the reconciliation be performed in a lesser time period? If so, please explain why.

We agree that client financial instruments should be reconciled at least monthly. We recommend that this reconciliation be undertaken more frequently should the need arise e.g. if there is an increasing number of aged reconciliation items arising.

Q12. Do you agree with the time allocation of ten days to complete these reconciliations or should it be performed in a lesser time period? If so, please explain why.

We agree with the allocation of ten days to complete these reconciliations which should give firms adequate time to undertake the reconciliation, adequately research reconciliation items and incorporate management review of these reconciliations including adequate analysis of trends and aged items.

Q13 Do you agree that an investment firm should immediately make good or provide the equivalent of any shortfall in client financial instruments? If not, please explain why.

We agree that an investment firm should immediately make good or provide the equivalent of any shortfall in client financial instruments.

Q14. Do you agree that a Collection Account should be reconciled each time a transaction occurs on that account? If not, please explain why.

We agree that a Collection Account should be reconciled in accordance with the requirements of Regulation 4 e.g. daily for collection accounts that have daily transactions. To clarify, in the event that there are a number of transactions daily, we do not agree that a Collection Account should be reconciled each time a transaction occurs on that account.

Q15. Do you agree that it is appropriate for a firm to report material reconciling items with the level of materiality determined by the firm? If not, please explain why.

We agree that it is appropriate for a firm to report material reconciling items with the level of materiality determined by the firm. The firm can take into account the items as outlined in the guidelines G4 (11) regarding the CBI's expectations when considering whether a reconciliation item is material. However we would encourage firms to proactively engage with their designated supervisor within the CBI when determining the level of materiality.

Q16. Do you agree with the components of an investment firm's Client Money Requirement and Client Money Resource? If not, please explain why.

We agree with the components of an investment firm's Client Money Requirement and Client Money Resource.

Q17. Do you agree with the Central Bank's approach to the computation of the Client Money Requirement and Client Money Resource for FSPs? If not, please explain why.

We agree with the CBI's approach to the computation of the Client Money Requirement and Client Money Resource for FSPs.

Q18. Do you agree that a firm's Client Money Resource should only contain what it is required to hold for its clients on a given day? If not, please explain why.

We do not agree that a firm's Client Money Resource should only contain what it is required to hold for its clients on a given day. We understand the CBI's position that the use of buffers may lead to indiscipline in particularly where firms maintain a healthy buffer. However the purpose of the Regulations is to protect clients and to ensure that assets are available to meet client asset requirements. We do not believe it is appropriate to eliminate the requirement upon firms to retain a buffer. In practice buffers ensure that in the event of a breakdown in the reconciliation process for whatever reason the client asset requirements may still be covered; where the absence of a buffer such a scenario may result in a large shortfall to client(s). We also suggest that firms maintain a risk adjusted percentage of client assets as a buffer.

Q19. Do you agree that the reporting of an investment firm's Client Money Resource shortfall should be investment firm specific based on its materiality appetite? If not please explain why.

We agree that the reporting of an investment firm's Client Money Resource shortfall should be investment firm specific based on its materiality appetite, particularly where a buffer is in place (please refer to Q13/Q18 above) . However where the requirement to maintain buffers is removed firms should be required to report a shortfall in their Client Money Resource without consideration of a materiality threshold.

We note that the CBI requires each investment firm to assess its own level of funding materiality and inform the CBI in writing as to its rationale in making this determination. We suggest that this assessment be documented, discussed and approved by the firm's board. In addition where necessary the CBI may engage with an investment firm to discuss its funding and its materiality rationale. We suggest that an indicative timeline be provided by the CBI as to when they expect firms to furnish this assessment of funding materiality and the associated rationale. We would also encourage a proactive engagement by both the CBI and investment firms to determine this materiality rationale.

Q20. Do you agree that a statement should be provided on an annual basis or should it provided on a more regular basis?

We do not agree that a statement should be issued annually by the investment firm to its clients as outlined in Regulation 6(16). We suggest that such statements be issued more frequently, at a minimum every six months, as receipt and review by client of same may act as an additional check. The frequency with which these statements are issued should be documented within the firm's CAMP. In addition the CBI may wish to provide further guidance regarding how such statements will be stored and in what timeframe they expect the investment firm to issue these statements.

Q21. Do you agree that a) to g) above will provide clients with sufficient information regarding their holdings? If not please explain why, providing details of additional information which should be included.

We agree that the requirements as outlined in Regulation 6 (16) will provide clients with sufficient information regarding their holdings.

Q22. Do you agree that a Fund Service Provider should issue a receipt to the client? If not, please explain why and put forward an alternative approach that will provide confirmation to a client that his/her money is deposited in a Collection Account.

Subject to our understanding the FSP will issue a contract note directly to the client on settlement, usually within 2-3 business days depending on the settlement cycle. Given the predominance of wire payments in the Irish funds industry, the additional requirement to issue a receipt to the client would be excessively onerous from an operational viewpoint.

Q23. Do you agree that an investment firm should seek prior written consent from its client in respect of the circumstances listed in a) to h) above? If not please explain why, providing details of additional circumstances which should be included.

We agree with the circumstances outlined in Regulation 6 (18) where an investment firm is required by the CBI to obtain prior written consent from a client, prior to receiving client assets.

Q24. Do you agree that a FSP should obtain prior written consent from a client in respect of the circumstances listed in a) to c) above and with the medium used to obtain this consent? If not please explain why, providing details of additional circumstances which should be included.

We agree with the circumstances outlined in Regulation 6 (19) where a FSP is required by the CBI to obtain prior written consent from a client. Whilst Regulation 6 (19) does not stipulate the medium to be used, we agree that the expectation, as outlined in Guidelines G6 (11), of obtaining the necessary prior written consent in the Investment Fund's Application Form is reasonable.

Q25. Do you agree that the CAKID will better inform the client with a greater understanding providing information in clear plain English that will equip the client to comprehend where and how his/her assets are held when deposited with a firm? If not please explain why.

We agree that the Client Asset Key Information Document ('CAKID') will better inform the client providing them with a greater understanding and equip the client to comprehend where and how his/her assets are held when deposited with a firm, assuming the CAKID is written clearly and in plain English.

Q26. Do you agree with the need to provide the CAKID to both existing and new clients distinguishing clients of an investment firm and a Fund Service Provider as outlined above? If not please explain why.

We agree with the need to provide the CAKID to both existing and new clients distinguishing clients of an investment firm and a FSP as outlined.

Q27. Do you agree with appointing a person to the role of CAOR which will be a pre-approved controlled function? If not, please explain why?

We agree with appointing a person to the role of Client Assets Oversight Role ('CAOR') which will be a pre-approved controlled function.

Q28. Do you agree with the responsibilities of the Client Asset Oversight Officer as provided for in a) to g) above? If not, please explain why, providing details of additional responsibilities which should be included.

We agree with the responsibilities of the CAOR as outlined in Regulation 7(2) but consider the definition of the role to be overly prescriptive given that the fitness and probity regime and the roles for PCF functions to date have not been so prescriptive.

Q29. Do you agree with the purpose of the CAMP and the minimum that should be included in this document? If not, please explain why, providing details of additional records which should be included.

We agree with the purpose of the Client Asset Management Plan ('CAMP'). We note that the requirements of Regulation 7(6) are highly prescriptive in relation to the minimum content of the CAMP. We would question whether it might be more appropriate and more proportionate to curtail the mandatory disclosure requirements under the Regulation and include information on content in the Guidance. .

Q30. Do you agree that Regulation 8.(3) provides for what should be included in a CAE? If not please explain why.

We agree that Regulation 8(3) provides for what should be included in a Client Asset Examination ('CAE')

Q31. Should this review be carried out more frequent than annually? If so, please explain why.

We agree that an annual review to provide the necessary assurance to the board and the CBI that the firm has complied with the Regulations and that the firm has acted in a manner consistent with its Client Asset Management Plan is appropriate. Whilst there may be a preference to have a 'one size fits all' approach to CAR it may be argued that based on a high PRISM rating it may be prudent to undertake the client asset review should occur on a bi-annual basis.

Q32. Do you agree with the type of assessment that should be carried out on the firm's initial CAMP by an independent external expert?

We agree with the type of assessment that should be carried out on the firm's initial CAMP by an independent external expert.

Q33. Do you agree that 3 months is sufficient time for a firm to obtain an assessment of the CAMP from an independent external expert? If not, please explain why.

We suggest that 3 months appears to be a somewhat aggressive timeline to obtain an assessment of a firm's initial CAMP from an independent external expert. We note that the firm, whilst in the process of compiling its CAMP will also be required to undertake a tender process to assess the expertise and independence of the relevant external expert We believe the timeline should be cognisant of the learning curve involved in compiling the initial CAMP as the requirements of the regulation may be subject to further discussions to ensure consistent application by firms in practice. We suggest additional time be given to firms to undertake this initial CAMP assessment process particularly if this assessment is being completed contemporaneously with a firm's year-end financial statements process. We would also suggest that within the stipulated time period an expected timeframe be issued to firms by which they are required to engage the independent external expert thereby giving the external expert sufficient time to plan, resource and undertake the assessment of the CAMP.

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