

## Thought Leadership Paper: Client Money & Unbreakable Deposits



### Publication of PS 18/2

On 22 of January 2018 the FCA published policy statement, PS18/2, enabling firms to hold a proportion of client money in unbreakable deposits up to 95 days, subject to certain conditions.

In this Paper, we summarise the main changes that the Policy Statement has brought to the FCA's Handbook and highlight a few unintended consequences and challenges these changes may have inadvertently brought about for CASS firms.

### Background to the Changes

In August 2017, the FCA released its consultation paper, CP17/29, 'Client Money and Unbreakable Deposits', with the aim of addressing the fact that investment firms had been experiencing increasing difficulty depositing client money at banks in accordance with the existing CASS requirements.

The proposals in the CP included permitting firms to deposit a proportion of their client money in unbreakable deposits to a maximum period of 90 days' subject to specific conditions being met. Based on feedback provided, PS18/2 extended the term period to a maximum of 95 days.

### Summary of the key rule changes

#### CASS 7.13 (Segregation of client money)

Rules were introduced to allow firms to utilise 95-day unbreakable deposits. Transitional provisions were also introduced to allow firms with existing waivers to either continue with their existing arrangements until they cease to have effect, or transition to the new rules.

#### CASS 10 (CASS RP)

A new paragraph has been added to 10.3.1R, paragraph (5B), to ensure that firms include their policy on the proportionate approach to the use of unbreakable deposits in their CASS resolution packs.

#### SUP 16.14 & SUP 16 Annex 29AG (CMAR)

New fields have been added to the CMAR template and accompanying guidance which require firms to present the proportion of funds they have in unbreakable deposits and also set out the time remaining on each term deposit.

Within the CMAR these balances are to be split across three sub categories; up to 30 days, 31 to 60 days and 61 to 95 days.



## Changes to CASS 7 - The Details

Following the Consultation Paper, Policy Statement 18/2 was published outlining the final changes to the 30-Day Rule which was designed to ensure consumers continue to be appropriately protected by firms holding their client money, and that undue delay would not occur in an insolvency situation.

When compared to the proposed rules within the consultation paper the final rules were amended illustrating that the FCA acknowledged some of the concerns raised by the industry.

The most significant and perhaps surprising of the changes was the agreement to increase the maximum period of a deposit from the proposed 90 days to 95 days. The result of this will remove these deposits from the PRA's proposed daily monitoring window for credit institutions<sup>1</sup>.

These accounts will still be captured by the PRA's proposed monthly monitoring window for credit institutions<sup>1</sup>, and it is hoped that any increase in risk is minimal, especially when considered in conjunction with the expected increased appetite of banks to hold client money.

The changes became effective from 22 January 2018; however, based on feedback on the disparity when compared to firms with existing waivers, transitional provisions were also introduced to allow these firms to either continue with their existing arrangements until they cease to have effect, or transition to the new rules without delay.

Whilst not offering detailed guidance, the FCA sets out that conditions on the use of 95-day term or notice deposits includes: mandatory client disclosure; setting a policy for the portion of client money held in unbreakable deposits;

implementing adequate monitoring controls; and introducing stress testing procedures to assess the impact of shocks to client money.

### Issues to note: potential pitfalls

#### Weekend expiry of 95-day unbreakable deposits

The FCA have clarified that a firm will be in breach of CASS should a 95-day unbreakable deposit expire on a non-working day in the UK, even if the firm is able to make a withdrawal on the next working day.

#### Explaining the risks to clients

With many firms having just refreshed their client terms of business having to write out to clients in advance of using 95-day unbreakable deposits may be seen as one communication too far. However, the rules are clear and firms will need to ensure that agreements are updated, and communications are made with clients before the use of any unbreakable deposits.

#### Consideration of other elements of the FCA and PRA's Handbook

The use of unbreakable deposits is not mandatory and consequently, firms looking to take advantage of this option should first establish that in doing so they will not be falling foul of any other FCA or PRA liquidity rules to which they are subject, or indeed their own counterparty and liquidity risk policy. This is especially key for firms that are subject to IFPRU and BIPRU 12.

#### New fields within CMAR

New fields have been added to the CMAR template and accompanying guidance with worked examples, however, we are yet to see how easy firms will find it to change their own templates and implement these changes.

<sup>1</sup> The PRA is presently consulting on changes to the Pillar 2 Liquidity and reporting rules



It is yet to be seen how firms will respond to the use of 95-day deposit accounts, and whether their banking partners will leave them with little or no choice in doing so, even if, such a move is not within their own appetite.

In addition, we are also keen to see how the CASS audit firms are going to view the policies, which firms are required put in place over the proportion of client money that they intend to hold in unbreakable deposits. Given that a firm's policy will be based on principles, rather than on prescriptive limits, the opinions of auditors and their macro view of all firms is likely to drive policy from the back seat. In a year or two, once the rules are embedded this could cause firms to revisit their policies to avoid falling foul of best practice and auditor identified issues.

One piece of the Consultation Paper that remained largely unchanged in the Policy Statement is the requirement for firms to take 'appropriate measures' to address the risk of not being able to access client money should they be required to do so. During the consultation process some respondents asked for more prescriptive guidance as to what the FCA deems to be 'appropriate' in this context but the FCA maintained its original stance and offered no further guidance, leaving firms to decide for themselves what is required.

As the FCA rightly points out the concept of stress testing should be familiar to most of the industry, and especially firms subject to BIPRU, so some guidance is out there in the market. However, we feel that firms left to their own devices on this matter may struggle to come up with realistic stress tests. For those firms that can design adequate tests, the question remains over what they should do with the results and what appropriate measures they should take. It is inevitable that any stress test results will

demonstrate some level of delay in an insolvency due the use of unbreakable deposits. This type of result will require some careful 'out of the box' thinking to design a process that justifies the continued use of unbreakable deposits. Please contact us should you wish to discuss this further.

## **Actions for today**

### **Unbreakable Deposits Balance Policy**

Firms who wish to make use of unbreakable deposits will first need to have a policy in place. This will need to explain the firm's proposed proportionate approach and how it will monitor the levels of cash in such accounts. We envisage that this could be difficult to manage in practice, as it will require firms to respond instantly to fluctuations in the overall client money pool whilst simultaneously having a portion of funds that are not easily realisable.

Additionally, firms will need to decide how to treat any infringements of their internal policy and how this will be dealt with through their CASS issue and breach management process.

### **Define what 'appropriate measures' means**

In connection with the point above firms should ensure that they have decided what 'appropriate measures' they are going to take to manage the risk of being unable to access client money when required. Firms will need to design a series of stress tests that are performed on a regular basis. Even if the stress scenarios have a low probability of occurring, each firm will also need to design some careful measures to deal with the results of any stress testing. These measures and an appropriate plan should be robust enough to demonstrate that delay to the return of client money can be minimised, and the proportion of client money held in unbreakable deposits can continue to be justified.



## Pressure from Banking Partners

We are yet to see whether the concern expressed by some of the industry responses to CP 17/29 are to be realised with regards to the unintended consequence of banks putting pressure on firms to make use of unbreakable term deposits.

In case this concern crystallises we believe that it would be a good proactive step for firms to consider their contingency plans in this area. By anticipating such a risk and engaging banks in conversations now, firms will be better placed to deal with any resulting consequences to their operating model.

These changes will impact all firms, regardless of size. We feel this is especially important for firms who either have a very dynamic client money balance, a heavy reliance on a single banking partner and / or, an operating model which requires instant access to significant proportions of their client money at any one time.

The new fields require firms to present the proportion of funds they have in unbreakable deposits and also set out the time remaining on each term deposit. The FCA intends to monitor the levels of client money in unbreakable deposits through its existing GABRIEL reporting process.

Within the CMAR these balances are to be split across three sub categories; up to 30 days, 31 to 60 days and 61 to 95 days.

## Contacts

If you would like to discuss any of the issues raised in this paper further, or would like to discuss any area of the FCA's conduct rules or your own operational model, please get in touch directly by email or by leaving a message on our website.

[www.rosediem.com](http://www.rosediem.com)

## Other Changes to CASS and SUP

Amendments were also made to the CASS RP with a new requirement added to 10.3.1R, paragraph (5B), which requires each firm to include their policy on the proportionate approach to the use of unbreakable deposits in their CASS resolution packs.

The Client Money and Asset Return ("CMAR"), detailed in SUP 16.14 and its associated guidance notes, SUP 16 Annex 29AG, have also been updated.



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