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DP16/2: CASS 7A & the Special Administration Regime Review

Dear Kate and Soo-Bee

I am pleased to attach TISA's response to this important Discussion Paper.

We believe that the introduction of a Bar Date, which we support, will mean that the current 30-day rule on unbreakable term deposits (UTDs) would make no sense, supporting our argument that the rule on UTDs should be amended to be no more than 95 days.

Q1: Do you agree with our proposed mechanism for the transfer of the CMP? If not, please provide reasons and suggestions as to how we could approach this differently.

We are concerned that there is a potential for client detriment in moving part of the pool in advance of the remainder.
Dealing with this through sub-pools may be cost prohibitive for smaller firms and those firms that have a reliance of efficient technology driven operating models.

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? If yes, please outline how this could operate in practice, and any safeguards we could consider.

There is obviously a risk of further detriment to a client on early distribution of the pool. This proposal could make sense for speed, but large mistakes could occur to the detriment of a cohort of clients, particularly as cash is fungible.

It would be better to be right and a bit delayed than swift but wrong.

Q3: Do you agree with our proposal to codify the transfer of custody assets including partial transfers? If not, please provide reasons why, and suggestions as to how we could approach this differently.

In principle, yes.

But, see our comments in response to Q2.

For assets, the risk is less stark than fungible cash, but there could be some material risk to clients if large trades failed on settlement before shortfall cover at the point of insolvency which could lead to one cohort of clients being treated significantly better than the other side of the partial transfer equation.

Clarity of the treatment of in-flight transactions would be beneficial.

Q4: Do you agree with a hard bar date for client money claims? If not, please provide reasons why and suggest alternative measures.

Yes. This will require clear guidance that defines the pre/post hard bar cut-off.
Otherwise there is a risk that the hard part is challenged by lawyers at length with delay in return of money to clients.

In general terms we support the introduction of a hard bar date. We would point out that if this is introduced, the current 30-day rule on unbreakable term deposits would make no sense, supporting our argument that the rule should be amended to be no more than 95 days.

Q5: Do you agree with the process we have set out above setting minimum contact requirements before a hard bar date becomes effective? If not, please provide reasons why, and any suggestions as to how we could approach this differently.

Yes. See answer to Q4.

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?

Yes. It makes sense to close the risk down as part of a managed insolvency.

Applying Hindsight maybe very complex for certain products or firms that operate without the need of a CCP such as those that offer financial spread trading with continuous settlement.

Q7: Do you consider that there may be other transactions to which the Hindsight Principle should be applied apart from cleared open margined transactions? If so, please explain why.

The clear risk here is this suggestion could significantly disadvantage a client cohort where they did not hold complex margin instruments, but where the firm failed as a consequence of a materially mismanaged complex product set. The Barings futures insolvency is a good illustration of this point.

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

No comment.

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?

No.

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? If so, what should such guidance cover?

The Treasury Proposal provides that "costs arising from compliance failures [in relation to CASS] should be borne by the [general] estate", essentially on the basis that it is unfair for these to be borne by clients whose fees include the costs of CASS protection. We would agree with this approach, as it provides further protection to clients entitled to CASS protection.

We think that there is a further, related, policy issue as to how costs are borne by clients with CASS 7 client money entitlements. The FCA's expectation that "if a firm complies with the CASS rules as a going concern, there should be minimal costs associated with distinguishing between client assets and firm assets" may be correct in many instances, but certain types of business can cause rather greater costs to be incurred than others even if they are operated in a CASS-compliant manner.

Administrators will generally want to 'kick the tyres' with their own legal counsel if the client money status of relevant monies and/or the associated entitlements is open to any doubt, or disputed by clients.

For instance, particular costs may arise in the case of title transfer arrangements with professional clients (particularly elective professional clients), if any clients seek to assert that their classification was defective and that they were therefore entitled to CASS 7 protection as retail clients. Given the short time span for client money adjudications, administrators may require legal advice even before clients actually make such claims.

The current statutory trust provides for the 'costs properly attributable to the distribution of client money…' to be paid out of client money. In addition to the proposed splitting-out of costs caused by compliance failings, it seems to us that it would be helpful to:

- clarify whether costs associated with unsuccessful client money claims (or arrangements particularly likely to give rise to such claims) should be allocated to the general estate or the client estate; and/or
- if these costs are to be borne by the client estate, consult on how firms may protect 'plain vanilla' retail clients from the higher insolvency costs arising on other types of business e.g. margined business involving title transfer (e.g. by means of prudent segregation).

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? If introduced, what should this include and should any exclusions apply?

No. By definition any product on CASS RP is designated investment CASS business.

What might be a simpler approach would be to get firms to share the rationale filed by field for each legal entity for the basis on which the CMAR is completed.
This language should detail why each field is on CMAR or in scope for CASS with rationale.

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

We consider that this is a matter for Insolvency Practitioners to respond to.

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?

No. Firms would only be willing to do this with prescribed wording.

Q14: Is the client statement the best place to provide this and what should this comprise? If not, how else could firms communicate this information to clients and what barriers exist to doing so?

Clients' statements already have to make appropriate warnings. If the regulators believe this is inadequate, they should consult specifically on the issue.

Any wording on this should be prescribed and statements are not always read by clients therefore using this medium to declare this information may not necessarily have the intended impact.

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?

No. This is unnecessary. See our response to Q11.

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?

TISA do not agree with the all the additions that are being proposed due to the fact that we feel they will be of little help to an IP in the first 48 hours of an insolvency. Client Specific Safe Custody Asset records will be vital but details of treatment of shortfalls will not aid the IP in any way. We would therefore encourage the FCA to take guidance from IPs as to what is critical within the initial insolvency period and refine the CASS 10 rules to reflect this. An increased number of documents also places pressure on the firm to maintain these in accordance with CASS 10 rules and could lead to further breaches.

As the FCA have pointed out, these records are already required under PS14/9. How will adding them to the CASS RP be anything other than duplication?

Q17: Do you agree that the detailed explanation of client statements would be a proportionate addition to the CASS RP? If not, please provide reasons why, and any suggestions as to how we could approach this differently.

No. We consider that the obligations for client statements are quite clear.

It might make sense to include a detailed procedure as to how the client statement is run for each client cohort by legal entity.

It would make sense then to have the head of client reporting included in insolvency plans so that their knowledge can be drawn upon by the IP to produce a statement client by client. A client money SME expert may be needed to tie the statement to the client money pool and understand any systemic discrepancies as the statement is not valid unless balances are tied to the client money pot available for any distribution.

Q18: Do you agree that clients and administrators should receive the same explanation of client statements? If not, please provide reasons why, and any suggestions as to how we could approach this differently.

We do not understand what FCA seeks to achieve by this proposal.

The requirements of an administrator, looking to manage an insolvency, are quite different from the requirements of a client holding assets with a firm while it is still a going concern. We do not think that conflating these different requirements will help clients.

Q19: Do you agree that a firm could provide this explanation in the client statements themselves and/ or on its website? If not, please provide reasons why, and any suggestions as to how we could approach this differently.

No. See response to Q18 and Q19.

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?

This would require a final Client Money Calculation. If this is required and the Insolvency Practitioner carries this out, what happens if the existing methodology is non-standard?

We should note that a material top up to the client money pool may drive a legal challenge (which will incur costs and delay) from the general creditors' pool.

Q21: Are there any other court decisions that would benefit from codification in the CASS 7A rules? If yes, please explain which and the reasons why this would be the case.

For the regime to work the FCA rules should continue to apply through CASS and the courts decision through the legal process. To add a third avenue will lead to legal challenge or delay.

Q22: Do any points in the LBIE judgments require further codification in the CASS 7A rules? If yes, please explain which and the reasons why this would be the case.
We believe that the CASS rules adequately capture the lessons learned from firm failures, particularly when coupled with the senior manager regime in force for banks from 7 March and remainder of industry from 2018.

We consider that it would be dangerous to attempt to codify trust law through regulation in this way, as there would be a risk that the codification would conflict with trust law as established through case law.

Q23: Should firms be encouraged to segregate a prudent margin in respect of administration costs? If not, please provide reasons why, and any suggestions as to how we could approach this differently.

No.

Firms already have adequate capital requirements. This would be nothing more than an attempt to impose more capital requirements on the industry. This would inhibit competition, raise costs, which would be bound to impact clients, and raise barriers to entry.

You could also argue that segregating more taints the client money trust.

In addition, planning for insolvency contradicts going concern accounting standards.

If the FCA believes more capital is required, it should explain why and consult on methodology and rules to effect this.

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

We do not consider that this should be determined by regulators. Further standardisation would be difficult and costly to implement, and frankly impossible across the myriad of industry platform solutions from the manual nature of a small unit trust manager through to Fin Tech houses.

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

Which clients should benefit, if any (some clients do receive interest, some do not, should clients with larger balances get paid out first…..?) How would it be offset again the debt of the estate?

It would be possible to write terms that allow this idea to work, but clients that are receiving interest for significant balances (especially if interest rates were to spike up again over time) would be likely to legally challenge a sudden block on their payment causing detriment to resolution.

Q26: Do you agree with our proposed de minimis values? If not, please provide reasons why and suggest alternative values.

Yes.

Q27: Do you agree with our proposed treatment of unclaimed client monies? If not, please provide reasons why, and any suggestions as to how we could approach this differently.

This is sensible as it clears down these balances once and for all instead of an IP having to retain funds to manage the pot on an ongoing basis or transfer to no purpose to another firm.

How would this align to bar date?

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Q28: Do you consider that an equivalent provision for unclaimed assets would be beneficial? If not, please provide reasons why, and any suggestions as to how we could approach this differently.

Yes.

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?

We agree with the principle. The levels should be consistent with the existing CASS rules

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?

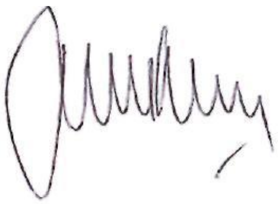
Yes. £25.

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

As stock is fungible, is there a need? We would support if the new rules speeded up resolution and removed uncertainty.

If you have any questions, or should like to meet to discuss, please let me know.

Yours sincerely



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