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By email to: dp16-02@fca.org.uk

13 May 2016

Dear Sirs

Discussion Paper 16/2: CASS 7A and the Special Administration Regime Review (DP 16/2)

Thank you for the opportunity to provide feedback on the potential changes to the client asset rules (CASS) that you are seeking views on in DP 16/2.

This submission is made by PricewaterhouseCoopers LLP (PwC), the UK member firm of the PwC network. In the UK, we are the auditor of many regulated firms and we report on their compliance with CASS, as well as providing advisory services in this area. Our wealth of practical experience comes from a range of CASS related assignments, including SARs experience and being the Administrators of many Lehman Brothers entities. We also have a team of dedicated specialists focusing on the impact that new regulatory developments have on the financial services sector. This letter is not intended to represent the views of our clients, but rather to identify and to comment on certain aspects of DP 16/2 which we believe to have particular significance.

We include our comments on the specific areas of DP 16/2 on which you sought feedback in the Appendix to this letter.

We hope that our response will be helpful to you and we would be pleased to discuss our comments further with you. If you would like to do so, please contact Mike Newman at the address below or on 0207 212 5201.

Yours faithfully

Michael P Newman

PricewaterhouseCoopers LLP

Appendix

Q1: Do you agree with our proposed mechanism for the transfer of the CMP?

Q2: Do you consider a partial transfer of the CMP a desirable outcome even though it may mean that some clients suffer a greater share of any shortfall?

Yes. We support the proposed mechanism. Any transfer of client money which enables clients to continue their investment business without further disruption (rather than setting up new investment business arrangements following the return of client money) should be welcomed. For this reason we would also support partial transfers of the CMP, where circumstances allow.

Partial transfers are unlikely to be practical in all circumstances. It is unlikely that an IP would allow a transfer if there is risk they could be personally liable if there is shortfall at some future point. If there is a concern about an eventual shortfall, an initial transfer could possibly be made at a reduced percentage.

The FCA may also wish to consider optional sub pools for some clients or enabling "active"/"live" client monies to be transferred leaving legacy/gone-away balances behind, with the proviso that remaining clients should not suffer a greater shortfall as a consequence.

Q3: Do you agree with our proposal to codify the transfer of custody assets including partial transfers?

No. We consider that codifying the transfer process may create new issues which may not be desirable. The method of full or part asset transfers has been tested through the Courts. Codifying it may lead to challenges on these rulings. It may also be difficult to codify all potential issues (e.g. in-flight or failed transactions).

Q4: Do you agree with a hard bar date for client money claims?

Q5: Do you agree with the process we have set out above setting minimum contact requirements before a hard bar date becomes effective?

We support the introduction of a hard bar date for client money claims, and the requirement for 'proportionate' efforts from the administrator to trace clients. We consider that it would be beneficial for more guidance to be provided on what is considered to be proportionate and sufficient, and this should be aligned with proposals on unclaimed and de minimis amounts.

Client contact and de minimis requirements need to be realistic in the context of cost of notification and the delay that a lengthy and onerous contact process creates for all creditors. Three attempts may be too many, depending on the circumstances. There needs to be some (albeit limited) onus on the creditor to come forward.

Q6: Do you agree that the Hindsight Principle should be applied to cleared open margined transactions? What potential issues might arise if this is introduced?

Q7: Do you consider that there may be other transactions to which the Hindsight Principle should be applied apart from cleared open margined transactions?

Q8: In what ways could a mismatch arise between a client's CME and the CMP?

Q9: Do you consider that contractual provisions or some alternative valuation method should be used either instead of, or in addition to valuation under the Hindsight Principle, and if so, in what circumstances?

We agree with the principle of using the amount obtained from closure of a contract as the individual CME, but question whether will this necessarily result in a 'fairer' outcome for clients in all circumstances. The unilateral closure of one client's positions is liable to have a negative impact beyond the cash value. It would be better (if possible) to port all such open positions, with a haircut if necessary to reflect any anticipated shortfall.

In general it is helpful if the value being claimed is easily/clearly defined in insolvency: in our experience the most contentious matter tends to be around the valuation date used. In relation to Q9, contractual claims can be made against the estate, but not client money pools. The consultation should consider the treatment of non-cash margin as well as cash.

The proposal in para 4.20 that open contracts should be treated differently if there is money held at a third party (in a client transaction account) rather than being held in a client bank account seems unfair and illogical (why should the treatment be determined by the contract price at PPE?) and, in any event, may be impossible to apply in practice. Where margin is posted to the third party on a net basis, it would not be possible for an administrator to determine which individual client trades are reflected by cash in the CMP, and which by cash at the third party.

Q10: Do you consider that we need to make changes to the statutory trust in CASS 7 (client money rules) to reflect the Treasury proposals set out above?

No. We do not believe that it is necessary for the CASS rules to contain guidance on matters which will be fully set out in the SAR, which may result in duplication or, at worst, contradictions or confusion between the two different sources. The CASS rules should be explicit about any areas where SAR takes precedence and vice versa.

Q11: Do you consider that additional information about how a product is structured would assist the administrator and the FSCS in the event of a firm's insolvency?

Q12: Is there any other information that you think would assist in ensuring FSCS compensation payments are made as quickly as possible?

An overview of products may be useful and could form part of the required CASS RP information, however we can foresee some practical challenges arising. We believe flags are unlikely to assist in most cases due to the complexity involved in identifying potentially protected clients.

FSCS is the only party that can confirm a claimants' eligibility - facilitating information flow between a firm and FSCS is likely to be the best mechanism for accelerating payments to customers.

Q13: Do you consider that firms should provide more clarity to clients around whether a firm's activities may or may not be covered by the FSCS?

Q14: Is the client statement the best place to provide this and what should this comprise?

We agree that further clarity over whether a firm's activities may be covered by FSCS is desirable from a consumer protection point of view, but we query whether firms will actually be able to give clients that clarity in relation to all of their activities in a way that is accurate, useful to the reader given their expected level of financial sophistication, and in a way that is fair, clear and not misleading. There is no value in firms providing a 'maybe' qualified statement, or worse, a positive statement which later turns out to be incorrect.

Being clear where facilities or products do not receive FSCS protection may be possible in relation to some products (e.g. certain off-shore funds). FCA might require firms to consider whether the situation is sufficiently clear that they are able to give an unequivocal and comprehensive statement. Otherwise, they should be silent on the issue. Our perception is that the great majority of explanatory material provided to consumers is never read.

If any disclosure is required, firms should have the option to determine how best to communicate it to customers. Ideally, firms should disclose any FSCS information at point of sale, not in an annual statement. We also suggest that the content of the customer statement would be better dealt with as part of the FCA's conduct of business rules (COBS) rather than CASS.

Q15: Should firms include details of the structure of products and whether they are carrying on designated investment business in relation to a particular product in the CASS RP?

Yes, in principle the CASS RP is the right place for such information, but the requirements should not be onerous. For example, a large retail bank will have many different products, which may or may not be regulated, covered by FSCS and/or subject to CASS. Is the suggestion that all of the bank's products are detailed in the CASS RP - regulated or not, CASS or not? The FCA would need to consider the cost/benefit of any additional requirements and the potential overlap with existing regulatory protections from recovery & resolution plans. To the extent possible, firms should only be required to include existing information in the CASS RP, rather than being required to create new material.

Q16: Do you agree with these proposed additions? Is there any other information that you think should be added to a CASS RP to assist administrators and the FSCS to achieve speedy return or transfer of client assets, and prompt payment of FSCS compensation where due?

Speed of payment will depend on how quickly the individual client assigns their claim to the FSCS, therefore the information held by the firm should be sufficient to enable the FSCS to assess the eligibility of the claimant. We are assuming that the FSCS is agnostic (in its assessment of a claimant) as to whether the claim is for client money or just an unsecured claim. Therefore some of the

information will not be needed to assess the claim/claimant, rather it will be used by the FSCS to assert its claim on the relevant funds (client money or firm money).

Para 4.35 refers to establishing a civil liability: presumably the firm going into administration will be the trigger for civil liability arising. Para 4.37 refers to 'additional documents': these would need to be defined in greater detail in the consultation before we could comment.

Q17: Do you agree that the detailed explanation of client statements would be a proportionate addition to the CASS RP?

Yes. Client statements are relatively simple and they potentially form the basis of the client's claim, so this information would be a worthwhile addition. Explanations should be provided for each product type and cover issues such as the timing of client money receipts and the treatment of unsettled trades. But whilst explanations may be helpful, the cost vs benefit of providing such information should be considered. Whether or not a client has a claim, and whether or not the administrator accepts that claim, will depend on the specific contract wording, and not on any information set out in an explanatory document.

Q18: Do you agree that clients and administrators should receive the same explanation of client statements?

No. Administrators and clients have widely varying levels of financial knowledge, capability and sophistication and very different information needs, so requiring uniformity of client statements would not be appropriate. The overarching requirement of ensuring whatever information is provided is fair, clear and not misleading should apply.

Q19: Do you agree that a firm could provide this explanation in the client statements themselves and/or on its website?

As noted in our response to Q14, if any disclosure is to be made, firms should have the option to determine where best to make it.

Q20: Do you consider that any changes are necessary to either the client money rules or the client money distribution rules to facilitate this proposal?

We welcome the clarity that a 'final reconciliation' could provide, although we foresee difficulties in establishing a static point in time at which that could be achieved. Also a final top-up may remove shortfalls from the CMP. Whilst this approach would clearly be of benefit to the client money creditors, there is a risk that it could be seen as disproportionate against general creditors (particularly considering that general creditors in a bank administration may include retail consumers who are outside of the CASS regime due to the deposit taking exemption).

Potentially, any movement of funds may create issues (incorrect processing/valuations, net accounting/settlements etc.), therefore introducing a final reconciliation may cause delays and additional cost due to legal disputes because one group of creditors is always going to experience a reduction in assets available.

Q21: Are there any other court decisions that would benefit from codification in the CASS 7A rules?

In general, we do not believe codification will be helpful. Referencing existing case law may be useful, but with codification there is a risk that processes previously established in the Court may become open to challenge.

Q22: Do any points in the LBIE judgments require further codification in the CASS 7A rules?

We have no comment on this question.

Q23 Should firms be encouraged to segregate a prudent margin in respect of administration costs?

No. We do not agree with the suggestion that firms which are a going concern should be made to pre-fund the hypothetical administration costs which could arise if they were to become a gone concern. This should not be a presumption. For small firms it could significantly increase overall costs to the detriment of clients of the going concern firm.

Q24: What types of data can be standardised to facilitate distribution of the client estate?

We have no comment on this question.

Q25: Which of the above proposed options for the treatment of interest would be preferable? And how should these be apportioned and paid out?

Q26: Do you agree with our proposed de minimis values?

Allocating interest as part of the assets to be distributed (and/or to meet costs of distribution) is sensible. Trying to calculate or allocate interest on an alternative basis is likely to be complex, costly and delay any return of funds to customers. There should be de minimis levels of payment for distribution and these should be set at a level whereby making the payment is actually cost effective. We would propose that payments to retail clients of less than £50 are not made. For professional clients we suggest a reasonable de minimis could be £100 or significantly higher. We consider that if possible, de minimis levels should be consistent throughout the CASS rules. In order to make claim payments cost effective, where possible, making a single combined payment to the FSCS (for all claims assigned to it) should be considered. The FSCS can then make the individual claimant payments, as the FSCS may be less constrained on the cost vs benefit of smaller payments.

We note that para 4.67 suggests that allocating interest to all clients in the CMP would align it to CASS 7. However in our experience where client money accounts are interest-bearing, typically the firm's terms and conditions specify how interest should be paid. In most cases, interest paid to clients under CASS 7 does not correspond to the actual receipt of interest but will be based on the terms and conditions which define interest entitlement. Therefore we do not consider that allocating interest on

client money to clients will provide alignment with CASS 7. Further relevant questions arising include how negative balances would be treated: should those clients be charged interest?

Allocation of the actual interest earned on client money balances would not remove the incentive to arbitrage with the general creditor pool where the statutory rates of interest are significantly higher.

Q27: Do you agree with our proposed treatment of unclaimed client monies?

Q28: Do you consider that an equivalent provision for unclaimed assets would be beneficial?

We are concerned that the cost of evidencing appropriate steps may be out of proportion to the amounts involved. Para 4.72 identifies three steps to be taken but is unclear whether these are alternatives or would all be required. It is not clear whether 'declining to claim' is required to be a positive refusal, or just an absence of response. Nevertheless we broadly support the proposals provided they do not duplicate existing provisions in SAR; and would support extending them to custody assets for both unclaimed balances and de minimis amounts (e.g. fractions) although, in line with other comments, we believe the de minimis thresholds should be higher.

Q29: Do you agree with the proposed treatment of de minimis client money entitlements? What minimum steps are proportionate and how should these be tiered?

Q30: Should this proposed rule include claimed de minimis balances where these are uneconomic to distribute and if so, what minimum level should this be set at?

We agree with the proposed treatment but we would recommend that levels should be higher to reflect the cost of distribution.

Q31: Should the FCA consider introducing distribution rules within CASS for custody assets? If so, what provisions should these contain?

We agree with this in principle, but recommend that consideration is given to the fact that the costs of dealing with the remaining asset pool may then be applied over a smaller group of assets.

Other observations

Although there is no specific question in the DP, para 4.82 raises a significant inconsistency in that the FCA authorises and regulates UK branches of overseas firms whilst they are going concerns, but has no authority over them as gone concerns.

Para 5.21 suggests that assets held which are available for re-hypothecation are necessarily held in different accounts from assets held on a pure custody basis. We do not believe that this treatment is required by CASS 6.4.1R or that it happens in practice.