Notification and justification for the FSA's requirements relating to client assets applicable to UK investment firms under Article 4 of Directive 2006/73/EC ("Level 2 Directive") implementing Directive 2004/39/EC ("Level 1 Directive").

1. The UK Financial Services Authority ("**FSA**") intends to implement four additional requirements to improve the protection of client assets and client money, as proposed in Consultation Paper 10/9. Each of these requirements will only apply to investment firms for which the UK is the home Member State. They relate to:

   (a) disclosure of information relating to the re-hypothecation of client assets by prime brokerage firms;
   (b) reporting by prime brokerage firms to clients on the status of their client assets and client money on a daily basis;
   (c) restricting placement of a percentage of client money with group entities; and
   (d) allocating overall responsibility for compliance with the FSA's client assets and client money rules to one position within a firm

   (each a 'Provision' and together the 'Provisions').

2. Article 4 of the Level 2 Directive (2006/73/EC) sets out the conditions which must be satisfied if a Member State intends to retain or impose any requirements additional to those of that directive. This notification of the Provisions is made in accordance with those conditions and explains how the Provisions satisfy the Article 4 conditions.

3. This notification is structured as follows:

   (1) Explanation of how the Provisions may be additional to the requirements of the Level 2 Directive;
   (2) Description of the specific risks to safeguarding client assets and client money and to market integrity in the UK addressed by the Provisions and/or how they address risks which became evident post-MiFID and which are not otherwise regulated by or under Community measures;
   (3) Explanation of why the Provisions are proportionate; and
   (4) Explanation of why the Provisions do not restrict or otherwise affect the rights of investment firms under Articles 31 and 32 of the Level 1 Directive.

Explanation of how the Provisions may be additional to the requirements of the Level 2 Directive.

A - Disclosure of information relating to the re-hypothecation of client assets by prime brokerage firms

4. The FSA is proposing to introduce a requirement for prime brokerage firms[1] for which the UK is the home Member State to include a disclosure annex within each

[1] A "prime brokerage firm" is typically an investment bank which provides a range of services and products to hedge funds.

executed prime brokerage agreement where that agreement includes a prime brokerage firm's right to re-hypothecate[2] the client's assets ("**Prime Brokerage Agreement**"). The annex will provide a summary of the key re-hypothecation provisions within the Prime Brokerage Agreement, including:

(a) the contractual limit on the amount of client assets which the prime brokerage firm is permitted to re-hypothecate;
(b) the definitions relevant to re-hypothecation on which the contractual limit is based;
(c) cross references to the re-hypothecation provisions within the agreement; and
(d) a statement of the key risks to clients on the prime brokerage firm's insolvency.

5. Use by a firm of a client's assets is permitted by Article 13(7) of the Level 1 Directive and Article 19 of the Level 2 Directive where a client's express consent is obtained. At least in the case of a firm's retail clients, their consent should be based, in part, on the firm having provided clear, full and accurate information on that use. Article 32(7) of the Level 2 Directive provides:

   An investment firm, before entering into securities financing transactions in relation to financial instruments held by it on behalf of a retail client, or before otherwise using such financial instruments for its own account or the account of another client, shall in good time before the use of those instruments provide the retail client, in a durable medium, with clear, full and accurate information on the obligations and responsibilities of the investment firm with respect to the use of those financial instruments, including the terms for their restitution, and on the risks involved.

6. The FSA is seeking to require the provision of the re-hypothecation disclosure annex by a prime brokerage firm to all of its clients for which it has a Prime Brokerage Agreement in order to ensure that express consent has been provided from those clients. Accordingly, the FSA considers that the information provided to retail clients under Article 32(7) should also be provided to the professional clients of prime brokerage firms. These firms are active users of client assets and their clients are predominantly professional clients. Our experience is that preceding the insolvency of Lehman Brothers International (Europe) ("**LBIE**"), many professional clients failed to undertake sufficient due diligence on their contractual agreements with their prime broker. Many clients agreed to their prime broker acquiring unlimited rights to use their assets without anticipating the effect which the insolvency of that prime broker would have on those assets. Accordingly, following the insolvency of LBIE, clients complained that they did not fully understand the terms of their Prime Brokerage Agreements particularly as to the extent and nature of the prime broker's re-hypothecation rights. We

[2] Re-hypothecation is a financing mechanism whereby the assets posted by an investment firm's client (e.g. a hedge fund) as collateral can be used as collateral also by the investment firm for its own purposes. It is standard market practice among many investment firms for prime brokerage agreements to include a provision whereby the client consents to this practice.

understand that the LBIE administration has required a high volume of bespoke legal analysis in relation to LBIE's Prime Brokerage Agreements and supplemental documentation to ascertain LBIE's contractual entitlements in relation to the use of its clients' assets. Such scope for misunderstanding can of course harm the interests of the underlying clients. We therefore see this re-hypothecation disclosure annex as necessary for all clients of prime brokerage firms in order for them to properly understand the risks involved when their assets are re-hypothecated.

7. Given that Article 32(7) of the Level 2 directive is a requirement which only applies in relation to retail clients, and that Article 19 of the Level 2 Directive is not prescriptive as to the manner of obtaining a client's express consent, we consider it possible to view the disclosure annex as an additional requirement which must satisfy the conditions of Article 4.

8. Alternatively so far as the requirements relate to professional clients, the re-hypothecation disclosure annex could be viewed as being beyond the scope of Article 32 of the Level 2 Directive as that article only applies in respect of retail clients. This information would then be provided in satisfaction of the more general requirement in Article 13(7) of the Level 1 Directive, as developed in Article 19 of the Level 2 Directive, to obtain a client's express consent to the use of that client's assets and it would be permissible for the FSA to impose it without crossing the maximum harmonisation achieved through the related provisions in the Level 2 Directive.

9. There is therefore an argument that requiring disclosure of information on the re-hypothecation of client assets should be seen as outside the scope of the Article 4 notification requirement and compatible with the implementation of the Directive. **However, the UK has included this requirement in this notification on a precautionary basis, in case it is deemed to be within the scope of Article 4.**

B - Requiring prime brokerage firms to report to clients on the status of their client assets and client money on a daily basis

10. The FSA is proposing to require prime brokerage firms to report to clients on a daily basis including the status of their clients' assets and clients' money. This requirement will only apply to prime brokerage firms for which the UK is the home Member State.

11. Article 43(1) of the Level 2 Directive provides:

    Member States shall require investment firms that hold client financial instruments or client funds to send at least once a year, to each client for whom they hold financial instruments or funds, a statement in a durable medium of those financial instruments or funds unless such a statement has been provided in any other periodic statement.

12. This Provision requires that investment firms report to clients on a more frequent basis than the minimum required by the Level 2 Directive. It also requires reporting to all clients of a prime brokerage firm.

13. This Provision reflects current best practice offered by prime brokerage firms to some clients. Following the uncertainty in the immediate period following the insolvency of LBIE, clients began to demand this data for their own risk management purposes and to respond to their underlying investor demand for greater information. LBIE's insolvency therefore demonstrated the market failures which can arise where a firm is only required to report such information to its clients annually.

14. As the market recovers, however, it is not sufficient to rely on best practice alone. This Provision will ensure the information provided to clients is not dependent upon the relative commercial importance of the client to the prime broker. It will no longer be possible for a prime brokerage firm to disadvantage certain clients by providing less frequent reports to them, causing them to be less aware of, for example, the re-hypothecation of their assets.

C - Restricting a firm's placement of client money in a group entity.

15. The FSA intends to restrict the percentage amount of client money placed within a bank, credit institution or qualifying money market fund which is a member of an investment firm's group to 20% of the client money held deposited in a client bank account by that investment firm. This requirement will only apply to investment firms for which the UK is the home Member State.

16. Article 18 of the Level 2 Directive provides that Member States shall require investment firms to promptly place client funds into either a central bank, credit institution, third country bank or a qualifying money market fund. In deciding upon the institution with which to place those funds, Article 18(3) provides in particular:

    Member States shall require that, where investment firms do not deposit client funds with a central bank, they exercise all due skill, care and diligence in the selection, appointment and periodic review of the credit institution, bank or money market fund where the funds are placed and the arrangements for the holding of those funds.

    Member States shall ensure, in particular, that investment firms take into account the expertise and market reputation of such institutions or money market funds with a view to ensuring the protection of clients' rights, as well as any legal or regulatory requirements or market practices related to the holding of client funds that could adversely affect clients' rights.

17. The purpose of the due diligence is therein expressed to be for the purpose of "ensuring the protection of clients' rights". Specifically, investment firms are to have regard to the "legal or regulatory requirements or market practices … that could adversely affect clients' rights". Client money deposited with a group bank, credit institution or qualifying money market fund, although held on trust by the investment firm, is treated as an ordinary deposit by that institution. We are of the view that the contagion risk of intra-group insolvency necessitates a restriction on placing client money intra-group. For example, LBIE placed approximately 51%

of its client money with Lehman Brothers Bankhaus AG. Subject to the outcome of German insolvency proceedings in relation to this matter, the intra-group client money may not be returned. In order to ensure the protection of client rights, we are of the view that a firm must not place more than 20% of client money held in client bank accounts with any group bank. This risk is amplified in relation to group banks which are often outside the jurisdiction of the investment firm. Typically, insolvency regimes will first protect the interests of domestic creditors such that client money belonging to an investment firm outside that country are not promptly returned and not returned in priority to other creditors.

18. There is therefore an argument that the due diligence requirement in Article 18(3) in practice requires diversification of the placement of client funds and should be seen as outside the scope of the Article 4 notification requirement and compatible with the implementation of the Directive. **However, the UK has included this requirement in this notification on a precautionary basis, in case it is deemed to be within the scope of Article 4.**

D - Allocating overall responsibility for compliance with the FSA's client assets and client money protections to one position within a firm

19. The FSA is proposing to require each firm which holds client assets and/or client money to allocate overall responsibility for ensuring operational compliance with the applicable national rules and guidance which protect those client assets and that client money to one director or senior manager within each firm, or where there are job-share arrangements in place (for example where two people are jointly responsible for one position within a firm), to one position in the firm. This requirement will only apply to investment firms for which the UK is the home Member State.

20. This function is separate to, and does not reduce the scope of, the compliance function of a firm which is required by Article 6 of the Level 2 Directive. In relation to client money and client assets, a compliance officer must continue to advise and assist relevant persons within a firm to comply with that firm's obligations under MiFID as well as monitor and assess the adequacy and effectiveness of relevant measures and procedures taken by that firm.

21. The Provision will introduce a new, distinct function which is the operational role of ensuring that the appropriate client assets and client money protections are actively being achieved by the firm in the course of its business. Compliance officers are ordinarily unable to perform this function because of the requirement in Article 6(3)(c) of the Level 2 Directive that any relevant persons involved in the compliance function must not be involved in the performance of the services or activities that they monitor, unless a firm is able to demonstrate that it is not proportionate to apply this in accordance with the second paragraph of Article 6(3). Where a firm is able to use that exception, the Provision does not prevent both of these functions to be performed by the same person.

22. Neither the Level 1 Directive nor the Level 2 Directive imposes detailed organisational requirements on the allocation of responsibilities within an investment firm in relation to the protection of client assets and/or client money.

23. Article 13 of the Level 1 Directive provides:

    1. The home Member State shall require that investment firms comply with the organisational requirements set out in paragraphs 2 to 8.
    ...

    7. An investment firm shall, when holding financial instruments belonging to clients, make adequate arrangements so as to safeguard clients' ownership rights, especially in the event of the investment firm's insolvency, and to prevent the use of a client's instruments on own account except with the client's express consent.

    8. An investment firm shall, when holding funds belonging to clients, make adequate arrangements to safeguard the clients' rights and, except in the case of credit institutions, prevent the use of client funds for its own account.

    ...

24. Article 16 of the Level 2 Directive provides:

    1. Member States shall require that, for the purposes of safeguarding clients' rights in relation to financial instruments and funds belonging to them, investment firms comply with the following requirements:

    ...

    (f) they must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client assets, or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence.

    ...

25. The FSA considers that both the "adequate arrangements" and "adequate organisational arrangements", as respectively described in the articles of the Level 1 and Level 2 Directives reproduced above, do not place requirements on the allocation of responsibility to individuals within that firm. If that was meant, additional detail would and should have been provided to specify this, as it has in relation to, for example, other functions described in Articles 6 to 8 of the Level 2 Directive.

26. Alternatively, if those articles are meant to include the allocation of responsibility to individuals, the FSA considers it is necessary for a firm to make the allocation explained above in order to provide adequate arrangements. Our experience has demonstrated that the current, more general requirements on firms, where several people may be responsible for ensuring compliance with client money and/or

client assets rules, has resulted in uncertainty in responsibility across a high proportion of firms, contributing to significant failures in compliance.

27. For these reasons, the Provision should be seen as outside the scope of the Article 4 notification requirement and compatible with the implementation of the Directive. **However, the UK has included this requirement in this notification on a precautionary basis, in case it is deemed to be within the scope of Article 4.**

Description of the specific risks to safeguarding client assets and client money and to market integrity in the UK addressed by the Provisions and/or how they address risks which became evident post-MiFID and which are not otherwise regulated by or under Community measures.

28. The recent financial crisis has tested the limits of the protection provided to client assets and client money in the UK, the high water mark being the administration of LBIE including over $35 billion in client assets and over $2 billion of client money tied up in the insolvent estate and which has been ongoing since 15 September 2008.

29. The aim of the protection provided by the Level 1 and Level 2 Directives was to ensure the protection and prompt return to clients of client assets and money held by an investment firm upon the occurrence of an event likely to have an adverse impact upon the rights of clients to those assets. LBIE's administration, as well as ongoing work carried out by the FSA in dealing with the impacts of the financial crisis, has demonstrated the need for additional protection to be provided to clients of investment firms in order to adequately safeguard client assets and money.

30. The UK, and London in particular, is home to a significant volume of investment banking business. The protection of client assets and client money is of central importance to market integrity.

31. The FSA has identified specific issues in respect of prime brokerage firms where many clients contract with the investment firm on the basis of their standard terms and are not fully aware of the terms of that contract and in particular the ability of the prime brokerage firm to re-hypothecate potentially all of their assets (depending on the contract). Despite detailed analysis which preceded the client asset protections put in place by the Level 1 and Level 2 Directives, the financial crisis, with the insolvency of the Lehman Brothers group in particular, has highlighted the importance of clients retaining their proprietary rights to assets held by investment firms, or, if they have properly consented to re-hypothecation, being fully aware of the risks involved.

32. The importance of clients having access to up-to-date information relating to their accounts has also been highlighted, and a failure in this regard led to significant market uncertainty and has had a negative impact on the ability of firms to recover their assets and/or money from the LBIE estate. This importance is also emphasised in sections of the market continuously involving fast moving balances of client assets and client money, including active trading by hedge funds. The

UK is proposing to deal with this by increasing the frequency of reporting to clients as described above.

33. Cross border insolvency laws have not yet been sufficiently developed in relation to investment firms to always provide priority to the claims of clients for any client assets and client money held by an insolvent firm in another jurisdiction. Prior to the insolvency of the Lehman Brothers group, and post-MiFID's application, the failure of a large investment firm, though always possible, was not thought to present a significant risk. Clients are significantly exposed to the credit risk of an investment firm where the firm places a significant proportion of its client money intra-group. As noted above, LBIE placed approximately 51% or US$1 billion of segregated client money with its German affiliate, Lehman Brothers Bankhaus AG, which is subject to German insolvency proceedings. To address this risk, the UK intends to impose a limit on the amount of client money which an investment firm may place with an intra-group institution as described above to limit the contagion risk if an entire group was to fail.

34. We have observed that responsibility for client assets and client money is often split between a number of staff across the compliance, operations, finance and/or corporate treasury functions of investment firms. The recent financial crisis and the insolvency of LBIE have demonstrated that this split of responsibility has been ineffective in providing the level of client assets and client money protection required by the Level 1 and Level 2 Directives because there was no single person or position with overall responsibility for ensuring consistency and for reporting to the senior management.

Explanation of why the Provisions are proportionate.

35. Our proposal for a re-hypothecation disclosure annex only brings together, in summary form, existing information requirements imposed on firms under MiFID. We considered whether a limit on re-hypothecation should be imposed, but concluded that a more proportionate method of increasing client protection was to instead provide clients with clear information on re-hypothecation. We also considered whether this information should include a standardised definition of "net indebtedness", a term which is generally used in prime brokerage agreements; however, again our view was that the most proportionate approach at this stage was the one proposed above.

36. We understand that since the insolvency of LBIE, most prime brokerage firms are now reporting to clients on a daily basis. In addition, Article 16(1) of the Level 2 Directive already requires firms to "keep such records and accounts as are necessary to enable them at any time and without delay to distinguish assets held for one client from assets held for any other clients, and from their own assets". Our proposed requirement will only give legislative backing for existing market practice and we anticipate will have minimal implementation effects on prime brokerage firms. Although we considered whether we should rely on market practice alone, we do not consider that this will be sufficient to safeguard the rights of clients in the long term.

37. The limitation on placing client money with a group bank is also proportionate because investment firms must already carry out due diligence to ensure that clients' rights are protected as a result of Article 18(3) of the Level 2 Directive and the requirement only provides legislative effect to the reasonable result of such due diligence. The requirement will also significantly reduce the risks to clients, particularly intra-group contagion risk which was highlighted by the insolvency of LBIE, by ensuring firms place the majority of client money with institutions that are not likely to be affected by their own insolvencies. We considered whether the same result could be achieved through increased clarity on the extent of the due diligence requirement, but we concluded that more substantial benefits would be achieved through specific provision for a minimum benchmark.

38. Requiring the allocation of responsibility for compliance with client asset and client money protections to one position within a firm, that being a director or senior manager, is a proportionate response to the market failures which the FSA has observed. Firms may continue to have multiple persons responsible for client assets and client money protection across different business lines, so long as there is one position within each firm that is given overall responsibility. This seeks to improve the consistency in applying a firm's applicable organisational requirements to its client assets and client money as these will be subject to review by the person holding a specific job function. We considered whether the function should be allocated more generally to senior management, but our view is that this leaves too much scope for ineffective allocation of responsibility. Our investigations in the market have observed that the majority of firms have not established appropriate oversight in this area and so we consider increased specificity in this responsibility is required. Our proposal also seeks to ensure that there is a clear line of responsibility for any failings that may have occurred within the firm.

39. We have attached a high level cost benefit analysis at Annex 1 following a pre-consultation survey of a representative sample of firms. Further details of this analysis are available on request.

Explanation of why the Provisions do not restrict or otherwise affect the rights of investment firms under Articles 31 and 32 of the Level 1 Directive.

40. The requirements will not restrict or otherwise affect the rights of investment firms under Articles 31 and 32 of the Level 1 Directive. This is because the FSA will not apply them to firms exercising rights under Articles 31 or 32.

ANNEX 1: High Level Market Failure Analysis and Cost Benefit Analysis

High-level Market Failure Analysis

1. Inadequate client asset and client money protection can lead to consumer detriment through the diminution of client money and assets and can lead to considerable delays to the return of client assets and client money in the event of an investment firm's insolvency. Asymmetric information between firms and clients has also contributed to these issues. We understand that an information gap also exists in the market which results in restricting a client's ability to assess their counterparty risk with the institution holding their money and assets (which will not be the firm with whom they contract).

2. Inadequate client asset and client money protection can lead to decreased market confidence in the case of the failure of a major institution. Apart from losses to affected clients, this can create systemic risk as uncertainty about the solvency of major financial firms which could spread across the financial system and liquidity in wholesale markets could decrease. In the immediate period following the appointment of an insolvency practitioner to large investment firms, for example prime brokers, we understand that there has been a high level of uncertainty because of a lack of information in the market concerning the failed institution and uncertainty with regards to the status of both house and client trades such as OTC derivative contracts. Investment firms and especially prime brokers can operate exceptionally complex businesses on a global scale and any insolvency can take a considerable period of time to fully resolve. Following the immediate insolvency practitioner appointment, client assets and money are in effect frozen and this can further reduce liquidity on a systemic basis, and may contribute to individual firm failures, for example a number of hedge funds themselves became insolvent because of the insolvency of LBIE.

3. Regulatory measures can address these market failures which provide greater benefits than costs.

High-level Cost-Benefit Analysis (CBA)

4. We have conducted a number of surveys to gather data from a representative sample of firms who will be affected by the changes we are proposing. The following CBA is based upon the data provided to us.

Disclosure of information on the re-hypothecation of client assets by prime brokerage firms

5. Disclosure of re-hypothecation practices via an annex to the Prime Brokerage Agreement will provide clients with clearer information and transparency about the risks involved when they permit re-hypothecation of their assets. This provision will ensure that disclosure and transparency is established and maintained in the future when the lessons learned from, for example, the insolvency of LBIE have been forgotten. It is likely to therefore increase clients' awareness and understanding of the Prime Brokerage Agreements. As well as assisting the prime brokerage firm's clients, who are usually hedge

funds, it will also assist the hedge fund in providing an overview of the Prime Brokerage Agreement to their underlying clients. It has the added benefit that prime brokerage firms will need to review their existing Prime Brokerage Agreements including version control, to ensure that the agreements have been properly executed and filed.

6. The cost associated in creating the disclosure annex is likely to be limited to the one-off costs for adjusting the standard Prime Brokerage Agreements. On average firms considered that amendments to the Prime Brokerage Agreement could amount to a one-off cost of up to £10,000. Once the Prime Brokerage Agreement had been amended to include the disclosure annex we do not anticipate that there would be any further on-going costs when contracting with new clients. For existing clients however, the repapering costs could be significant depending on the number of clients. We estimate that each relevant prime brokerage firm has between 100-350 clients and corresponding Prime Brokerage Agreements.

Requiring prime brokerage firms to report to clients on the status of their client assets and client money on a daily basis

7. Reporting by prime brokerage firms to their clients who have Prime Brokerage Agreements on a daily basis helps clients manage their exposures to their prime brokerage firm, especially when a right to use has been exercised over their assets. It will also enable clients to make more efficient use of their assets (for example ensuring that shares are not re-hypothecated while they want to exercise voting rights on them). Prior to the insolvency of LBIE, the standard market practice was not to report on a daily basis. Upon the failure of LBIE, this resulted in the fact that clients had limited certainty and a lack of information about which assets had been re-hypothecated and/ or whether or not their pending trades had been actioned and whether they would settle. There are similar problems with house trades.

8. Following the LBIE insolvency we understand that clients requested additional reporting from investment firms covering at the least their client assets and client money. Accordingly, many investment firms now provide daily reporting to their clients. Firms have therefore already incurred most of the costs of this proposal. To the extent that clients now receive daily reporting the benefits of this proposal have also been realised. The main additional benefit of the proposed rule is to ensure that this practice is maintained in the future and available for all clients.

9. We understand that many prime brokerage firms in the UK had provided this information for a number of years and offered daily transaction reporting as a basic feature of their platform. Not all prime brokerage firms offer daily reporting to all clients however, but we understand the incremental costs for extending daily reporting to all clients would be negligible.

Restricting a firm's placement of client money in a group entity

10. There are divergent market practices in relation to depositing client money with group banks. Placing client money deposits with group banks exposes

the client to the credit risk of the group generally, because when one group entity fails it is more likely that the whole group will then fail. The failure of LBIE demonstrated this issue with the placement of approximately $1 billion with a group bank (Lehman Brothers Bankhaus AG). Also, it can be argued that there is a conflicting incentive between safeguarding client money and the interests of the group, where client money could be seen as source of intra-group liquidity where it has a lower cost of capital than external sources[3].

11. While existing FSA handbook guidance addresses the requirement on firms to diversify their client money deposits, greater specificity as to how this ought to be achieved is required.

12. A hard 20% limit on client money which can be deposited intra-group would limit the level of group contagion risk and credit risk to which clients are exposed. On a firm specific basis, whether or not a hard limit would result in a net economic benefit or a net cost depends to a large extent on the status of third party banks compared to group banks. In particular in times of market stress firms may be forced to place client money at higher risk third party institutions. We understand that the largest firms also face operational issues in placing very large amounts of client money outside the group because there are only a limited number of quality institutions that could accept such large deposits. We expect firms to address this issue by diversifying their client money holdings but will address any specific issues on a case by case basis.

Establishing a CASS oversight controlled function

13. We have found that a lack of central oversight has contributed to some firms' failings in relation to adequate protection of client assets and client money[4]. A specific controlled function (CF) for all client assets and client money aims to provide enhanced clarity regarding who is responsible for these matters.

14. Creating a single position in every firm which holds client money and/or client assets which will be responsible and accountable for compliance with the requirements applicable to that client money and client assets across all relevant business units will provide central oversight and a clear line of responsibility. We expect this requirement to improve firms' compliance with the relevant rules and to promote consistency and dedication to oversight.

15. There will be implementation and ongoing costs associated with introducing a CASS oversight CF both for firms in applying for the new CF and for us in approving the applicants. We consider that adding a CASS oversight CF to our existing regime will have incremental one-off information system (IS) costs, of approximately £350,000 to us. Ongoing costs will be met by our ongoing budget funding by levying fees on the firms we regulate.

16. Initially we consider that approximately 350 medium firms and 50 large firms will require authorisation in 2011-12. This will result in an estimated one-off

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[3] One firm provided data stating that the opportunity cost of capital moving from intra-group deposit to external would be approximately 15 basis points.
[4] www.fsa.gov.uk/pubs/other/cass_risk.pdf

cost to us of £70,000[5]. On an ongoing basis, if we assume a 10% turnover in staff, we will have to process approximately 40 applications each year, of which approximately 5 will be from large firms that require competency-based interviews. The ongoing cost for us is therefore estimated to be £7,000 p.a.

17. We estimate that the administration cost to a firm of preparing and submitting an application is £200[6], and large firms, in addition, will incur £1,850[7] per application associated with preparing and attending an interview. The firms will therefore incur a one-off cost of £170,000[8], and an ongoing cost of £17,000 p.a.

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[5] 44* (350+50)+1050*50= £70,100

[6] According to the '*Real Assurance Estimation of FSA Administrative Burdens'* (June 2006)

[7] See CP 10/03 – *'Effective Governance'.* Assuming an hourly rate for a director's time of £365 (based on basic salary rate of 2 large banks) and approximately an average of 5 hours for the SIF interview process. Some firms may wish to use the services of external agencies to help prepare candidates for an interview, but we have not included this discretionary cost in our estimates.

[8] 200*(350+50)+1850*50=£172,500.