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Dear Ms Harding

CP11/15 Client assets sourcebook: custody liens and title transfer collateral arrangements**

This is the Financial Services Consumer Panel's response to CP11/15** Client assets sourcebook.

The Panel has strongly supported previous proposals to strengthen consumer protection and enforce compliance by firms with the requirements of the Client Assets Sourcebook (CASS) and we have been greatly encouraged by the work of the dedicated CASS team. We accept that if anomalies or unintended consequences have arisen in relation to the requirements already agreed they should be addressed, but it is important for consumers that the FSA does not step back from the robust stance it has taken on this important consumer protection issue.

It is essential that the FSA takes action to mitigate the greater risk to consumers presented by the proposed amendments to CASS rules. Only if the FSA puts in place specific and sufficiently robust safeguards in the form of focused supervisory monitoring and enforcement to ensure that individual clients do not suffer detriment as a result of these changes, do we support the main proposals as they stand. We also expect the FSA to require firms to keep their clients informed of the position regarding their assets and of the potential impact of any liens.

Our comments on the specific questions in the Paper are set out below.

Custody liens

Q1: Do you agree with our proposal to switch off CASS 6.3.5R for all agreements subject to this rule for six months from 1 October 2011 expiring on 31 March 2012?

and

Q2: Do you agree with our proposal to permit a lien or right over an omnibus client account where it is confined to properly incurred charges and liabilities arising from the provision of custody services in respect of the assets held within that account?

and

Q3: Do you agree with our proposal to permit liens over omnibus accounts held at securities depositories, in securities settlement systems and at central counterparties for the purpose of facilitating the settlement of trades in respect of the assets held in those accounts?

We have considered the arguments put forward in the Paper for the package of rule changes to address the issues raised by industry around the practicality of the day to day application of CASS 6.3.5R and 6.3.6R, including the 'switching off' of CASS 6.3.5R for six months until 31 March 2012, during which time it would effectively be replaced by the reinstated guidance at CASS 6.3.3G(4).

Clearly it is important for both consumers and industry that the FSA puts in place rules that work. There is a balance to be struck between protecting clients from general liens on their assets that would have a detrimental impact on future access and availability, and taking a pragmatic approach to cost effective ways of facilitating custody and settlement arrangements.

As the FSA acknowledges in CP11/15**, the use of inappropriate general liens is a threat to the regulator's consumer protection objective and is also in our view a substantial threat to individual consumer interests. We found the level and nature of market failure which led to the original proposals CP10/9** Enhancing the Client Assets Sourcebook, quite astonishing. There had been failings in some of the most basic areas, such as lack of establishment of trust status for segregated accounts and unclear arrangements for the segregation and diversification of client money. This review had followed a 'Dear Compliance Officer' letter less than a year earlier which we understand would have set out firms' obligations to protect client assets and put them on notice that the FSA would be assessing firms' compliance with the requirements. To provide these same firms with the amount of flexibility contained within the latest proposals is, therefore, a serious concern for the Panel.

Although we are pleased to see the FSA reinstating earlier guidance, this in itself is not sufficient safeguard for clients. We believe the risk presented by the proposed changes is significant and should be mitigated by increased levels of supervisory scrutiny of the activities of a representative sample of firms that will be taking advantage of the interim relief period and revised future rules. Instances of non-compliance should be addressed immediately and steps taken to protect client assets. Firms should also be required to inform clients of the impact of any general lien on their assets. Only on this basis do we support the proposals set out in Chapter 2 of the Paper on omnibus accounts.

Q4: Do you agree with our proposed amendments to CASS 6.3.6R(3)(a) so that general liens may be granted over client assets in overseas jurisdictions if such a lien is necessary for an individual firm to gain access to a local market?

Q5: Do you agree with our proposal to change CASS 6.3.6R(3)(b) so that general liens may be granted over client assets in overseas jurisdictions (without the firm taking reasonable steps to establish that the grant of the lien is in the best interests of the client) if a professional client has instructed that the asset be held in that jurisdiction?

and

Q6: Do you think that our proposal to change CASS 6.3.6R(3)(b) should be specifically limited to situations where the professional client is not provided with advice as to where the assets should be held?

In the case of overseas jurisdictions, we believe that there is scope for confusion resulting from the different approaches by and requirements imposed on firms, although we accept that much of this will be outside the direct control of individual businesses. We would like to see requirements enforced that will ensure that clients are aware of the existence and impact of general liens over assets in overseas jurisdictions. Where a professional client has instructed that assets be held in a particular jurisdiction the firm should of course act on those instructions, although we would still expect the client to be informed of the implications of doing so.

Title transfer collateral arrangements (TTCA)

Q7: Do you agree with our proposal to prohibit the use of TTCA with rolling spot forex contracts offered to retail clients in the form both of futures and contract for difference?

We agree with this proposal and support the FSA's continued work in this area.

Cost benefit analysis

Q8: What are your views on the benefits and costs of our proposed policy measures relating to custody liens?

and

Q9: what are your views on the benefits and costs of our proposed policy measures relating to title transfer collateral arrangements and rolling spot forex contracts?

We have no comments on the cost benefit analysis.

Yours sincerely

Adam Phillips
Chair
Financial Services Consumer Panel