
Client money held in Individual Savings Accounts: Feedback to CP14/9 and final rules

July 2014



In this Policy Statement we report on the main issues arising from Consultation Paper 14/9* (*Client Money in Individual Savings Accounts*) and publish the final rules.

Please send any comments or queries to:

Jane Moore and Yujin Baskett
Client Assets & Wholesale Conduct Department
Markets Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Telephone: 020 7066 1000
Email: CASS.Queries@fca.org.uk

You can download this Policy Statement from our website: www.fca.org.uk. Or contact our order line for paper copies: 0845 608 2372.

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Abbreviations in this document

CASS	Client Assets sourcebook
CBA	cost benefit analysis
CIS	collective investment scheme
client money	for the purpose of this PS, any money belonging to a client which a firms holds under the client money rules in CASS 7
CMAR	client money and asset return
CP	Consultation Paper
FCA	Financial Conduct Authority
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services Market Act 2000
HMRC	Her Majesty's Revenue and Customs
ISA	Individual Savings Account
MiFID	European Parliament and Council Directive on Markets in Financial Instruments Directive (No. 2004/39/EC)
NISA	New Individual Savings Account
PRA	Prudential Regulation Authority
PS	Policy Statement

1 Overview

Introduction

- 1.1 On 11 June 2014, we published a Consultation Paper (CP) proposing amendments to the client money rules in response to recent changes made to the Individual Savings Account (ISA) regulations which come into force on 1 July 2014. This Policy Statement (PS) summarises the feedback we received to the CP, our response to this feedback and sets out the finalised rules.

Who does this affect?

- 1.2 This PS makes changes to the rules in the Client Assets sourcebook (CASS). These affect ISA managers who manage either stocks and shares ISAs or cash ISAs, and who hold, or wish to hold, these monies as client money. It does not affect ISA managers who hold money within ISAs that they manage as deposits with themselves.
- 1.3 This paper may also be of interest to deposit takers of money held within ISAs managed by investment firms.

Is this of interest to consumers?

- 1.4 This PS is of interest to consumers who currently have an ISA or may consider one in the future.
- 1.5 While the changes apply to the management of ISAs consumers will largely see no difference in the day-to-day operation of their ISA(s).
- 1.6 There are currently significant differences in the maximum level of protection provided by the FSCS, depending on whether consumers hold their cash savings in cash ISAs or in stocks and shares ISAs, and these differences will continue to exist.
- 1.7 The rule changes in this PS will apply the client money rules to all money held within stocks and shares ISAs. However, many consumers may prefer to continue to hold cash in a separate ISA from that in which they hold stocks and shares. The client money rules will not automatically apply to cash ISAs, though firms operating cash ISAs may opt into the client money rules.

Context

- 1.8 An ISA is a popular scheme of investment predominately overseen by Her Majesty's Revenue and Customs (HMRC). There are two types of ISAs: cash ISAs and stocks and shares ISAs.

- 1.9 To date, under CASS, money held in cash ISAs has not been considered to be client money¹, while money held in stocks and shares ISAs has been considered to be client money. This was because before 1 July 2014, under the ISA regulations, all money within stocks and shares ISAs was held for the purpose of investing in qualified investments, creating clear separation between cash ISAs and stocks and shares ISAs.
- 1.10 On 19 March 2014, the Government announced in the Budget that ISAs would be reformed into the New Individual Savings Accounts². These changes were brought about by the Individual Savings Account (Amendment No 2) Regulations 2014 which come into force on 1 July 2014. One of these amendments is that money in a stocks and shares ISA need not be held for the purpose of investment. This allows consumers to use stocks and shares ISAs for both cash saving and investment purposes without distinguishing between the two.
- 1.11 The client money rules currently require firms to hold client money separately from money which is not client money. Without making any amendment to the client money rules to address the changes to the ISA regulations, if an investment firm wished to take advantage of the new ISA regime by offering cash savings as well as investments in its stocks and shares ISA, it would need to identify and separate money held as cash savings and client money held for investment purposes. In practice this is likely to be difficult as there will be ambiguity as to what money is, and should be, protected by the firm under the client money rules.
- 1.12 In response to the changes made to the ISA regulations, on 11 June 2014 we published CP14/9: *Client Money Held in Individual Savings Accounts*.³ In this, we proposed rule changes to apply the client money rules to all money held within stocks and shares ISAs. This aligns our client money rules with the changes to the ISA regulations with minimal impact, removing the potential ambiguity over the status of money that may be held in ISAs. The CP also proposed allowing firms to opt into the client money rules for cash ISAs and proposed disapplying the rules that prevent the use of unbreakable term deposits of longer than 30 days where the money is held in an ISA wrapper.
- 1.13 This PS sets out the amended client money rules that will apply to investment firms managing ISAs following the consultation.
- 1.14 The changes to CASS rules are designed to advance our objectives of:
- securing an appropriate degree of protection for consumers, and
 - promoting effective competition in the interests of consumers.

¹ For CASS 7 definition of Client Money, see: <http://fshandbook.info/FS/glossary-html/handbook/Glossary/C?definition=G160>

² Her Majesty's Revenue and Customs' bulletin regarding changes to ISAs: www.hmrc.gov.uk/isa/bulletin57.pdf

³ CP14/9 can be found here: <http://www.fca.org.uk/your-fca/documents/consultation-papers/cp14-09>

Summary of feedback and our response

- 1.15 We received 21 responses to our CP. Respondents included industry associations, firms, individual consumers, support businesses and governmental departments. We would like to thank all respondents for their feedback.

Next steps

What do you need to do next?

- 1.16 All investment firms who manage ISAs, or are considering managing ISAs, should review the instrument set out in Appendix 1 in detail and establish how the changes we are making will affect their business.
- 1.17 The rule changes to the client money regime in PS14/9: *Review of the client assets regime for investment firms* should not affect the rule changes in this PS.

What will we do?

- 1.18 The rule changes outlined in this PS take force on 1 July 2014.

2 Consultation feedback

- 2.1 In this chapter we summarise the feedback received to the proposed rule changes in CP14/9 and set out our response to this feedback. The final client money rules are set out in Appendix 1.

Stocks and shares ISAs

Q1: Do you agree with our proposal to require all money held within stocks and shares ISAs managed by investment firms to be held as client money? If not, please provide reasons?

- 2.2 In the CP, we identified a potential issue with the status of money held in stocks and shares ISAs. Under the changes to the ISA regulations, it may not be clear whether money held in a stocks and shares ISA is client money or not. We proposed requiring firms to hold all money in stocks and shares ISAs as client money, thereby protecting these sums in line with the client money rules.
- 2.3 There was universal support for this proposal from respondents to the CP. Respondents agreed this provides certainty to investment firms that are ISA managers and their clients, creates a level playing field for investment firms that are ISA managers, and ensures that clients' money receives adequate protection.
- 2.4 A few respondents asked for clarification as to whether our intention was for deposit takers to hold cash in stocks and shares ISAs as client money (i.e. deposit takers currently offering ISAs could no longer use the banking exemption under the client money rules).
- 2.5 A number of respondents raised the issue of different levels of FSCS protection for consumers, depending on the choice between stocks and shares and cash ISAs and the kind of firm that is the ISA manager. One respondent suggested that we consider amending the FSCS regime to ensure customers investing in ISA products are given the same level of protection regardless of provider, while several others encouraged the FCA to work with ISA managers and the FSCS to communicate levels of protection clearly to consumers.

Our response

- 2.6 We are proceeding with this rule change as consulted on.
- 2.7 This rule change affects investment firms who manage stocks and shares ISAs. Credit institutions that currently use the banking exemption in the client money rules may continue to do so following these rule changes.
- 2.8 As set out in the CP, FSCS protection does and will apply to cash held in stocks and shares ISAs where the contractual arrangements are such that the cash is held in connection with investment in stocks and shares. FSCS protection does not and will not apply to money in a cash ISA managed by a firm which is not a deposit taker should

that firm fail and investors suffer losses as a consequence. This situation existed before the changes to the ISA regime were announced. We and the FSCS have explained this for consumers on our respective websites. In the longer term we will consider this position regarding limits and coverage further, and may make changes subject to the normal process of consultation.

Cash ISAs

Q2: Do you agree with our proposal to allow money held within cash ISAs managed by investment firms to be held as client money? If not, please provide reasons?

- 2.9 Having observed varying practices within the industry in relation to how investment firms are holding pure cash ISA monies, we proposed allowing these firms to hold cash ISA money as client money and apply client money rules. This would not prevent credit institutions from treating such monies as deposits.
- 2.10 The vast majority of respondents agreed with this proposal, noting that this is a pragmatic solution to an ongoing issue. One respondent suggested this proposal should not be restricted to investment firms, but extended to deposit takers. Another supported the proposal but pointed out that firms must explain clearly to clients how their cash ISAs will be treated under the chosen regulations.
- 2.11 A few respondents noted that unless changes are made to the FSCS regime, cash ISAs would fall outside the scope of FSCS protection.
- 2.12 A few respondents suggested that making it mandatory for investment firms providing cash ISAs to apply the client money rules to money held in such ISAs would improve consumer protection.
- 2.13 One respondent suggested that ISA managers without FCA authorisation would be permitted by this rule to apply the client money rules to cash ISA monies.

Our response

- 2.14 We are proceeding with this rule change as consulted.
- 2.15 Any firm (as defined in the FCA Glossary) managing a cash ISA may opt into the client money rules in relation to this money, including credit institutions.
- 2.16 As noted in CP14/9, firms must notify affected ISA customers if the firm has decided to make use of this opt-in to client money rules for cash ISAs.
- 2.17 With respect to FSCS coverage generally, as noted in CP14/9, firms are expected to explain the relevant FSCS coverage clearly to their customers. FSCS protection does not and will not apply to money in a cash ISA managed by a firm which is not a deposit taker should that firm fail and investors suffer losses as a consequence. Please also note paragraph 2.8 above in relation to FSCS protection.
- 2.18 We are not making it mandatory for firms managing cash ISA money to comply with the client money rules. Given the potential impact on managers of cash ISAs that such a change may have, this is not a change that could be made without further consultation.

- 2.19 The final rules do not permit firms without FCA (or PRA) authorisation to opt-into the client money rules in relation to cash ISA money that they hold. Also, firms must ensure that if they opt into the client money rules under this change they have the necessary requirement on their Part 4A permission to hold client money.

Unbreakable term deposits

Q3: Do you agree with our proposal to disapply the rules around unbreakable term deposits to money held within ISAs? If not, please provide reasons?

- 2.20 In PS14/9, rules were introduced preventing investment firms from placing client money in unbreakable term deposits with an unbreakable term of longer than 30 days⁴. Given that consumers may wish to hold money in unbreakable term deposits within their ISA wrapper, and that ISA managers who are deposit takers may be able to offer these types of products, we proposed that any money within the ISA wrapper held as client money by ISA managers that are investment firms would be excluded from these rules.
- 2.21 Feedback for this proposal was mixed with some respondents being supportive and others raising concerns or issues.
- 2.22 One respondent suggested consideration could be given to what the maximum term should be for an unlimited term deposit held within an ISA.
- 2.23 Respondents also queried why ISA managers should be given different treatment under the client money rules from other investment firms when any client money held by ISA managers is subject to the same risks as client money held by any other investment firms (namely, the risk that it is not returned swiftly in the event of the failure of the investment firm and the risk that the firm is unable to respond to changing market conditions by withdrawing or moving that client money).
- 2.24 A few respondents also noted that the ISA regulations require customers to be able to withdraw or transfer savings within 15 or 30 days (for cash ISAs or stocks and shares ISAs, respectively). One respondent queried whether allowing ISA managers to hold client money in unbreakable term deposits would lead to customers being penalised given that the ISA regulations require transfers to be made within these specified timelines. HMRC questioned the compatibility of unbreakable term deposits with the ISA regulations, given that an investor must be able to withdraw or transfer their savings within 15 or 30 days (as the case may be), and noted that an ISA fundamental is that it is not a lock-in account.

Our response

- 2.25 In light of this feedback we are not proceeding with making this change.

⁴ CASS 7.4.11AR

- 2.26 Given that both credit institutions and investment firms are subject to the ISA regulations, including the requirements to be able to withdraw or transfer savings within defined periods⁵, they are on a level playing field in this regard.
- 2.27 Any investments of cash within term deposits must be placed in deposits which enable firms to meet their obligations under the applicable rules or regulations. It may be that clients are required to pay a penalty when withdrawing or transferring ISA savings.
- 2.28 Firms must also consider their obligations under Principle 10 and treating customers fairly when depositing the client money they hold.
- 2.29 We agree that the client money held by investment firms that are ISA managers is subject to the same risks as client money held by other types of investment firms.
- 2.30 Taken together, this cumulative feedback has led us to reconsider this proposal and amend the final rules to ensure that investment firms that are ISA managers will be subject to the rules that prevent them from placing client money in an unbreakable term deposit of greater than 30 days.

Unregulated collective investment schemes

- 2.31 We received feedback that there is a view that if a firm holds ISA monies, other than for the purposes of investment, collectively with a third party (for example as client money) then that creates an unregulated collective investment scheme (CIS).

Our response

- 2.32 Having further considered this issue, we are of the view that these firms are not establishing, operating or winding up CISs because they can rely on the exemption for pure deposit-based schemes. To fall within the exemption, the money would have to be deposited by the firm with an authorised deposit taker.
- 2.33 One respondent asked whether these firms would be accepting deposits. This is for each firm to consider, but we are not of the view that managing the cash element of an ISA will, in itself, result in firms accepting deposits.

⁵ Provisions regarding time limits for transfer/withdraw instructions can be found in 4.(7) of the consolidated ISA regulations: www.tisa.uk.com/regulations/53_ISARegs_2013C.pdf

Cost benefit analysis

Q4: What are your views on the benefits and costs of these proposals? Please provide explanations and qualitative evidence to support your response where appropriate.

- 2.34 Respondents largely agreed that the cost benefit analysis (CBA) was proportionate and not burdensome on firms.
- 2.35 Several noted the increased competition between firms would present positive outcomes for ISA customers, or that our proposals result in a level playing field in respect of ISA providers.
- 2.36 One respondent noted that investment firms that need to change their client money handling arrangements are likely to incur costs from entering into new agreements with their clients.

Our response

- 2.37 We have not revised our CBA in light of responses received.
- 2.38 As set out in CP14/9, we expect that investment firms that are ISA managers who hold cash within stocks and shares ISAs will be able to operate largely as they do under the current rules and the rule changes in the CASS sourcebook should not impose incremental compliance costs on affected firms, including the need to repaper clients.
- 2.39 We did reconsider whether not proceeding with the proposal to disapply rules surrounding unbreakable term deposits of longer than 30 days would affect the CBA, and concluded any impact would be immaterial. Firms are already required to comply with ISA regulations regarding time limits for transfer and withdraw instructions from ISA clients. Not proceeding with our proposal does not affect firms' existing compliance obligations with HMRC.

Annex 1:

List of non-confidential respondents

AXA Wealth

Brian Shearing and Partners Ltd

Daniel Elkington

Deloitte

HMRC

Institute of Chartered Accountants in England and Wales

Interactive Investor

Invesco Perpetual

Jane Ball

Matthew Speck

PricewaterhouseCoopers LLP

Rathbones

Standard Life

St James's Place

The Share Centre Ltd

The TA Forum

TISA

In addition to the above, there were 4 respondents who provided us their feedback confidentially.

Appendix 1:

Made rules (legal instrument)

CLIENT ASSETS SOURCEBOOK (AMENDMENT NO 6) INSTRUMENT 2014

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); and
 - (4) section 139A (Power of the FCA to give guidance).
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force as follows:
- (1) Annex A and Part 1 of Annex B to this instrument come into force on 1 July 2014.
 - (2) Part 2 of Annex B to this instrument comes into force on 1 June 2015.

Amendments to the FCA Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Client Assets sourcebook (CASS) is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Client Assets Sourcebook (Amendment No 6) Instrument 2014.

By order of the Board of the Financial Conduct Authority
26 June 2014

Annex A

Amendments to the Glossary of definitions

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

Comes into force on 1 July 2014

Insert the following new definition in the appropriate alphabetical position. The text is not underlined.

stocks and shares ISA business a firm's activities, in its capacity as an *ISA manager*, in connection with an *ISA* which contains only a *stocks and shares component* and is not either or both *MiFID business* and *designated investment business*.

Amend the following definition as shown

client money ...

- (2A) (in *FEES*, *CASS 6*, *CASS 7*, *CASS 7A* and *CASS 10* and, in so far as it relates to matters covered by *CASS 6*, *CASS 7*, *COBS*, *GENPRU* or *IPRU(INV)*) subject to the *client money rules*, *money* of any currency:
- (a) that a *firm* receives or holds for, or on behalf of, a *client* in the course of, or in connection with, its *MiFID business*; or
 - (b) ~~which that~~, in the course of carrying on *designated investment business* that is not *MiFID business*, a *firm* holds for a *client*; or
 - (ba) that a *firm* receives or holds for, or on behalf of, a *client* in the course of, or in connection with, its *stocks and shares ISA business*; or
 - (c) ~~which that~~ a *firm* treats as *client money* in accordance with the *client money rules*.

Annex B

Amendments to the Client Assets sourcebook (CASS)

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

Part 1: Comes into force on 1 July 2014

7.1 Application and purpose

7.1.1A R This chapter applies to a *firm* that receives *money* from or holds *money* for, or on behalf of, a *client* in the course of, or in connection with, its:

- (1) *MiFID business*; and/or
- (2) *designated investment business*; and/or
- (3) *stocks and shares ISA business*;

unless otherwise specified in this section.

...

Opt-in to the client money rules

7.1.3 ...

(1B) ...

(1C) (a) A *firm* may elect to comply with all the provisions of this chapter for *money* that it receives or holds in respect of an *ISA* that only contains a *cash deposit ISA*.

(b) Where a *firm* makes an election under (a), this chapter applies to it in the same way that it applies to a *firm* that receives and holds *money* in the course of or in connection with its *MIFID business*.

...

...

7.1.3B R Where a *firm* opts into this chapter under CASS 7.1.3R(1C) it must notify *clients* for whom it holds the opted-in *money* that it is holding their *money* in accordance with the *client money rules*.

7.1.4 G The opt-in to the *client money rules* in this chapter does not apply in respect of *money* that a *firm* holds outside of either the:

- (1) scope of the *insurance client money chapter*; or
- (2) relevant *cash deposit ISA* wrapper;

as the case may be.

...

- 7.1.6 G (1) A firm that is only subject to the *insurance client money chapter* may not opt to comply with this chapter under either or both CASS 7.1.3R(1) and CASS 7.1.3R(1B).
- (2) Under CASS 7.1.3R(1C) a firm may opt to comply with this chapter regardless of whether it is otherwise subject to the *client money rules*.

Part 2: Comes into force on 1 June 2015

7.10 Application and purpose

7.10.1 R This chapter applies to a *firm* that receives *money* from or holds *money* for, or on behalf of, a *client* in the course of, or in connection with, its:

- (1) *MiFID business*; and/or
- (2) *designated investment business*; and/or
- (3) *stocks and shares ISA business*;

unless otherwise specified in this section.

...

Opt-in to the client money rules

7.10.3 ...

(2) ...

(2A) (a) A firm may elect to comply with all the provisions of this chapter for *money* that it receives or holds in respect of an *ISA* that only contains a *cash deposit ISA*.

(b) Where a *firm* makes an election under (a), this chapter applies to it in the same way that it applies to a *firm* who receives and holds *money* in the course of or in connection with its *MIFID business*.

...

7.10.3A R Where a *firm* opts into this chapter under CASS 7.10.3R(2A) it must notify *clients* for whom it holds the opted-in *money* that it is holding their *money* in accordance with the *client money rules*.

...

- 7.10.5 G The opt-in to the *client money rules* in this chapter does not apply in respect of *money* that a *firm* holds outside of either the:
- (1) scope of the *insurance client money chapter*; or
 - (2) relevant *cash deposit ISA* wrapper;
- as the case may be.

...

- 7.10.7 G (1) A *firm* that is only subject to the *insurance client money chapter* may not opt to comply with this chapter under either or both *CASS 7.10.3R(1)* and *CASS 7.10.3R(2)*.
- (2) Under *CASS 7.10.3R(2A)*, a *firm* may opt to comply with this chapter regardless of whether it is otherwise subject to the *client money rules*.

...

Financial Conduct Authority



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25 The North Colonnade Canary Wharf
London E14 5HS
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