

General Comment

The Investor Compensation Company Limited [“ICCL”] particularly empathises with the objective set out under bullet point 3 of CP71’s Introduction (i.e. the provision of a system which in the event of a firm’s insolvency will enable the expeditious return to available client assets to the owner at the lowest cost) and most of the comments below reflect its support of that objective. The ICCL would recommend, in the context of the recent determination¹ in respect of IBRC, the inclusion of “*Credit Institutions providing investment services*” as entities to be covered by the Central Bank of Ireland’s Client Asset Regulations [“CAR”].

Client Register

The ICCL recommends that the Central Bank consider the introduction of a “Client Register” the purpose of which would be to facilitate the expeditious identification of clients and their investments by the relevant insolvency practitioner, in the event of the failure of an investment firm, with a view to:

- (a) returning client assets as efficiently as possible and
- (b) identifying individual client’s entitlement to compensation and the amount, if any.

The Register would contain in respect of each client:

- the full name of each client, clearly distinguishing between natural persons, trusts (including SSAPs), corporate clients and unincorporated entities e.g. clubs;
- the client’s address;
- the client’s contact details;
- the value of investments made, cash lodgements made or investment instruments given or entrusted (collectively referred to as “*investments*”) to the firm;
- the location of the investments referred to above, including those held in a pooled account or as part of the investment firm’s own assets (relevant margin money);

¹ On 17th May 2013 the Central Bank of Ireland made a determination under section 31(3) of the Investor Compensation Act, 1998 that the Irish Bank Resolution Corporation (in Special Liquidation) [‘IBRC’] was unable to meet its obligations arising from claims by clients who conducted investment business with the firm.



- the status of the client in the context of the Investor Compensation Act 1998 i.e. an eligible investor or an excluded investor and in the latter case identifying what category of exclusion applies e.g. a professional investor, a pension fund etc;
- specific relevant documents should be linked to the client's records e.g. confirmation of professional status, account opening documentation, etc.

A firm's systems should be capable of producing the Register regularly, at a minimum weekly, and this should be retained for subsequent review or inspection. It could be held electronically or otherwise.

The ICCL acknowledges that many aspects of the proposed Register are covered separately in various provisions of the CAR. However, in the event of insolvency, the ICCL consider that a single source of information should be readily to the Insolvency Practitioner in order to carry out work as expeditiously as possible, including responsibilities arising from his/her role as Administrator under the Investor Compensation Act, 1998, as amended ["the ICA"]. The ICCL understand that, on foot of similar concerns, deposit taking institutions must be in a position to provide similar information at short notice in order to facilitate a potential payout under the Deposit Guarantee Scheme.

Fraud

Failures in investment firms, which lead to losses for clients, are most often a direct result of fraud which may include the misappropriation of client assets. Experience has shown that the return of client assets and the payment of compensation to affected clients is frequently complicated by the unreliability, absence and/or falsification of the investment firm's records and client documentation. This may be compounded by poor compliance or incompetence at management level within the firm. Firms with a strong compliance culture and robust management reporting systems should have little difficulty compiling such a Register.

While no set of rules will prevent fraud, the existence of a Register would provide the external auditor, internal auditor/compliance function/client asset oversight officer ["CAOO"] and Central Bank inspection teams with a single source of information on the failed investment firm's clients. As set out under Principle 7, the Register could be used as a basis for randomly sampling and verifying the firm's records. This could be achieved by directly contacting the relevant clients while independently confirming the physical existence of related client investments. An investment firm

could be required to provide the latest Register as a prerequisite to a Central Bank inspection. The Central Bank could require that the Internal Audit/Head of Compliance/CAOO provide it with a direct periodic report on his/her review and testing of the accuracy of the Register.

Insolvency

A Register would also allow the Insolvency Practitioner to quickly establish the extent of the potential impact on clients of the failure of an investment firm, to contact the firm's clients, to provide a list to the ICCL and, in conjunction with the other records of the failed investment firm, to use as a basis for the verification and return of client assets and for the calculation of a client's compensatable losses.

Single Resource

While the ICCL recognises that many elements referred to above are included in the Consultation Paper, a Client Register as proposed would be an effective overarching single resource/document bringing all elements together.

Legislation

It should be noted that Section 80 of the Central Bank (Supervision and Enforcement) Act 2013 ['CBSEA'] made three amendments to the ICA, including a new Section 33B. This provides the Minister for Finance with the power to make regulations for return of investors' funds or investment instruments where the Minister considers it necessary to do so in order to provide for their efficient, equitable and prompt return. Section 33 B was inserted in response to a recommendation contained in the Morrogh Working Group's Report which identified the lack of clarity on predetermined client asset distribution rules as an impediment to an efficient and prompt return of those assets. The provision states that regulations may include provision for:

- (a) the procedures and steps to be taken for the purpose of identifying, recording and, to the extent necessary, reconciling, the books, records or other documents of the investment firm to establish-
 - i. the monies, investment instruments or documents of title relating to such investment instruments which are held or which ought to be held on behalf of clients by the investment firm or by its nominee, and
 - ii. the claims of the clients of the investment firm against those monies, investment instruments or documents of title (whether or not those monies, investment instruments or documents of title continue to exist),

- (b) the satisfying and the raking of claims against investment instruments or classes of investment instruments,
- (c) the number, value and nature of claims against monies held or which ought to be held by an investment firm on behalf of clients,
- (d) the treatment and abatement of claims by clients,
- (e) the return of dividends, monies and investment instruments to clients,
- (f) the allocation and provision of reasonable expenses of a liquidator, receiver, administrator, examiner or official assignee subject to Regulations 157 and 158 of the European Communities (Markets in Financial Instruments) Regulations 2007 (S.I. No. 60 of 2007), and
- (g) the making of reports by an administrator to the Company containing such information relating to the administration of claims and at such time or times and in such manner as may be specified in the regulations.

The proposed Register of Clients would facilitate the processes envisaged by any legislation which would be introduced on foot of Section 33B of the ICA.

Responses to Questions raised by CP 71

Please find below, responses to certain questions posed by Consultation Paper 71. In relation to other questions posed, no response has been provided either because the ICCL agreed with the proposal or, given certain of the nature of the issues raised, had no comment to make.

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.

A: Generally yes, however, in the experience of the ICCL point 2 could be expanded slightly to oblige firms to clearly identify clients and client assets i.e. ensure key client data is up-to-date and relevant (address and contact details should be refreshed periodically).

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.

A: Yes, as long as prompt and practical action is taken to identify the relevant client.

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.

A: Yes – see other comments

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.

A: Yes: the CAO should ensure that shortfalls are investigated. Where the shortfall resulted from a failure on the part of the Investment Firm the CAO should ensure that a remedial action is put in place to prevent reoccurrence.

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.

A: Material deficiencies could raise a red flag pointing to fundamental difficulties with regard to fraud or failures in a firm's core systems. Taking account of a firm's authorised activities, turnover and compliance record the Central Bank should consider setting firm specific reporting thresholds by percentage of assets categories held and/or absolute value.

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.

See responses to questions 13 and 15 above: in that context the ICCL believes that the CAO should report to the Central Bank where the shortfall results from a systems failure within the firm.

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

A: Generally the ICCL agrees with annual statements, however, more regular reporting may be indicated where client's assets are above a certain (pre-determined) level.

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.

A: Generally yes, however, there would be value in including whether or to what extent client assets are pooled and the quantum of fees charged (taken) over a given period.

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?

A: See answers to questions: 13, 15 and 19.

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.

A: See above. The CAO should ensure a report is made directly to the Central Bank on foot of any investigation initiated in relation to a material issues report. It should also be stipulated that either the Central Bank or the CAO can request a meeting in the absence of any other senior officer of the firm.

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.

A: Yes, however, the ICCL recommend maintenance of a Client Register as a single resource as referred to above.

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

A: Yes. The ICCL particularly welcomes the inclusion of instructions to the auditor to include items (a) external confirmations and (b) positive confirmation requests. The External Auditor should copy any recommended remedial actions directly to the Central Bank.

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

A: Yes where (a) the level of client assets exceeds a (pre-determined) threshold or (b) a firm's compliance record is poor.