

Client money and unbreakable deposits

Consultation Paper

CP17/29*

August 2017



How to respond

We are asking for comments on this Consultation Paper (CP) by 1 November 2017.

You can send them to us using the form on our website at: www.fca.org.uk/your-fca/documents/consultation-papers/cp17-29-response-form.

Or in writing to:

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Client Assets and Resolution
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Financial Conduct Authority
25 The North Colonnade
Canary Wharf London E14 5HS

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1 Summary

Why we are consulting

- 1.1** This consultation paper (CP) consults on minor amendments to the Client Assets sourcebook (CASS). Some investment firms are experiencing difficulty depositing client money at banks in accordance with CASS requirements. The proposals in this CP are intended to address the potential harm to consumers resulting from this.

Who this applies to

- 1.2** This CP proposes changes to CASS that are applicable to certain regulated firms that hold client money in relation to investment business. The proposals will not apply to general insurance intermediaries that only hold client money under CASS 5 or debt management firms that only hold client money under CASS 11. The proposals will also not apply to client money received by a firm in its capacity as a trustee firm.
- 1.3** This CP will interest banks with whom firms deposit client money. It may also interest auditors in relation to the provision of client assets audit reports.
- 1.4** The proposals in this CP will ensure consumers continue to be appropriately protected by firms receiving or holding their client money in accordance with CASS. We welcome feedback from consumer and consumers groups on these proposals.

The wider context of this consultation

- 1.5** Some firms are experiencing difficulty depositing client money with banks. Feedback from industry strongly suggests that this is partly due to the unintended combined effects of a rule¹ in the client money rules (CASS 7) and the prudential liquidity rules applicable to banks. CASS 7 prevents firms from placing client money in bank accounts with unbreakable terms of longer than 30 days (30-Day Rule). Banks have cited the cost of liquidity requirements associated with such 30-day money as their main reason for their reduced appetite for client money.
- 1.6** Our proposals aim to prevent the potential harm to consumers if a firm reaches a point where it is unable to deposit client money at banks which meet its risk tolerance. This could result in client money being returned to clients against their wishes or being deposited with banks that do not meet due diligence requirements.
- 1.7** We are consulting on an amendment to the 30-Day Rule to ensure consumers continue to be appropriately protected by firms holding their client money. See Chapter 2 'The Wider Context' for further background.

1 CASS 7.13.13R(3)



What we want to change

- 1.8** We are seeking views on the following proposed changes to CASS:
- permit a firm to deposit an appropriate proportion of client money in an unbreakable deposit (UD) of a maximum of 90 days
 - where a firm deposits client money in a UD of 31 – 90 days, it must comply with certain conditions
 - require CASS medium and large firms to report client money in a UD of 31 – 90 days in their client money and asset return (CMAR)
- 1.9** Our proposals are intended to enhance our client assets regime and improve consumer outcomes by ensuring client money continues to be appropriately protected when it is held by firms. We welcome feedback from respondents on whether there are any unintended consequences that could result from our proposals and how these might be avoided.

Outcome we are seeking

- 1.10** Our proposals aim to make it easier for firms to place client money in client bank accounts, as banks should be more willing to accept this client money on a longer term deposit. This in turn will ensure clients don't suffer harm as a result of firms needing to give money back to clients or needing to place client money at banks they would not otherwise choose.

Measuring success

- 1.11** We propose to monitor the placement of client money in UD's through firms reporting this information in the CMAR. Success will be firms continuing to be able to place client money in bank accounts, thereby helping to ensure that client money is not rejected by firms.

Next steps

- 1.12** We want to know what you think of our proposals. Please send us your comments by 1 November 2017.
- 1.13** To submit a response, please use the online response form on our website or write to us at the address in the contact box at the beginning of this CP.
- 1.14** Following consideration of feedback to this CP, we aim to publish a policy statement making final rules. Our current expectation is for the rules to come into force concurrent to the Handbook changes required by the Markets in Financial Instruments Directive II (MiFID II) coming into force. The instrument in Appendix 1 has been drafted as applied post-MiFID II.

2 The wider context

The harm we are trying to address

- 2.1** CASS 7 applies to money received or held by a firm for, or on behalf of, a client in the course of, or in connection, with its MiFID business, designated investment business or relevant ISA business.² Pursuant to CASS 7³, firms are required to deposit client money in an account opened with an authorised bank, a central bank or a qualifying money market fund.
- 2.2** In July 2014⁴ we introduced the 30-Day Rule in response to behaviour we had seen in the market, where some firms were depositing client money in three to four year UD's. We note that, generally speaking, the nature of client money is that it is held by a firm on a transitory basis en route to being invested.
- 2.3** The policy rationale behind introducing the 30-Day Rule was:
- firms are required to carry out risk assessment on the banks with which they deposit client money and should ensure they are able to react to that risk assessment by withdrawing and re-locating client money if necessary
 - client money must be readily available for distribution to clients in the event of the failure of a firm
- 2.4** In that paper, we set out our view that the use of UD's with lengthy terms to hold client money is incompatible with the purpose of the client money regime. The client assets regime aims to ensure client money held by a firm is well protected and, in the case of a firm insolvency, as much of the client money as possible can be returned to clients as quickly as possible.
- 2.5** We have received strong feedback that some firms are experiencing increasing difficulty depositing client money at banks. Feedback from industry suggests this is partly due to the unintended combined effects of the 30-Day Rule and the prudential liquidity rules applicable to banks. The liquidity requirements applicable to banks under the Liquidity Coverage Ratio (LCR) require banks to have highly liquid assets to cover 100% of their potential net cash outflows over 30 days. All client money is therefore subject to the LCR. Banks have cited this cost associated with 30-day money as the main reason for their reduced appetite for client money. Industry feedback suggests the issue has been exacerbated by the significantly increased amount of client money in the system and low interest rates.

2 CASS 7.10.1R

3 CASS 7.13.3R

4 See PS14/9: Review of the Client Assets Regime for investment business, paragraph 7.98–7.106



- 2.6** The LCR is a component of the Basel III reforms, which are global regulatory standards on bank capital adequacy and liquidity. The LCR standard has been implemented in the EU through the Commission Delegated Regulation (EU) 2015/61.⁵
- 2.7** There may be potential harm to consumers if a firm reaches a point where it is unable to deposit client money at a bank. This could result in client money being returned to clients against their wishes and firms not being able to provide services to clients, or client money being deposited with banks outside the firm's risk tolerance. The scale of the difficulties and the potential consumer outcomes differ from firm to firm.

How it links to our objectives

- 2.8** Our proposals aim to improve protection for consumers by ensuring that firms can continue to deposit client money at appropriate banks.

What we are doing

- 2.9** We are seeking feedback to our proposals set out in Chapter 3.

Equality and diversity considerations

- 2.10** We have considered the equality and diversity issues that may arise from the proposals in this CP. Overall, we do not consider that the proposals in this Consultation Paper adversely impact any of the groups with protected characteristics ie age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment.
- 2.11** We will continue to consider the equality and diversity implications of the proposals during the consultation period, and will revisit them when publishing the final rules.
- 2.12** In the interim, we welcome any input to this consultation on such matters.

⁵ European Commission: 'Commission Delegated Regulation (EU) No2015/61 of 10 October 2014 to supplement EU Regulation (EU) No 575/2013 of the European Parliament and Council with regard to liquidity coverage requirement for Credit Institutions', <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R0061&from=EN>.

3 Proposed amendments affecting unbreakable deposits

3.1 In this chapter, we outline:

- the pre-consultation work that we have carried out in the lead up to this paper
- our proposed changes to CASS 7 affecting the length of term a firm can deposit client money in a UD
- further explanation of certain aspects of the proposal

Pre-consultation work

3.2 In the first quarter of 2017, the FCA formed a technical working group comprising a small number of firms (each representing an industry association) in order to investigate this issue in greater detail. We would like to thank the technical working group for their feedback.

3.3 Firms, banks and industry associations have also independently provided information to the FCA in connection with this issue.

3.4 We have worked with the Bank of England to finalise the proposals in this CP.

The proposals

3.5 Feedback from industry has consistently recommended that if the 30-Day Rule were amended to allow firms to place client money in bank accounts with unbreakable terms of longer than 30 days, banks would regain some appetite to hold client money. This is because client money held in UDs of longer than 30 days would not be as expensive to banks, as it would not attract the same treatment under the LCR. A range from 35 to 95 days has been suggested.

3.6 In this CP, we propose:

- a. Firms are permitted to deposit an appropriate proportion of client money in client bank accounts with unbreakable terms or notice periods of between 31 and, up to a maximum of, 90 days ('90-Day UDs').
- b. Prior to a firm depositing client money in 90-Day UDs, it must:
 - i. produce a written policy that sets out:
 - the maximum proportion of client money held by the firm, on a per business line basis, that it considers would be appropriate to hold in such accounts having



regard to the need to manage the risk of the firm being unable to access client money when required, for example, to meet client instructions

- the firm's rationale for reaching this conclusion, and
 - the measures the firm will put in to place to manage the risk of the firm being unable to access client money when required, taking in to consideration a number of factors including historic and expected client money receipts and payments and stress scenarios
- ii. provide each client with a written explanation of the risks that arise as a result of the longer notice periods for withdrawals
- c. Whilst a firm uses 90-Day UD's, it must:
- i. take appropriate measures to manage the risk of the firm being unable to access client money when required, for example, in order to carry out instructions for clients or act on a client's behalf
 - ii. keep its written policy under review, amending it where necessary
 - iii. for CASS medium and large firms, report the 90-Day UD's in their CMAR under section 3, data field 13⁶
 - iv. before holding or receiving client money from new clients, provide them with a written explanation of the risks that arise as a result of the longer notice periods for withdrawals

3.7 The proposed rules include an evidential provision setting out in more detail how a firm can demonstrate compliance with the requirement to take appropriate measures to manage the risk of being unable to access client money when required. We are not proposing at this time a prescriptive 'stress testing' or liquidity risk management regime such as that set out in BIPRU 12.4, which is applicable to some firms in the context of their liquidity requirements. BIPRU 12.4 for example sets out detailed requirements that a firm must consider, including the potential impact of a range of scenarios on their liquidity position and different liquidity risk mitigation tools. In this CP we are proposing a less prescriptive set of provisions that a firm should consider to manage the risk of being unable to access client money when required.

3.8 We propose requiring a firm to retain the written policy (and any subsequent versions) for a period of five years. We also propose requiring a firm to include the written policy in its CASS Resolution Pack (CASS RP).

3.9 The proposed rules make it clear that firms will not be in breach of the rules in cases where the unbreakable term expires on a day the relevant bank is not open for business, provided that the firm is able to make the withdrawal of client money on the next day the bank is open for business.

3.10 The proposed rules do not allow the use of UD's in the context of client money sub-pools. Client money sub-pools are permitted in the CASS rules in the context of regulated clearing arrangements between firms and clearing houses and are intended

⁶ CASS Small firms are not subject to the CMAR (SUP 16.14.1R)

to facilitate the porting of client positions and monies where possible in the event of a firm failure. The use of any UD would not be appropriate in this context as this would have the potential to delay porting following a firm failure.

- 3.11** We note that firms are not prohibited from holding client money in long term *breakable* deposits. Trustee firms are not prohibited from placing trustee firm client money in UDs⁷ (although the proposals in this CP would be applicable to client money these firms hold in a capacity other than as trustee firms).

Further explanation

- 3.12** The risks of placing client money in lengthy unbreakable terms remain: the potential for client money not being available for distribution to clients in the case of a firm insolvency and the inability of a firm to react to market information, putting all client money in a UD at risk of diminution. However, we have considered the 30-Day Rule in light of the current market environment for depositing client money.
- 3.13** In proposing an amendment to the 30-Day Rule, we have taken into account the timelines of CASS firm insolvencies, the need for a firm to react promptly to its due diligence and the current market for client money deposits. We have also considered the PRA's proposed regime applicable to banks that hold client money (see paragraph 3.17).

90 Days

- 3.14** As set out above, our view remains that the use of UDs with lengthy terms to hold client money is incompatible with the purpose of the client money regime. However, we recognise the difficulties that firms are having in placing client money and the consequent, potential harm to consumers.
- 3.15** Keeping in mind our statutory and operational objectives, our position is that any amendment to the 30-Day Rule must strike the right balance between upholding our policy intention (as set out in PS14/9) and having a regime that in practice allows firms to deposit their client money at banks.
- 3.16** In our pre-consultation discussions, feedback indicates that 90-day deposit products are available for firms at banks and shorter term products are also available, but less widely so. However, to take into account (i) the fact that in certain three-month periods there may be (up to) 92 days rather than 90 days (eg March to May or July to September), this being relevant for term deposits, and (ii) the expiration of a 90-day notice period may fall on a weekend or a bank holiday, the suggestion has been that the CASS rule should permit up to 95-day term deposits or notice periods. Pre-consultation discussions also indicated that term deposits are more administratively burdensome than notice accounts and more infrequently used. In addition, we understand that market convention is that if the expiration of a notice period falls on a Saturday, money is released the day before (ie Friday), whereas if the expiration falls on a Sunday, money is released the following day (ie Monday).

7 CASS 7.13.3R(4)



- 3.17** On 13 July 2017, the PRA published Consultation Paper CP13/17 on Pillar 2 liquidity.⁸ In CP13/17, the PRA outlined its view that a 90-day horizon is essential to ensure an effective monitoring of firms' liquidity risks and proposed to monitor credit institutions' contractually due cash flows with daily granularity of up to 92 days (to accommodate months with 31 calendar months).
- 3.18** Should the PRA implement its proposal, an amendment to the 30-Day rule to permit client money to be held in 90-Day UDs would ensure such deposits fall within the PRA's proposed monitoring window for credit institutions. Conversely, an amendment of the 30-Day Rule to permit longer than 90 days would take the portion of client money held in a 90+ day account outside the PRA's proposed monitoring window.
- 3.19** We note that under the Financial Services Authority's previous liquidity monitoring regime, banks were required to monitor their liquidity on 30 and 90-day bases. We therefore expect a number of banks are likely to have retained the systems and products set up to monitor and offer 90-day UDs. We note that setting the maximum unbreakable term of a client money deposit for any period longer than 30 days would not attract the same treatment under the LCR, which industry has cited is the main reason for bank's reduced appetite for holding client money.
- 3.20** In light of this, in our view, setting the maximum unbreakable term of a client money deposit at 90 days for a proportion of client money achieves the appropriate balance for the following reasons:
- A range of products from 31 to 90 days are available and offered by banks, but up to 90-day products are more attractive to banks.
 - Extending the rule to 90 days will allow firms to place client money in bank accounts, while protecting client money in line with the original policy intention.
 - As set out in this and other policy documents, one overall aim of the client money regime is to ensure that, in the event of a firm's failure, client money can be returned to clients or transferred to another service provider⁹ as soon as possible. While not all client money will necessarily be returned to clients or transferred within 30 or 90 days following a firm's failure, where client money is 'stuck' in lengthy UDs, this process cannot start, potentially to the detriment of all clients expecting to share in the client money pool. That said, we recognise the need to balance firms' compliance with the CASS rules on an ongoing basis and the rules in place to ensure client money can be returned as swiftly as possible in the case of a failure.
 - We consider that ensuring that client money deposits fall within the 31 to 90-day monitoring period proposed by the PRA furthers our consumer protection objective by ensuring that banks and certain investment firms will also monitor these deposits as part of their own liquidity management.
 - As noted above, pre-consultation discussions indicated that term deposits are infrequently used for client money compared to notice accounts, as they are administratively burdensome compared to notice accounts. Partly with this in mind, a maximum of 92 days is not reflected in the proposed rules. The proposed rules directly address the issue of the expiration of a 90-day term deposit or notice

⁸ Pillar 2 liquidity – CP13/17: <http://www.bankofengland.co.uk/pr/Pages/publications/cp/2017/cp1317.aspx>

⁹ PS17/18, CASS 7A and Special Administration Regime review

account falling on a bank holiday, so firms placing client money in 90-day products should not be in breach of CASS 7 in this event.

- Q1:** Do you agree with our proposal to permit firms to deposit client money in UD's of up to 90 days? If not, why not? Please provide specific examples.
- Q2:** Do you agree with our proposal that where the expiry of a notice period falls on a day the bank is closed, provided that the firm is able to make the withdrawal on the next day that bank is open for business, this is not a breach of CASS 7. If not, why not? Please provide specific examples.
- Q3:** Do you agree with our proposed conditions for firms that deposit client money in UD's of greater than 30 days? If not, why not?
- Q4:** Are the provisions setting out how a firm can demonstrate compliance with the requirement to take 'appropriate measures to manage the risk of the firm being unable to access client money when required' understandable and achievable? Would it be helpful to set out more detailed requirements and guidance such as for example those found in BIPRU 12.4 for considering stress scenarios or developing a contingency funding plan?
- Q5:** Do you agree with our policy to require a firm to include the written policy in its CASS RP? If not, why not?

CMAR reporting

- 3.21** As set out above, for CASS medium and large firms, we propose requiring them to report 90-Day UD's in their CMAR's under section 3, data field 13.
- 3.22** Given that firms already complete the CMAR on a monthly basis and will be required to monitor the amount of client money held in 90-Day UD's as part of the proposals set out in this paper, we do not consider it to be overly burdensome for firms to report this information in an existing field of the CMAR. Our intention is to use this information to help us supervise the use of these deposits, to understand which firms are using them, which banks are offering them and on what term lengths.
- 3.23** We have proposed amending the Guidance to the CMAR¹⁰ on how these UD's should be reported by firms. This includes the table below as an illustration of how firms should complete data field 13 for UD's. Column B should be used to set out both the name of the institution and the length of the unbreakable term. Column C should be used to list the amount of client money in 'up to 30 day' deposits and then separately itemise the amount of client money in each different deposit term length. In the table below, at Bank A Ltd the reporting firm holds £500,000 in up to 30-day deposits, £25,000 in 35-day UD's and £30,000 in 90-day UD's, and at Bank B Ltd the reporting



firm holds £100,000 in up to 30-day deposits, £60,000 in 35-day UD^s and £50,000 in 90-day UD^s.

Table 1: Illustration of how firms should complete CMAR section 3, data field 13 if using a 90-day UD

A	B	C	D	E
Type	Institution	Client money balances (£k)	Country of incorporation of the institution	Is this a group entity?
Bank	Bank A Ltd	500	UK	No
Bank	Bank A Ltd unbreakable 35	25	UK	No
Bank	Bank A Ltd unbreakable 90	30	UK	No
Bank	Bank B Ltd	100	UK	No
Bank	Bank A Ltd unbreakable 60	60	UK	No
Bank	Bank A Ltd unbreakable 90	50	UK	No
	etc			

Q6: Do you agree with our proposal to require CASS medium and large firms to report UD^s in this way? If not, why not.

Annex 1

Questions in this paper

- Q1:** Do you agree with our proposal to permit firms to deposit client money in UD's of up to 90 days? If not, why not? Please provide specific examples.
- Q2:** Do you agree with our proposal that where the expiry of a notice period falls on a day the bank is closed, provided that the firm is able to make the withdrawal on the next day that bank is open for business, this is not a breach of CASS 7. If not, why not? Please provide specific examples.
- Q3:** Do you agree with our proposed conditions for firms that deposit client money in UD's of greater than 30 days? If not, why not?
- Q4:** Are the provisions setting out how a firm can demonstrate compliance with the requirement to take 'appropriate measures to manage the risk of the firm being unable to access client money when required' understandable and achievable? Would it be helpful to set out more detailed requirements and guidance such as for example those found in BIPRU 12.4 for considering stress scenarios or developing a contingency funding plan?
- Q5:** Do you agree with our policy to require a firm to include the written policy in its CASS RP? If not, why not?
- Q6:** Do you agree with our proposal to require CASS medium and large firms to report UD's in this way? If not, why not.
- Q7:** Do you have any comments on our cost benefit analysis? Please provide explanations and quantitative evidence to support your response where appropriate.

Annex 2

Cost benefit analysis

1. The Financial Services and Markets Act 2000 (FSMA), as amended by the Financial Services Act 2012, requires us to publish a cost benefit analysis (CBA) when proposing draft rules. Specifically, section 138(2)(a) requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits' that will arise if the proposed rules are made. It also requires us to include estimates of those costs and benefits, unless these cannot reasonably be estimated or it is not reasonably practicable to produce as estimate.
2. In this chapter we summarise the proposals and assess the costs and benefits. The CBA compares the overall position if the proposed rule amendments are applied and the overall position if they are not (ie the baseline).

Table 2: Summary of estimated costs and benefits to industry as a whole

	Number of firms ¹¹	One-off costs to industry (£)	Ongoing costs to industry (£)	Ongoing net benefits to industry (£) ¹²	Ongoing net benefits to consumers ¹³ (£)
CASS small	124	57,288	Minimal	41,850–58,590	4,650–6,510
CASS medium	443	209,096	212,640	35,691,624–50,044,824	3,965,736–5,560,536
CASS large	29	64,380	13,920	97,862,472–137,012,472	10,873,608–12,223,608
Total	596	330,764	226,560	133,595,946–187,115,886	14,843,994–20,790,654

Benefits of the proposals

3. Pre-consultation feedback confirms that the main benefit to our proposal is that it will make it easier for firms to place client money in client bank accounts, as banks should be more willing to accept this client money. The proposal will reduce the time and costs that firms spend in negotiating their banking arrangements, part of which may be passed on to consumers. This in turn will help to ensure that clients do not suffer as a result of firms needing to either give money back to clients or place client money at banks they would not otherwise choose.
4. The increased length from 30 to 90 days of the term (or notice period) on client money in a UD is expected to increase the rate of interest earned on these deposits. Based on pre-consultation feedback, we estimate that the interest rate is expected to increase from zero by 25 to 35 basis points on a 90-Day UD.
5. The table below provides an estimation of the expected interest earnings of a firm

¹¹ Figures as at 7 June 2017 of firms holding client money

¹² 90% of interest earnings estimated in Table 3 minus on-going costs estimated in this chapter

¹³ 10% of interest earnings estimated in Table 3

placing 50% of its client money in a 90-Day UD. We assume at least 10% of these earnings may be passed on to consumers.

Table 3: Estimated increased interest earnings for industry

	Number of firms ¹⁴	Average client money holdings (£) ¹⁵	Estimated interest earnings for a firm (25–35 basis points) (£) ¹⁶	Estimated interest earnings of proposal for industry as a whole (£) ¹⁷
CASS small	124	300,000	375–525	46,500–65,100
CASS medium	443	72,000,000	90,000–126,000	39,870,000–55,818,000
CASS large	29	3,000,000,000	3,750,000–5,250,000	108,750,000–152,250,000
Total	596	3,072,300,000	3,840,375–5,376,525	148,666,500–208,133,100

6. In PS 14/9, we noted that one of the purposes of the 30-Day Rule was to ensure that a firm could respond swiftly to return client money quickly in the event of a firm's failure.¹⁸ If a firm with client money in a 90-Day UD fails, on the face of it the firm will not be able to distribute that client money until it receives it when the 90-day term has matured. Analysis of recent firm failures shows that 20–30% of cases have taken less than 90 days to distribute or transfer some or all client money following a primary pooling event.¹⁹ We are aware that, in a firm failure situation, some banks may consider breaking the fixed term to return client money swiftly.
7. Similarly, a firm will not be able to withdraw money in response to market information concerning a bank²⁰ until the 90-day term has matured. However, firms will be able to get this client money back more swiftly than they might in the absence of any rule as firms may otherwise be tied into longer term UD's.²¹
8. In our view, a benefit of our proposal is that it strikes the right balance between firms being able to respond to market information and collect client money in failure situations, and place this client money with banks on a business as usual basis.

Costs of the proposals

9. We do not consider there to be any cost to firms associated with the term extension from 30 to 90 days as, as stated above, we believe this will make it easier for firms to place client money in client bank accounts. As mentioned in paragraph 6, we also do not envisage any significant costs to consumers associated with the term extension from 30 to 90 days.

14 Figures as at 7 June 2017 of firms holding client money

15 Figures as at 7 June 2017 of firms holding client money

16 For 25 basis points, 0.25% x (50% x client money holdings); for 35 basis points, 0.35% x (50% of average client money holdings)

17 Number of firms x estimated interest earnings per firm

18 In accordance with the client money distribution rules (CASS 7A)

19 CASS 7A.2

20 For example, the bank's failure which would trigger a secondary pooling event under CASS 7A.3. Clients who request to have their client money placed in a designated client bank account at a bank different from a bank that later fails should not suffer the loss of the bank that has failed (CASS 7A.3.5G).

21 PS14/9, Review of the client assets regime for investment business, paragraph 7.106



10. There may be costs associated with the proposed conditions attached to allowing a firm to place client money in 90-Day UD's and with reporting these in the CMAR. These are estimated below.

Disclosure to clients

11. We estimate that a firm choosing to place client money in a 90-Day UD will incur the following costs as a result of being required to disclose risks of this to their clients:

Table 4: Estimated cost of disclosure to clients

	Number of firms ²²	One-off median costs for a firm (£) ²³	One-off median costs for industry as a whole (£) ²⁴
CASS small	124	250	31,000
CASS medium	443	250	110,750
CASS large	29	1,500	43,500
Total	596	2,000	185,250

Appropriate measures in place to be able to meet instructions from clients in relation to client money held

12. We are aware that many firms already have some form of management process to ensure they have sufficient liquid client money to meet client instructions. Firms are also required to manage their own liquidity risk.²⁵ In addition, firms currently subject to the 30-Day Rule would need to ensure client instructions can be met. We are therefore aware that firms already manage this risk in relation to client money. On this basis, we expect minimal costs associated with this proposal.

Written policy document

13. As set out above, we are aware that many firms have some form of management process to ensure that they have sufficient liquid client money to meet client instructions. We therefore expect that some of these firms will already have written policies and procedures in place around this. We estimate a firm will incur one-off costs in producing the written policy as follows:

Table 5: Estimated costs of written policy document

	Number of firms ²⁶	One-off costs for a firm (£) ²⁷	One-off costs for industry as a whole (£) ²⁸
CASS small	124	192	23,808
CASS medium	443	192	85,056
CASS large	29	240	6,960
Total	596	624	115,824

22 Figures as at 7 June 2017 of firms holding client money

23 Based on previous cost survey figures on disclosure to clients for CP13/5: Review of the client assets regime for investment business.

24 Number of firms x estimated costs per firm

25 BIPRU 12.3

26 Figures as at 7 June 2017 of firms holding client money

27 Based on previous cost surveys on compliance costs, we estimate this will take a compliance officer a maximum of four hours to complete at £48 per hour for CASS small and CASS medium firms (based on existing due diligence and risk management processes) and a maximum of five hours at £48 per hour for CASS large firms (given their complexity).

28 Number of firms x estimated costs per firm

14. We expect minimal ongoing costs to maintaining the policy as firms will already be maintaining existing policies around liquidity risk management. We also expect a firm will incur minimal incremental costs as a result of having to retain all versions of the written policy document for five years (for example, we expect incremental costs of no more than £0.05 per firm annually).²⁹

Adding written policy document to CASS RP

15. We estimate the following one-off costs for a firm adding the written policy document to its CASS RP:

Table 6: Estimated costs of updating CASS RP

	Number of firms ³⁰	One-off costs for a firm ³¹ (£)	One-off costs for industry as whole ³² (£)
CASS small	124	20	2,480
CASS medium	443	30	13,290
CASS large	29	30	870
Total	596	80	16,640

16. We expect a firm will incur minimal ongoing costs to ensure that the written policy document is up to date in the CASS RP, as a firm will only need to update it when the written policy document is updated.

CMAR reporting

17. We expect there will be minimal costs associated with CASS medium and large firms³³ reporting their client money balances in a 90-Day UD in their CMAR, given these firms already complete the CMAR on a monthly basis and, as part of the proposals set out in this paper, will be required to monitor the amount of client money held in a 90-Day UD. We estimate the following ongoing costs based on previous cost survey figures relating to reporting processes.³⁴

Table 7: Estimated costs of CMAR reporting

	Number of firms ³⁵	Ongoing costs for a firm ³⁶ (£)	Ongoing costs for industry as whole ³⁷ (£)
CASS medium	443	480	212,640
CASS large	29	480	13,920
Total	596	960	226,560

29 See NERA report, Estimated compliance costs of conduct of business regulation for general insurance, 2003 (figures adjusted for inflation), p 28, available at www.fsa.gov.uk/pubs/cp/187/nera.pdf

30 Figures as at 7 June 2017 of firms holding client money

31 Based on previous cost surveys on the CASS RP for CP11/16, Recovery and Resolution Plans. We estimate this will take an employee a maximum of one hour to complete at £20 per hour for CASS small firms and £30 per hour for both CASS medium and CASS large firms.

32 Number of firms x estimated costs per firm

33 CASS small firms are not subject to the CMAR requirement (SUP 16.14)

34 CP11/16, Recovery and Resolution Plans, Annex 1

35 Figures as at 7 June 2017 of firms holding client money

36 We estimate this will take an employee a maximum of one hour per month to complete at £40 per hour for both CASS medium and CASS large firms.

37 Number of firms x estimated costs per firm



Q7: Do you have any comments on our cost benefit analysis?
Please provide explanations and quantitative evidence to support your response where appropriate.

Annex 3

Compatibility statement

Compliance with legal requirements

1. This annex explains how our proposals for consultation in this CP are compatible with the requirements under section 138I of FSMA.
2. When consulting on new rules, we are required by section 138I(2)(d) of FSMA to explain why the proposed rules are compatible with our strategic objective of ensuring relevant markets function well, advances one or more of our operational objectives, and has regard to the statutory principles in section 3B of FSMA. We are also required by section 138K(2) of FSMA to state our opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.
3. This annex also sets out our view of how the proposed rules are compatible with our duty to discharge our general functions (including rule making) in a way that promotes effective competition in the interests of consumers (section 1B(4) of FSMA). This duty applies in so far as promoting competition is compatible with advancing either or both of our consumer protection and integrity objectives.

The FCA's objectives and regulatory principles: Compatibility statement

4. Our proposals in this CP aim to improve protection for consumers by ensuring firms can continue to deposit client money at appropriate banks, thereby reducing the risk that client money may be returned to the client against the client's wishes or being deposited with banks that do not pass firms' due diligence requirements.
5. In preparing the proposals in this CP, we have had regard to the principles set out in section 3B of FSMA.

Compatibility with the principles of good regulation

6. **The need to use our resources in the most efficient and economical way**
We believe that the proposals in this CP will have minimal impact on our resources.



Expected effect on mutual societies

7. We do not expect that the proposals in this CP will have an impact on mutual societies as we are not aware of any mutual societies that hold client money and would, therefore, be subject to these proposed rules.

Compatibility with the duty to promote effective competition in the interests of consumers

8. We have a duty to discharge our general functions (which include rule making) in a way that promotes effective competition in the interests of consumers (section 1B(4) of FSMA). This duty applies in so far as promoting competition is compatible with advancing our consumer protection and/or integrity objectives.
9. In relation to competition, we do not expect that the proposed changes will materially affect the number of firms providing investment services, or their incentives to compete with each other for customers. However, we expect it will improve competition to the extent that it will make it easier for firms to deposit client money at appropriate banks.

Equality and diversity

10. We are required under the Equality Act 2010 to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. As part of this, we have conducted an equality impact assessment to ensure that the equality and diversity implications of any new policy proposals are considered.
11. Our findings indicate that these proposals have no anticipated positive or negative impacts on particular groups as a result of any protected characteristic.

Legislative and Regulatory Reform Act 2006 (LRRRA)

12. We are required under the LRRRA to have regard to the principles in the LRRRA and to the Regulators' Compliance Code when determining general policies and principles and giving general guidance (but not when exercising other legislative functions).
13. We have also considered the Regulators' Compliance Code for the parts of the proposals that consist of general policies, principles or guidance. We consider that the proposals are proportionate to the potential risk to consumers identified.

Annex 4

Abbreviations in this document

CASS	Client Assets Sourcebook
CASS RP	CASS resolution pack
CBA	Cost-benefit analysis
CMAR	Client money and asset return
CP	Consultation Paper
FCA	Financial Conduct Authority
FSMA	Financial Services and Markets Act 2000
ISA	Individual savings account
MiFID II	European Parliament and Council Directive on markets in financial instruments (No. 2014/65/EU), commonly referred to as the 'Markets in Financial Instruments Directive II'
PRA	Prudential Regulation Authority
QMMF	Qualifying money market fund
UD	Unbreakable deposit

We have developed the policy in this Consultation Paper in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 7066 9644 or email: publications_graphics@fca.org.uk or write to: Editorial and Digital team, Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS



Appendix 1

Draft handbook text

CLIENT ASSETS (TERM DEPOSITS) INSTRUMENT 2017

Powers exercised

- A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137A (The FCA’s general rules);
 - (2) section 137B (FCA general rules: clients’ money, right to rescind etc);
 - (3) section 137T (General supplementary powers);
 - (4) section 138C (Evidential provisions); and
 - (5) section 139A (Power of the FCA to give guidance).
- B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on [*date*].

Amendments to the Handbook

- D. The Client Assets sourcebook (CASS) is amended in accordance with Annex A to this instrument.
- E. The Supervision manual (SUP) is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Client Assets (Term Deposits) Instrument 2017.

By order of the Board
[*date*]

Annex A

Amendments to the Client Assets sourcebook (CASS)

In this Annex, underlining indicates new text and striking through indicates deleted text.

7 Client money rules

...

7.13 Segregation of client money

...

7.13.13 R (1) An account which the *firm* uses to deposit *client money* under CASS 7.13.3R(1) to CASS 7.13.3R(3) must be a *client bank account*.

(2) ~~Each~~ In respect of each *client bank account* used by a *firm* ~~must be held on terms under which~~ to satisfy its obligation under CASS 7.13.3R(1) to (3):

(a) the relevant bank's contractual counterparty ~~is~~ must be the *firm* itself ~~that is subject to the requirement under CASS 7.13.3R;~~ and

(b) ~~unless the *firm* has agreed terms that comply with CASS 7.13.13R(3)~~ subject to paragraph (3A), the *firm* is ~~must be~~ able to make withdrawals of *client money* promptly and, in any event, within one *business day* of a request for withdrawal.

Transitional provision CASS TP 1.1.10AR applies to (2).

(3) ~~*Firms* may use *client bank accounts* held on terms under which withdrawals are, without exception, prohibited until the expiry of a fixed term or a notice period of a maximum of 30 days. [deleted]~~

(3A) Where the requirement under sub-paragraph (2)(b) is not satisfied and provided that the *client bank account* is not included in a *sub-pool*, a *firm* may use a *client bank account* from which it will be unable to make a withdrawal of *client money* until the expiry of a fixed term or notice period lasting:

(a) up to 30 days; or

(b) provided the *firm* complies with CASS 7.13.14AR, from 31 to 90 days.

(4) Paragraphs (2)(b) and ~~(3)~~ (3A) do not apply in respect of *client*

money received by a firm in its capacity as a trustee firm.

7.13.14 G CASS 7.13.13R(2)(b) and CASS 7.13.13R(~~3~~) (3A) do not prevent a *firm* from depositing *client money* on terms under which a withdrawal may be made before the expiry of a fixed term or a notice period (whatever the duration), including where such withdrawal would incur a penalty charge to the *firm*.

7.13.14 R A firm may only use one or more *client bank accounts* under CASS
A 7.13.13R(3A)(b) if:

- (1) prior to using any such *client bank accounts*, it:
 - (a) produces a written policy that sets out:
 - (i) for each of its business lines, the maximum proportion of the *client money* held by the *firm* that the *firm* considers would be appropriate to hold in such *client bank accounts* having regard to the need to manage the risk of the *firm* being unable to access *client money* when required;
 - (ii) the *firm's* rationale for reaching its conclusion(s) under (i); and
 - (iii) the measures that it will put into place to comply with sub-paragraph (2)(a) of this rule, having regard to CASS 7.13.14CE; and
 - (b) provides each of its *clients* with a written explanation of the risks that arise as a result of the longer notice period for withdrawals that:
 - (i) is clear, fair and not misleading; and
 - (ii) in respect of the medium of the explanation, satisfies whichever of COBS 6.1.13R (Medium of disclosure) or COBS 6.1ZA.2.15EU (Medium of disclosure) applies to the *firm* in respect of its obligations to provide information to the *client*; and
- (2) while the *firm* uses any such *client bank accounts*, it:
 - (a) takes appropriate measures to manage the risk of the *firm* being unable to access *client money* when required;
 - (b) keeps its written policy under sub-paragraph (1)(a) under review, amending it where necessary;
 - (c) if SUP 16.14 (Client money and asset return) applies, allocates a specific row in data field 13 of its CMARs for each *client bank account* that falls under CASS 7.13.13R(3A)(b),

marking them as “unbreakable” within data field 13B and also specifying in that data field the length of the relevant period under CASS 7.13.13R(3A)(b) for that *client bank account*; and

(d) provides any of its *clients* to whom it has not previously provided the explanation under sub-paragraph (1)(b) with such a written explanation before it starts to hold or receive *client money* for them.

7.13.14 B R (1) A *firm* must make and retain a written record of:

(a) the written policy it produces under CASS 7.13.14AR(1)(a); and

(b) each subsequent version of the written policy it produces as a result of CASS 7.13.14AR(2)(b).

(2) The *firm* must make the record:

(a) under sub-paragraph (1)(a) on the date it produces the written policy; and

(b) under sub-paragraph (1)(b) on the date it produces the new version of the written policy.

(3) The *firm* must keep each record under this *rule* for a period of five years after the earlier of:

(a) the date on which the version of the policy to which the record relates was superseded; and

(b) the date on which the *firm* ceased to use *client bank accounts* under CASS 7.13.13R(3A)(b).

7.13.14 C E (1) Appropriate measures under CASS 7.13.14AR(2)(a) include the *firm* considering the need to make, and making where appropriate, quarterly or more frequent adjustments to the amount of *client money* held in *client bank accounts* under CASS 7.13.13R(3A)(b), taking into consideration the following factors:

(a) historic and expected future *client money* receipts and payments;

(b) the *firm's* own analysis of its exposure to the risk of being unable to meet instructions from its *clients* in relation to *client money* that it holds, applying an appropriate set of time horizons and stress scenarios; and

(c) the content of the *firm's* written policy under CASS

7.13.14AR(1)(a)(i) and (ii).

- (2) Compliance with (1) may be relied on as tending to establish compliance with CASS 7.13.14AR(2)(a).
- (3) Contravention of (1) may be relied on as tending to establish contravention of CASS 7.13.14AR(2)(a).

7.13.14 D G (1) Under CASS 7.13.14AR(2)(b) a firm should consider whether amendments to its written policy under CASS 7.13.14AR(1)(a) are needed for any reason, including in light of the firm's analysis in the course of its measures under CASS 7.13.14AR(2)(a).

(2) Each time a firm amends its written policy under CASS 7.13.14AR(1)(a), it should also update the rationale for the amended policy under CASS 7.13.14AR(1)(a)(ii).

(3) The stress scenarios under CASS 7.13.14CE(1)(b) should include a variety of severe yet plausible institution-specific and market-wide liquidity shocks.

7.13.14E R A firm will not be in breach of CASS 7.13.13R(3A) in cases where a fixed term or notice period for a withdrawal that is permitted under that rule expires on a day on which is not a business day for the relevant bank, provided that the firm is able to make the withdrawal on the next business day for the relevant bank.

...

10 CASS resolution pack

...

10.3 Existing records forming part of the CASS resolution pack

10.3.1 R A firm must include, as applicable, within its CASS resolution pack the records required under:

...

(5B) CASS 7.13.14BR (policy for use of client bank accounts under CASS 7.13.13R(3A)(b));

...

...

Insert the following new row in the appropriate numerical position in Schedule 1 (Record keeping requirements). The text is not underlined.

Sch 1.3G

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
...				
CASS 7.13.14BR	The <i>firm's</i> written policy produced under CASS 7.13.14AR(1)(a) in respect of the <i>firm's</i> use of <i>client bank accounts under CASS</i> 7.13.13R(3A)(b), and subsequent versions of it	(i) For each of the <i>firm's</i> business lines, the maximum proportion of the <i>client money</i> held by the <i>firm</i> under CASS 7.13.3R(1) to (3) in respect of the business line that the <i>firm</i> considers would be appropriate to hold in such accounts; (ii) the <i>firm's</i> rationale for reaching its conclusion(s) under (i); and (iii) the means by which the <i>firm</i> will comply with CASS 7.13.14AR(2)(a), having regard to CASS 7.13.14CE.	On the date it creates the version of the policy	Five years after the earlier of: (1) the date on which the version of the policy was superseded; and (2) the date on which the <i>firm</i> ceased to use <i>client bank accounts under CASS</i> 7.13.13R(3A)(b).

Annex B

Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text.

16 Reporting requirements

...

16 Guidance notes for the data item in SUP 16 Annex 29R Annex 29AG

...

Section 3 Segregation of client money

...

13B Institution where *client money* held

A *firm* should report the full name and firm reference number (if applicable) of the individual legal entity with which it has placed *client money*.

If the *firm* used *client bank accounts* under CASS 7.13.13R(3A)(b) during the reporting period, then to comply with CASS 7.13.14AR(2)(c) it should use this section to report:

- the banking institution where that *client bank account* is held;
- the fact that the *firm* cannot make a withdrawal for a given period, using the marker “unbreakable”; and
- the duration of the relevant period under CASS 7.13.13R(3A)(b), expressed in *days*.

The *firm* should adopt the following format for this: “Bank Name unbreakable [duration in days]”. See Table 13C for an example of this.

13C *Client money* balances

A *firm* should report the total amount of *client money* which it has placed with each institution identified in 13B.

If the *firm* used *client bank accounts* under CASS 7.13.13R(3A)(b) during the reporting period, then to comply with CASS 7.13.14AR(2)(c) it should report both:

- the total balance of *client money* held at that institution in *client bank accounts* falling under CASS 7.13.13R(2)(b) or CASS 7.13.13R(3A)(a); and
- in separate rows, the total balance of *client money* held at that institution in each of the *client bank accounts* under CASS 7.13.13R(3A)(b).

See Table 13C for an example of this.

...

The balance shown in that row may also include any balance that is included in data field 17.

Table 13C

Table 1 shows an example of how a *firm* that used *client bank accounts* under CASS 7.13.13R(3A)(b) during the reporting period should complete data field 13.

<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>	<u>E</u>
<u>Type</u>	<u>Institution</u>	<u>Client money balances ('000)</u>	<u>Country of incorporation of the institution</u>	<u>Is this a group entity?</u>
<u>CRD Credit Institution</u>	<u>Bank A Ltd</u>	<u>500</u>	<u>UK</u>	<u>No</u>
<u>CRD Credit Institution</u>	<u>Bank A Ltd unbreakable 35</u>	<u>25</u>	<u>UK</u>	<u>No</u>
<u>CRD Credit Institution</u>	<u>Bank A Ltd unbreakable 90</u>	<u>30</u>	<u>UK</u>	<u>No</u>
<u>CRD Credit Institution</u>	<u>Bank B Ltd</u>	<u>100</u>	<u>UK</u>	<u>No</u>
<u>CRD Credit Institution</u>	<u>Bank B Ltd unbreakable 60</u>	<u>60</u>	<u>UK</u>	<u>No</u>
<u>CRD Credit Institution</u>	<u>Bank B Ltd unbreakable 90</u>	<u>50</u>	<u>UK</u>	<u>No</u>

...

