Consultation Paper CP71 – Client Asset Regulations and Guidance –

Independent Trustee Company

Client Asset Core Principles

The Review recommended that the revised client asset regime should make greater use of higher level principles reinforced with appropriate guidance. The Regulations are based on seven Client Asset Core Principles which reflect the fundamental obligations on all firms holding client assets.

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.

Answer:

Yes. However, additional consideration needs to be given to the concept of segregation of assets. Notional segregation is less effective against creditor challenge and makes for lack of transparency; physical segregation offers superior protection. Segregation of assets needs to take place not just internally within the account provider; client assets must be discernible and capable of individual allocation even by 3rd parties.

CAR may not always offer superior client protection. As an example, trusteeship may offer a level of segregation superior to CAR which gives comfort to clients in terms of protection and safeguarding of assets as trust assets are entirely segregated from assets of the provider. Accordingly, trusteeship provides superior asset protection in insolvency situations as the funds, when properly applied, are immediately distinguishable from the provider's own assets.

1. Segregation

A firm should physically hold, or arrange for the holding of, client assets separate from the firm's own assets and maintain accounting segregation between firm and client assets; for the avoidance of doubt this principle applies to clients' assets that may be held in nominee accounts.

Principle of Segregation:

- **Scope of Client Funds**

The Central Bank is proposing to adopt a wider scope for client funds. The CAR states that client funds consist of funds which, in the course of carrying on investment services, a firm receives or holds for or on behalf of clients. The Central Bank is proposing 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. Until the investment decision is taken, in accordance with Regulation 2. (7), the funds should be deposited within the timeframe permitted in a designated client asset bank account.

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

Answer: No.

To the extent that it is now anticipated that the definition of 'client funds' should be extended to all funds received irrespective of whether received for the purposes of investment services, we are opposed to it. Could the extension to the CAR regime potentially bring assets currently outside of CBI regulation, such as certain contributions to pension funds within the remit of the Central Bank? This is surely not intended. As outlined in our reply to Q1, the protection offered by trusteeship is in many way the equivalent or superior to the protection offered by CAR. Due consideration ought to be given to the impact of these measures. In the pensions industry,

trusteeship works well as an asset protection concept.

- **Identification of client funds**

The Central Bank is aware that there may be instances where a firm receives client funds from a client either by way of a cheque or electronic transfer and the firm is not in a position to identify the client or the client has submitted inadequate documentation to enable the firm to set up the account on its system.

As the Regulations cannot cover all eventualities that may occur in the industry and cognisant of Regulation 2. (7), the Central Bank, in attempting to adopt a practical approach is proposing that the firm should at the outset, assess if it is appropriate for the firm to accept such client funds in the absence of the necessary paperwork and/or until such time as the client is identified.

Regulation 2.(8) requires a firm when it receives funds where it is not clear which client owns such funds or there is insufficient documentation to identify the client who owns such funds, within two business days, to either identify the client concerned or return the funds.

The Central Bank expects a firm to set out in its CAMP, the steps a firm would follow in assessing how to deal with the receipt of client funds in this manner. Consideration of other regulations/legislation should be taken into account, e.g. anti-money laundering obligations, a firm should seek legal advice if it is in any doubt. Such assessment should be made without delay but in any event a firm should ensure it takes action in order to act in accordance with Regulation 2. (8). The firm should have clear procedures in place to ensure that those unallocated funds are monitored and reconciled each day. All such client funds should be included in the firm's daily reconciliation and daily calculation.

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.

Answer:

Consideration ought to be given to be given to the fact that a very short period, such as 2 days, for returning unallocated client funds may not be in the best interest of the consumer. Sufficient time ought to be granted allowing the consumer to be identified and assets allocated, in particular in circumstances where the difficulty experienced by the firm are of a trivial nature.

In the interest of consumer protection, the rule should allow for a longer period than 2 days before returning unidentified funds.

It ought to be a matter for the firm, in its CAMP, to set out the policy, steps and time frames appropriate for identifying client funds. Only in the context of the particular firm's type of business and manner of operating do such rules acquire relevance.

- **Collection Accounts**

The Central Bank is seeking to develop a proportionate regime, for the operation of subscription and redemption accounts, collectively known as Collection Accounts. A Collection Account is an account operated by a Fund Service Providers ("FSP") where funds are transferred from the client to the FSP for onward transmission to the Fund and likewise where money flows back from the Fund to the Collection Account for onward transmission to the underlying client. The Client Asset Regulations would apply to the money in the Collection Account. When the money is transferred to the Investment Fund, the Client Asset Regulations will not apply.

Regulation 2.(2) states a firm shall not place in a client asset or a Collection Account any asset other than a client asset except in accordance with Regulations 5.(3) and 5.(6). Regulation 2. (7) states any client funds received shall be deposited in a client asset account or Collection Account without delay and in any event not later than one business day after receipt of such funds.

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

Answer:

No comment.

- **Pooled Client Asset Accounts**

Where a firm holds client assets in pooled client asset accounts/Collection Accounts, accounting segregation must be maintained. In its internal records, a firm must maintain detailed accurate records in order to identify how much each client holds in that pooled client asset account/Collection Account and movements in that balance.

Regulations 2. (16) and 2. (17) set out what is required in relation to the recording of each transaction in respect of client assets in respect of each client. A firm should be able to identify where those pooled client assets are held externally, for example, if pooled client asset accounts/Collection Accounts are held with a number of third parties, a firm must be in a position to identify which client assets are held in each pooled account with each third party for each individual client. If a firm is not in a position to identify what portion of a client's assets are held in a pooled client asset account/Collection Account held with a third party, a firm will be unable to determine what clients are impacted if a third party fails.

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.

Answer:

Yes. Additional consideration needs to be given to the concept of segregation of assets. Notional segregation is less effective against creditor challenge and makes for lack of transparency; physical segregation offers superior protection. Segregation of assets needs to take place not just internally within the firm; client assets must be immediately discernible and capable of individual allocation

Where assets are held in a client asset account which in anyway is pooled this ought to be disclosed and highlighted to the consumer. Where the client does not get the full benefit of the pooled arrangement, for example because of a loss of interest, this must be disclosed.

- **Client's Margin**

An investment firm is permitted, under the existing Client Asset Requirements to apply required margin (the amount of cash or collateral which a person is required to deposit at any time as security for an investment position) received from a client in respect of a margin transaction as firm money. Any excess margin received over the required margin should be treated as client assets and should be deposited into a client asset account.

The Central Bank is seeking the views of stakeholders' in relation to how a client's required margin could be best protected in the event of the liquidation of an investment firm that writes margin transactions. At present, a client's required margin is allowed to be treated as firm money and can be lodged into the firm's own bank account for the firm's own use. Uncertainty arises where a firm is winding down or in particular in the event of its liquidation, when a client's position would be closed. Where such a client has made a profit on the closure of this

position, the money would flow back into the firm's own bank account. Does this situation create a risk to the client, in particular in the event of liquidation, where there may be insufficient money in the firm account to pay over to the client asset bank account.

One possible solution may be to hold 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 the situation described above occurring, the money would flow back into that same designated client asset margin bank account and would be there for the client.

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.

Answer:

No comment.

- **Retention of Records**

To demonstrate compliance with all of these Regulations, a firm is required under Regulation 2. (19) to keep records for six years after the date of the creation of the record concerned. Such records can be in hard or soft copy. Where the 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

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

Answer:

In order to offer maximum consumer protection, consideration ought to be given not just to limitation periods but to the rules of the courts. In effect, due the rules of the courts, court proceedings may be served up to one year after the expiry of the limitation period. On that basis, 7 years may be a more appropriate period for retention of records.

Under rules of trusteeship records generally have to be kept for 6 years after the wind-up of the trust. This offers a much longer protection when compared to the CAR system which operates with a retention period which starts to run immediately following the completion of the transaction.

2. Designation and Registration

A firm should ensure that client assets are clearly identified in its internal records and in the records of external parties and are identifiable from a firm's own assets.

Principle of Designation and Registration:

- **Funds and Financial Instruments Facilities Letter**

Before a firm deposits client assets with a third party, it shall enter into agreement with the third party known as 'Funds Facilities Letter' in respect of client funds and 'Financial Instruments Facilities Letter' in respect of client financial instruments. These letters are regarded as master letters obtained at the outset of the business relationship with the third party, if such a relationship changes, the letters may need to be reviewed.

Notwithstanding the above master letters, a firm has also to obtain a written Confirmation in advance from the third party as outlined in Regulation 3.(9) each time a client asset account/Collection Account is opened with the third party. Each Confirmation should clearly document the applicable client asset bank/Collection Account and

safe custody account numbers. Where client asset accounts are opened simultaneously (on the same day), one Confirmation may be obtained but the firm should ensure that the Confirmation from the third party lists all applicable accounts.

Regulation 3. (6) requires that a firm in advance of depositing client funds with a third party should enter into an agreement to be known as a Funds Facilities Letter which incorporates the following requirements:

(a) the funds in the client asset account/Collection Account are held by the firm as trustee;

(b) the third party will hold and record client funds separate from the firm's funds and that of the third party;

(c) the third party will designate the title of the account in its records in such a way as to make it clear that the client funds do not belong to the firm, in the case of a Collection Account, the title should be 'Collection Account';

(d) the third party is not entitled to combine the client asset account/Collection Account with any other account or to exercise any right of set-off or counterclaim against client funds in that client asset account/Collection Account in respect of any sum owed to it by any person, including any other account of the firm;

(e) the third party will deliver to the firm a statement or similar document as frequent as is required, to enable the firm to comply with Regulations 4.(1), 4.(2) and 4.(4) and it should specify all client funds held;

(f) the third party will not make withdrawals other than to the firm or on the firm's instructions by authorised signatories; and

(g) the extent of the third party's liability in the event of the loss of client funds whether caused by the fraud, wilful default or negligence of the third party or otherwise, or an agent appointed by the third party:

Regulation 3.(7) requires that an investment firm in advance of depositing client financial instruments with a third party should enter into an agreement to be known as a Financial Instruments Facilities Letter which incorporates the following requirements:

(a) the financial instruments in the client asset account are held by the investment firm as trustee;

(b) the third party will hold and record financial instruments separate from the investment firm's financial instruments and that of the third party;

(c) the third party will designate the title of the client asset account in its records in such a way as to make it clear that the financial instruments do not belong to the investment firm;

(d) the third party is not entitled to combine the client asset account with any other account or to exercise any right of set-off or counterclaim against financial instruments in that account in respect of any sum owed to it by any person, except

i. to the extent of any charges relating to the administration or safekeeping of that client's financial instruments; or

ii. where that client of the investment firm has failed to settle a transaction by its due settlement date;

(e) the third party will specify what the arrangements will be for registering financial instruments if they will not be registered in the client's name;

(f) the third party will not make withdrawals other than to the investment firm or on the investment firm's instructions by authorised signatories;

(g) the third party may only claim a lien or security interest over an individual client's financial instruments:

i. to the extent of any charges relating to the administration or safekeeping of that client's financial instruments; or

ii. where that client of the investment firm has failed to settle a transaction by its due settlement date;

(h) the extent of the third party's liability in the event of the loss of client assets whether caused by the fraud, wilful default or negligence of the third party or otherwise, or an agent appointed by the third party; and

(i) that the third party will deliver to the investment firm a statement or similar document as often as is required to enable the investment firm to comply with Regulation 4. (3) and such statement shall specify all financial instruments held and a description and the amount of all the financial instruments held in the client asset accounts.

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

Answer:

No comment.

- **Withdrawal of client assets if not held in a designated client asset account by a third party**

Regulation 3.(5) requires a firm within one business day of the initial lodgement of the client assets in a client asset account or Collection Account with a third party to verify that the assets are held in an account which is designated as a client asset account or Collection Account and requires a firm to withdraw the client assets without delay but in any event within one business day of the verification process if the third party has not designated the account as a client asset account/Collection Account.

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.

Answer:

Inflexible requirements may be easily enforceable but may not best serve consumer protection purposes. You need to allow time for the rectification of clerical errors and other circumstances of a trivial nature.

It ought to be a matter for the firm, in its CAMP, to set out the policy, steps and time frames appropriate for dealing with funds which are not applied to a client account. Only in the context of the particular firm's type of business and manner of operating do such rules acquire relevance.

3. Reconciliation

A firm should keep accurate books and records as are necessary to enable it, at any time and without delay, to provide an accurate record of the client assets held by a firm for each client and the total held in the client asset account. A firm should conduct on a regular basis, reconciliation between its internal records and those external records of any third party with whom client assets are held.

Principle of Reconciliation:

- **Reconciliation of client asset accounts which hold client funds**

Regulation 4.(1) requires an investment firm to reconcile, at least monthly, the balance of all client funds held as recorded by the investment firm with the balance of all client funds held as recorded by third parties and such reconciliation shall be carried out by the end of the following business day to which the reconciliation relates. Regulation 4.(2) requires that client asset accounts which hold client funds and have daily transactions should be reconciled daily and such reconciliation shall be carried out by the end of the following business day to which the reconciliation relates.

The Central Bank expects client bank accounts such as term deposit accounts to fall into the category of Regulation 4.(1) on the basis that these accounts do not have daily transactions processed through the account and transactions would be effected at fixed times, for example at maturity or if the length of the term was 'broken'. An investment firm may have other client asset accounts such as a current account(s), call accounts; while the frequency of transactions in these accounts may be infrequent they may be subject to a greater risk of misappropriation, the Central Bank expects a firm to apply Regulation 4.(2) in respect of such accounts. A firm should have procedures in place to be able to monitor when transactions are processed through its client bank accounts.

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.

Answer:

Where accounts have infrequent transactions, monthly reconciliation of the account ought to suffice.

- **Reconciliation of client asset accounts which hold client financial instruments**

Regulation 4.(3) requires an investment firm to reconcile, at least monthly, the balance of client financial instruments held as recorded by the investment firm with the balance of all client financial instruments held as recorded by third parties and such reconciliation shall be carried out within ten business days of the date to which the reconciliation relates.

Where reconciling items arise from the reconciliation, an investment firm should investigate and identify the cause of any differences in the reconciliation within one business day, as required by Regulation 4.(9). If, following the investigation of the reconciling items, a shortfall in client financial instruments is identified, an investment firm should immediately:

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.

Answer:

No comment.

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.

Answer:

No comment.

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.

Answer:

An obligation to make good any shortfall should only be imposed where the shortfall has arisen directly as a result of the action of the investment firm. Where proper disclosure is made to the client regarding the destination of the funds there seems to be no compelling reason for imposing a strict liability on the investment firm.

- **Reconciliation of Collection Accounts**

In accordance with Regulation 4.(4) a fund service provider shall reconcile the Collection Account each day that a transaction occurs on that account, but in any event, at least monthly and such reconciliation shall be carried out by the end of the following business day to which the reconciliation relates.

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

Answer:

No comment.

- **Material Reconciling Differences arising from a firm's Reconciliation**

The Central Bank does not require a firm to report all reconciling differences arising from its Client Asset/Collection Account reconciliation but rather expects a firm to report material reconciling items with the level of materiality determined by the firm. In considering its determination of materiality, the Central Bank draws attention to the guidance provided by the Central Bank in G 4 (10) to G 4 (12) and in particular to the maximum timeframe provided by the Central Bank in G 4 (13) under the reconciling categories of: timing differences, errors on the part of a 3rd party and errors on the part of a firm. When the Regulations take effect, the Central Bank will write to each firm instructing a firm when and how often it has to report its material reconciling differences. The Central Bank where necessary may engage with a firm to discuss how its material reconciling differences have been determined and assess if other factors need to be considered.

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.

Answer:

Yes.

4. Daily Calculation

Each business day a firm should ensure that the aggregate balance on its client asset bank accounts (client money resource) as at the close of business on the previous business day is equal to the amount it should be holding on behalf of its clients (its client money requirement).

Principle of Daily Calculation:

- **Client Money Requirement and Client Money Resource for Investment Firms**

The Client Money Requirement represents all money held on behalf of clients or validly due to clients as of the date of the calculation that should be recorded in the books and records of the investment firm appropriately adjusted by reference to reconciling items on the client asset bank reconciliation. For example, money is validly due to the client if the client has delivered an asset and has not been credited with the proceeds, or funds have been returned to the client but have not cleared in the client asset bank account of the firm (e.g. uncashed cheques).

An investment firm writing margin transactions should also include:

(a) any excess margin due to clients and

(b) the amount a firm would be liable to pay to clients in respect of their margined transactions, if each client open position was liquidated and the account closed.

Less

the net amount a firm would receive in respect of the firm's margined transactions for clients with counterparties, if each client open position was liquidated and the firm's account with the counterparty closed.

The Client Money Resource represents the sum of all the investment firm's client asset bank balances that should be recorded in the books and records of the investment firm appropriately adjusted by reconciling items on the client asset bank reconciliation. Any funds held in foreign currency should be converted to the base currency using the Central Bank rate for that day or any other established automatic rate feed.

In accordance with Regulation 2.(3), a firm should not use for the account of one client, the funds of another client except where such use is in accordance with a legally enforceable agreement.

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

Answer:

No comment.

- **Client Money Requirement and Client Money Resource for Fund Service Provider ('FSP')**

In respect of Collection Account(s) held by a FSP, the Client Money Requirement includes cash which is mainly received for pending subscriptions prior to the dealing date of the investment funds or cash received from the investment funds as a result of, for example redemptions/ dividends and has yet to be paid to the investors of the investment funds.

The Client Money Resource for Collection Accounts stands as the sum of all Collection Accounts in credit that should be recorded in the books and records of the FSP appropriately adjusted by reconciling items on the client asset bank reconciliation and not the net sum of the Collection Accounts as stated in the client asset bank statement.

Where a Fund Service Provider transfers funds from the Collection Account to an investment fund prior to receiving such funds into the Collection Account from the client, it will result in a deficit in the Collection Account. The Fund Service Provider should ensure that any credit balances available in the Collection Account

are not used to fund or reduce this deficit. Prior to operating in this manner, the Fund Service Provider should ensure that it has a credit facility in place to finance such deficits or it operates a separate Collection Account for credit balances. Where a credit facility exists, the FSP should ensure that such credit facility does not attach a lien/charge over the client assets. Whatever approach a FSP decides to take, it is the FSP's responsibility to ensure that it is acting within its authorisation received from the Central Bank.

In accordance with Regulation 2.(3), a firm should not use for the account of one client, the funds of another client except where such use is in accordance with a legally enforceable agreement.

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.

Answer:

Yes.

- **No excess firm's own funds in the form of a 'buffer' should be maintained in a client asset account over a firm's Client Money Requirement**

Regulation 5.(1) and 5.(4) requires that each business day a firm performs a Daily Calculation to ensure that its Client Money Resource as at the close of business on the previous day is equal to its Client Money Requirement. In the interest of the protection of clients, Regulation 5.(3) and 5.(6) requires that in the event of a shortfall in a Client Asset Account/Collection Account a firm shall, without delay and in any event within one business day, deposit in the Client Asset Account/Collection Account such money as is necessary to cover the shortfall. The money deposited by the firm in the Client Asset Account/Collection Account for the purpose of covering the shortfall will be regarded as client money.

In order to uphold the core principle of Segregation, a firm must maintain accounting segregation between firm and client assets. Regulation 2. (2) state that a firm shall not place in a client asset account/Collection Account any asset other than a client asset except in the case of Regulations 5. (3) and 5. (6). The Regulations do not permit a firm to maintain any asset other than client assets in a client asset bank account/Collection Account, e.g. firm's own funds in the form of a 'Buffer'. Where its Client Money Resource is less than its Client Money Requirement, a firm shall without delay deposit its own firm money into the client asset bank account. Where the Client Money Resource is greater than its Client Money Requirement, a firm shall transfer any excess firm's own funds over and above the Client Money Requirement to the firm's own bank account i.e. no excess firm's funds over the client money requirement should be maintained in a client asset bank account. Therefore, a firm's Client Money Resource should only contain what the firm is required to hold for its clients on a given day.

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.

Answer:

The maintenance of a 'buffer' in the client account may be appropriate. If the buffer is reconciled and allocated to the firm itself, such a precautionary measure may be appropriate to safeguard client's funds.

- **When should a firm notify the Central Bank regarding a shortfall in its Client Money Resource to cover its Client Money Requirement?**

The Central Bank does not require an investment firm to notify it each time it has to fund a client money resource shortfall, it is seeking to be informed of funding levels when they are material. However, given that each investment firm varies in size and business model, it is not possible to put forward a threshold level for shortfall funding that would be material for all investment firms. As a result, the Central Bank will require each investment firm to assess its own level of funding materiality and inform the Central Bank in writing as to its rationale in making this determination.

When these Regulations take effect, the Central Bank will write to each investment firm instructing the investment firm to report its material funding levels each day together with the reasons for the funding. Likewise, the Central Bank will also instruct an investment firm to notify the Central Bank in writing and the reasons thereof, when the level of money it withdraws from its client asset bank account is material; this is on the basis that its client money resource exceeds its client money requirement. The Central Bank, where necessary, may engage with an investment firm to discuss its funding and its materiality rationale.

When the Regulations take effect, the Central Bank will engage with the funds industry to agree when and how a FSP should report to the Central Bank when it has to fund a shortfall. The Central Bank would welcome the views of the funds industry on this matter.

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.

Answer:

Daily reporting to the Central Bank, in particular where there are limited fluctuations in the need for covering a client money shortfall, is excessive. Reporting should occur where there is a material shortfall. Investment firms are well-used to assessing materiality in other areas of Central Bank regulation. There seems to be no reason for disapplying materiality as a parameter in the case of client asset regulations.

5. Client Disclosure and Client Consent

A firm should provide information to its clients in a way that informs the client on how and where their client assets are held and the resulting risks thereof. A firm should also inform its clients when their assets are operating within the client asset protection regime and when their assets are held outside the client asset protection regime.

Principle of Client Disclosure and Consent:

The focus of this principle is about informing the client. Under this principle, there are a number of Regulations imposed on the firm where the firm has to ensure that a client is informed of where his/her assets are held, by whom, what are the risks and if there any regulatory/legal implications of where the assets are held.

While the Central Bank does not prescribe where and how this information is disclosed to its client, it is envisaged that a firm will provide this information in its terms of business and in the case of the Fund Service Provider in the Investment Fund's Prospectus and where applicable in the Investment Fund's Application Form.

- **What should be included in an Annual Statement issued by the investment firm to its clients?**

Regulation 6.(16) requires an investment firm to provide its clients with an annual statement which shall include the following information:

(a) details of all the financial instruments held by the investment firm for the client at the end of the period covered by the statement and the jurisdiction of where they are held,

(b) the extent to which any client assets have been the subject of securities financing transactions,

(c) the extent of any benefit that has accrued to the client by virtue of participation in any securities financing transactions and the basis on which that benefit has accrued,

(d) the amount of cash balances (which may be shown on a separate statement) held by the investment firm as of the statement date and the jurisdiction of where they are held,

(e) whether client assets held by the investment firm are covered by the provisions of these Regulations,

(f) identification of those client financial instruments registered in the client's name which are held in custody by, or on behalf of, the investment firm separately from those registered in any other name, and

(g) the market value of any collateral held as at the date of the statement.

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

Answer:

Yes – annual is sufficient

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.

Answer:

As set out above, we suggest that the Annual Statement in addition ought to include:

- A statement of the nature of segregation of client funds, whether notional or physical, and whether segregated from the firm's own funds,
- The mechanisms which the client may employ to verify his/her asset holding, and
- To what extent interest accrued on any pooled funds is fully allocated to the client (or is being retained by the investment firm).

- **Should a Fund Service Provider provide annual statement to its clients?**

Given the short period of time that client funds are deposited in a Collection Account, issuing an annual statement to a client would not be practicable but more importantly it would not provide any benefit to the client as the money may have moved into the Investment Fund by the time the client receives the statement. Instead, the Central Bank requires the FSP to issue a more detailed receipt to its client over and above what is required in Regulation 2.(18). Regulation 6.(17) provides that each time a Fund Service Provider receives client funds, the Fund Service Provider will as soon as practical issue to the client a receipt in writing for those funds and include at a minimum:

a) the date on which the client funds will be transferred out to the investment fund; and

b) information that these Regulations will apply to the client funds in the Collection account but will cease to apply when the client money is transferred to the investment fund.

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.

Answer:

No comment.

- **Prior written consent from a client of an investment firm**

Regulation 6.(18) requires an investment firm, prior to first receiving client assets, to obtain prior written consent from a client in the following circumstances:

(a) where granting to any third party a lien or security interest over the client's assets;

(b) with respect to the arrangements for giving and receiving of instructions by, or on behalf of, the client and any limitations to that authority, in respect of the provision of safe-keeping services which it provides;

(c) where client assets are be passed to other persons;

(d) where client assets are passed to a third party outside the State;

(e) where a client instructs an investment firm to deposit client assets with a specific third party that does not meet the investment firm's [internal risk assessment];

(f) when client assets are held in a pooled client asset account;

(g) where interest earned on client funds is to be retained by the investment firm;

(h) where client financial instruments are to be deposited with a third party in a third country that does not regulate the holding and safekeeping of client financial instruments.

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.

Answer:

In principle yes. However, flexibility ought to be introduced in compelling circumstances allowing for a subsequent consent and oral consent to be given. Inflexible rules may be straightforward to enforce but may not best serve client protection needs.

- **Prior written consent from a client of a Fund Service Provider**

A FSP is required to comply with Regulation 6.(19) whereby prior to first receiving client assets and without prejudice to any other provision in the Regulations requiring the consent of a client, a fund service provider shall obtain the consent in writing of the client in the following circumstances:

a) where client assets are to be passed to other persons other than the investment fund;

b) when client asset are held in a pooled collection account;

c) where interest earned on client funds is to be retained by the Fund Service Provider.

For FSP's, the Central Bank expects a FSP to obtain the necessary prior written consent in the Investment Fund's Application Form. The FSP should maintain evidence of obtaining the required client's prior written consent.

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.

Answer:

No comment.

- **Client Asset Key Information Document for a Firm**

Clients can sometimes struggle to understand or may overlook the technical text in a client document. In order to address this concern, the Central Bank also requires a firm to provide to its client a simple 'plain English' standalone document known as the 'Client Asset Key Information Document' ("CAKID"). While the Central Bank provides in Regulation 6. (20) what should be disclosed to the client in the CAKID, it is not an exhaustive list. When a firm is drafting the CAKID, it should approach the drafting with a blank sheet, with the objective of having a CAKID that will inform a client without the technical jargon of how and where his assets are held, the resulting risks if any at each stage and what protection is available.

Where an investment firm secures new clients after these Regulations take effect, the CAKID should be provided during the client account opening process. In the case of clients that existed at the time of the Regulations taking effect, the investment firm should issue the CAKID to them, documenting in its CAMP how it will provide this document to the client.

Where a FSP has clients that invest in an Investment Fund that is launched after these Regulations take effect, the CAKID should be attached to the Investment Fund's Application Form, these would be regarded as new clients for the purpose of the Regulations. In the case of clients that make a subsequent subscription for shares in an Investment Fund that existed prior to the Regulations taking effect, the FSP should document in its CAMP the medium it will use to provide the CAKID to its client.

A firm should ensure a client receives the most up to date version of the CAKID.

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.

Answer:

Yes. However, the CAKID may give rise to confusion where the client receives several CAKID as the funds pass through more than one client asset account.

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.

Answer:

No comment.

6. Risk Management

A firm should ensure it has and applies systems and controls that are appropriate to identify risks in relation to client assets and should put in place mitigants to counteract these risks.

Principle of Risk Management:

- **Client Assets Oversight Role ("CAOR")**

Rigorous senior management oversight of the controls and processes in place to safeguard client assets is critical. Evidence has shown the responsibility of complying with the current client asset requirements seems to fall across a number of functions within a firm, e.g. the Compliance function and/or the Finance function. This is not the ideal approach as there may be a lack of clarity as to who is responsible for what and staff may not have the appropriate experience to understand the firm's client asset obligations. There may also be a lack of understanding of the firm's business model and therefore staff cannot always assess how the business model may contribute to risks associated with safeguarding client assets.

In order to have a key individual taking responsibility and ownership for the firm's compliance with the Regulations, thereby ensuring that key client asset related issues are given priority and are brought to the attention of the Board of the firm, the Central Bank is proposing the role of CAOR. This person would be a pre-approved controlled function appointed under Part 3 of the Central Bank Reform Act 2010. Appointing a person as the CAOR ("Client Asset Oversight Officer") would not distract from the overall responsibility of the firm's governing body to safeguard client assets. In most cases, the Central Bank would expect a director to be nominated for the CAOR position. Where a firm proposes to appoint an individual who is not a director, e.g. in a large firm, the individual should be a senior manager with direct access to the Board in respect of the client assets function.

Regulation 7.(2) provides details of the responsibilities of the Client Asset Oversight Officer, which shall include:

a) that the client asset management plan referred to in Regulation 7.(3) is produced, maintained, reviewed and updated as information upon which the client asset management plan is based, changes;

b) that any matters relating to the safeguarding of client assets are reported to the Board of the firm in the case of a company or to each of the partners in the case of a partnership;

c) ensuring that the Bank is notified of any breaches of these regulations;
d) approving any returns to the Bank in relation to client assets;

e) reporting to the Board in respect of any issues raised by the external auditors in relation to client assets;

f) ensuring that the persons performing the daily calculations as required under Regulation 5.(1) and Regulation 5.(4) and the reconciliations required under Regulations 4.(1) to 4.(4) have sufficient skill and expertise to perform those functions;
g) an assessment of risks to client assets arising from the firm's business model

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?

Answer:

It should be possible for the Finance Director of the firm to assume the role of CAOR.

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.

Answer:

The duties of the CAOR ought to be set out in the CAMP, with approval by the firm's board of directors. It ought to be a matter for the firm, in its CAMP, to set out the responsibilities of the CAOR. Only in the context of the particular firm's type of business and manner of operating do the responsibilities of the CAOR acquire relevance.

- **Client Assets Management Plan ("CAMP")**

Evidence has shown a deficiency in detailed information a firm may hold in respect of its client assets. There has been a lack of documentation on a firm's business model, the risks to client assets, what controls are in place to mitigate these risks, what is the daily oversight and monitoring of these controls and by whom and ultimately what level of oversight is being exercised by the Board or where applicable the partners of a firm.

The key purpose of the CAMP is to:

a) demonstrate how the firm's systems and controls meet the objectives of the client assets regime;

b) document the firm's business model and related risks in respect of the safeguarding of client assets and the controls in place to mitigate these;

c) enable the Board to document and monitor material changes to the firm's business model, changes to controls and processes and therefore the changes in the associated risks to the safeguarding client assets;

d) make information readily available to assist in the prompt distribution of client assets in the event of the firm's insolvency.

The CAMP should be a 'live' working document produced by the Client Asset Oversight Officer and approved by the Board of the firm

Regulation 7.(6) sets out what a firm should at a minimum include in its CAMP. This information can be included in an actual CAMP document or it may refer to where such information may be located. For example, the CAMP may record where the most recent bank reconciliation can be located within a firm as opposed to inserting a copy of the most recent reconciliation each time reconciliation is carried out, which would be cumbersome and would result in possible duplication of work.

While a firm should develop its CAMP depending on the nature, scale and complexity of a firm's business model, it should be of sufficient detail to enable a reader to understand the business model, the resulting risks to safeguarding the client assets and the mitigants in place to minimise the impact of these risks. The information contained in the CAMP should also be sufficient to facilitate the distribution of client assets, particularly in the event of the insolvency of the firm.

Regulation 7.(4) requires that the CAMP is reviewed and updated at least annually or more frequently, if there is any change to the firm's business model which effects the manner by which client assets are held. The effectiveness and the firm's compliance with its CAMP must be monitored regularly. Material changes to the

CAMP should be notified to the Board, including any significant changes to the firm's business or arrangements or any errors, omissions or control weaknesses highlighted from the regular monitoring, including the external auditors review of the CAMP (see Principle of Client Asset Examination), to ensure it remains current. Regulation 7.(5) requires that the Board of a firm or each of the partners in a firm shall approve the CAMP on an annual basis or if there is any change to the firm's business model which effects the manner by which client assets are held.

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.

Answer:

Yes.

7. Client Asset Examination

A firm should engage its external auditor to report on the firm's safeguarding of client assets.

Principle of Client Asset Examination ("CAE"):

The Central Bank is proposing that a revised approach should be adopted in assessing a firm's compliance with the Regulations. The assessment by the firm's external auditor will be performed annually rather than semi-annually as currently required.

It is the responsibility of the Board to ensure that a firm's policies, procedures and operations are robust and complete so that client assets are safeguarded and, in the event of a firm's insolvency, available assets may be returned to the owner at lowest cost. The CAE is intended to provide assurance to the Board and the Central Bank that the firm has complied with the Regulations and that the firm has acted in a manner consistent with its CAMP.

Regulation 8.(1) requires a firm to arrange for an external auditor to prepare a report in relation to that firm's safeguarding of client assets on an annual basis. Regulation 8.(3) states that the report should include an assessment of the following matters as at the period end date:

a) the adequacy of the processes and systems in place to meet the requirements of these Regulations throughout the period concerned;

b) the firm's compliance with these Regulations;

c) any matter that has come to the attention of the auditor to suggest that the firm has acted in a manner which is not consistent with the client asset management plan which has been in operation throughout the period concerned;

d) whether changes made to the client assessment management plan since the date of the last report are in sufficient detail to meet the objectives of the Regulations; and

e) risks faced by the firm in holding client assets with regard to the nature and complexity of the business of the firm.

A firm needs to ensure that it engages an external auditor that has the necessary skillset to carry out the CAE outlined in Regulation 8.(3) providing a reasonable assurance in respect of Regulation 8.(3) (a) and (b) and a limited assurance in respect of Regulation 8.(3) (c), (d) and (e).

In addition to all other procedures which the auditor deems necessary for the completion of the CAE, subject to the considerations as set out within the auditor's technical standard on auditing the Regulations, the Central Bank expects that a firm would instruct the auditor at a minimum to seek:

a) external confirmations of any balances held in respect of client assets by other financial institutions both at year-end and also on one other randomly scheduled date during the year; and

b) positive confirmation requests, from a representative sample of clients as determined by the auditor, of client asset balances at the randomly selected date during the year, not to be the period end date.

Regulation 8.(5) requires a firm to assess the findings of the CAE with Regulation 8.(6) requiring a firm to ensure that any remedial actions necessary are carried out, thereby taking responsibility for a firm's compliance with the Client Asset Regulations.

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

Answer:

No comment.

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

Answer:

No, the daily oversight by the CAOR coupled with an annual review should suffice.

Transitional Regulation

The Transitional Regulation will be a once-off regulation on a firm's initial CAMP, this does not prohibit the Central Bank requesting further reviews internally or by an external party on an individual firm if it is found there are issues with a firm's CAMP at any time.

Regulation 9.(1) requires that within 3 months from the date of the taking effect of these Regulations, a firm shall, obtain an assessment of the client asset management plan from an independent external expert (not being the firm's external auditor) and such an assessment shall include:

a) whether the CAMP has been drafted in sufficient detail to capture the risks faced by the firm in holding client assets given the nature and complexity of the business of the firm and the environment within which it operates;

b) whether the controls identified within the CAMP have been implemented in a manner consistent with that documented within the CAMP;

c) whether the CAMP adequately covers all of the requirements as set out in Regulation 7.(6);

d) the identification of areas where in the opinion of the external expert the CAMP could be improved;

e) an assessment of the appropriateness of the process to be undertaken by the firm to assess the on-going adequacy of its CAMP including evidence of the steps taken by the firm to test and maintain the CAMP.

It is of paramount importance that the independent expert engaged by a firm is somebody of relevant expertise that will provide value to a firm resulting in an assessment that will inform a firm.

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?

Answer:

No. We do not view the need to have this type of assessment carried out by an independent external expert. It should be sufficient for the firm's external auditor to carry out this assessment as part of its overall external audit of the firm.

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.

Answer:

See reply to Q32.