

Financial Services Authority
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For the attention of Matthew Shaw, Institutional Business Policy

6 June 2008

Dear Sirs

CP 08/6 Review of the Client Assets Sourcebook

We welcome the proposals to simplify the CASS rules and are pleased to offer comments on some of the issues raised in this consultation paper.

Reconciliations (Questions 10 and 21)

We note the proposals to apply the MiFID approach to non-MiFID business in relation to the frequency and method of reconciliations but have the following concerns.

CASS 6 and 7 do not contain explicit requirements for firms to carry out internal reconciliations. The guidance in CASS 6.5.4/7.6.6 is linked only to the general rules on maintaining records in CASS 6.5.2/7.6.2. We suggest that there should be a rule on internal reconciliations equivalent to CASS 6.5.6/7.6.9 on external reconciliations.

In accordance with the principles-based approach to drafting, there are references to SYSC in CASS 6.5.4 and 7.6.6 and we suggest that these should also be incorporated in other relevant guidance, eg CASS 6.1.22, 6.2.1, 6.2.2 and CASS 7.1.16, 7.3.1 and 7.3.2.

We also suggest that the guidance should cover the frequency with which external reconciliations should be performed.

It is proposed to extend the facility for firms to adopt their own method of performing an internal reconciliation if they first obtain a report from their auditors (CASS 7.6.8; there are also provisions for special audits in CASS 6.5.5 and CASS 7.4.15). The report should state that 'the firm has in place systems and controls which are adequate to enable it to use another method effectively.' Although these provisions have been used only rarely to date, we suggest that the FSA should discuss with the auditing profession what is meant by 'effectively', with a view to substituting more precise wording.

Scope of audit

In our response to CP 07/15, we noted that Article 20 of the MiFID level 2 Directive requires that “Member States shall require investment firms to ensure that their external auditors report at least annually to the competent authority of the home Member State of the firm on the adequacy of the firm's arrangements under Articles 13(7) and (8) of Directive 2004/39/EC and this Section.” We assume that the FSA will seek to treat non-MiFID business consistently.

The main problem with the current rules in SUP 3.10 is that they cloud the responsibility for reporting non-compliance. Firms are obliged to report breaches of certain CASS rules (e.g. by CASS 4.3.87 and CASS 6.5.13) but otherwise only 'significant' breaches under Principle 11 and SUP 15. However, auditors have to report all CASS breaches, including those which the firm has already reported and others which are minor. We suggest that the rules should be revised to emphasise that the primary duty to report should be on the firm and that auditors need only report significant breaches that they have discovered.

The other main issues in relation to CASS audit reports include:

- whether the requirement to report on compliance as at a specific date should be retained;
- whether 'negative assurance' will still be required where a firm doing investment business is not permitted to and/or does not hold client money and/or custody assets. We assume that it is not intended that a negative assurance opinion will be required for arrangers of safe custody (CASS 6.1.6J) that do not actually hold custody assets;
- which rules should be covered by the audit requirement, e.g. whether the rules on mandates, collateral and/or distribution should be included
- under which standards the work should be performed (e.g. ISAE 3000) – this should be tied in with guidance prepared for s166 RARs.

Proposed implementation date

The paper envisages an implementation date of 1 February 2009. Since the proposed changes are mostly permissive, it should not be necessary for much delay after the publication of the feedback in September. In our experience, most client asset audits cover periods ending 31 December. An implementation date of 1 January 2009 would simplify the audit approach in 2009 and help contain audit costs.

Other matters

CASS 6.1.16J applies CASS 6.3.2(1) to arrangers but we question whether an ongoing monitoring obligation is appropriate to a one-off activity.

CASS 6.3 is to be headed 'Depositing assets *and arranging [for] assets to be deposited* with third parties' but the new rule 6.3.1A relates to arranging registration rather than depositing assets.

In CASS 6.1.16D we believe the reference should be to CASS 6.1.16C.

In CASS 7.1.3 and 7.4.3 we believe that it would be clearer to refer to 'CASS 5' and 'CASS 6' rather than to 'the insurance client money chapter' and 'the custody chapter' which then require glossary entries.

The sub-heading after CASS 7.1.7D seems unnecessary.

Conclusion

We would welcome the opportunity to discuss our comments further. If you wish to do so then please contact John Tattersall (020 7212 4689) or Peter Milroy (020 7212 5282) by telephone or in writing at the above address.

Yours faithfully

PricewaterhouseCoopers LLP