



Ms María Teresa Fábregas
EUROPEAN COMMISSION
Internal Market and Services DG
FINANCIAL SERVICES POLICY AND FINANCIAL MARKETS
Securities markets (G.3)
2, rue de SPA
B-1049 Brussels
BELGIUM

18 November 2014

Re: Notification under Article 4 of Directive 2006/73/EC (Implementing Directive) and under Regulation 79 of S.I 60 of 2007 European Communities (Markets in Financial Instruments) Regulations 2007, in respect of Proposed Client Asset Regulations for Investment Firms

Dear Ms Fabregas

I refer to previous correspondence from the Central Bank of Ireland (“Central Bank”) to the European Commission regarding the proposed Client Asset Regulations for Investment Firms¹. In accordance with Article 4 of the Implementing MiFID Directive 2006/73/EC and Regulation 79 of Statutory Instrument No 60 of 2007 European Communities (Markets in Financial Instruments) Regulations 2007, the Department is notifying the European Commission regarding its revised Client Asset Regulations for Investment Firms (as set out in Annex 3).

The proposed Client Asset Regulations for Investment Firms were approved by the Central Bank Commission on 26 September 2014 and by the Minister for Finance on 18 November 2014 and are intended to be implemented under Section 48 of the Central Bank (Supervision and Enforcement) Act 2013.

¹ Correspondence/meetings with Mr Salvatore Gnani and Ms Lucia Marin in September 2012, August 2013 and August 2014 refers

Justifications for the proposed Client Asset Regulations

The Central Bank and the Department are of the view that the proposed Client Asset Regulations for Investment Firms are in line with the fundamental principles established in the Implementing Directive. We consider that these Regulations address specific risks to investor protection or to market integrity that are of particular importance to Ireland and are not adequately addressed by the Implementing Directive (see Annex 2).

These changes are necessary in order to provide a revised client asset regime that will enable an investment firm to enhance the protection of the assets of its clients' while also reflecting how change in industry practice has evolved since the existing Client Asset Requirements were first introduced.

You will note that many of the Regulations that appear to be additional to the MiFID requirements are in fact in line with the main principles established in the MiFID Level 1 and the Level 2 Directives and are already included in the existing Client Asset Requirements.

The Client Asset Regulations for Investment Firms will only apply to those investment firms authorised by the Central Bank, therefore they will not be imposed on any investment firm passporting into Ireland or any branch of a European Economic Area investment firm operating in Ireland. Such investment firms will be subject to Home State supervision in respect of client assets.

Background to the development of the proposed Client Asset Requirements

In 2012, an independent review was conducted by the Central Bank on the Regulatory Regime for the Safeguarding of Client Assets. This review found that there were issues as to the form, scope and substance of the existing Client Asset Requirements which could give rise to inconsistencies in interpretation and application. In addition, investment firms' senior management and others who were not working routinely with the current Client Asset Requirements indicated that they had difficulty in understanding the rationale and content of some of the requirements.

Having considered the best approach to address these difficulties, the Central Bank decided that any revision should focus on three objectives:

- a) The maintenance of public confidence in the client asset regime;
- b) The mitigation of the risk of misuse of client assets whether as a result of maladministration or fraud; and
- c) The provision of a system which in the event of a firm's insolvency would enable the expeditious return of client assets to the owner at lowest cost.

The following approach was adopted in developing the proposed Regulations:

- a) High level principles were devised reinforced with guidance so as to introduce greater flexibility into the regime with a more accessible explanation of the rationale of the rules; and
- b) Unnecessary and potentially contradictory statements were eliminated.

The attached proposed Client Asset Regulations for Investment Firms ("Regulations") provides a framework for a client asset regime based on seven core Client Asset Principles as follows:

1. Segregation – client assets have to be held separately from the investment firm's own assets.
2. Designation and Registration - the client asset accounts have to be clearly identifiable in both the internal records of the investment firm and the records of the third party.
3. Reconciliation - accurate books and records have to be maintained with a daily reconciliation of each client asset account containing client funds and monthly in the case of client financial instruments.
4. Daily Calculation - an investment firm has to carry out a daily calculation to ensure that it has sufficient money in its client asset accounts to meet what it should be holding for its clients, funding these accounts out of its own money where there is a shortfall.
5. Client Disclosure and Client Consent - an investment firm should provide information to its clients in a way that informs the client on how and where their client assets are held and the resulting risks thereof.
6. Risk Management - appointment of a Pre-approval controlled person responsible for the investment firm's safeguarding of client assets. The

creation and maintenance of a Client Asset Management Plan - this plan should document an investment firm's business model and related risks in respect of the safeguarding of client assets and the controls in place to mitigate these risks.

7. Client Asset Examination - the investment firm has to engage an external auditor at least annually to prepare a report on the investment firm's safeguarding of client assets.

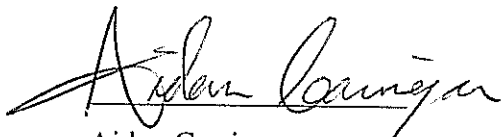
These core Principles are underpinned with detailed Regulations which set out what an investment firm, holding client assets, is required to comply with. The Regulations where necessary will be supported by Guidance to assist an investment firm in the interpretation of the Regulations.

The proposed Client Asset Regulations for Investment Firms document should be read in conjunction with this letter.

Appendix 1 sets out the index of attachments to this letter.

Should you have any queries, please do not hesitate to contact Niall O'Sullivan (Tel: 353 1 604 5532; Email niall.osullivan@finance.gov.ie)

Yours sincerely


Aidan Carrigan
Financial Services Division

Appendix 1

List of Attachments

- **Appendix 2** - Article 4- Justification for inclusion to address specific risks to investor protection or to market integrity that are of particular importance to Ireland and are not adequately addressed by the Implementing Directive
- **Appendix 3** - Copy of draft S.I XXXX of proposed Client Asset Regulations for Investment Firms

Appendix 2

Article 4- Additional Regulations to address risks to investor protection or to market integrity that are of particular importance to Ireland and are not adequately addressed by the Implementing Directive

This appendix gives a brief summary of the significant changes followed by the justification for amendment

1. Principle of Risk Management- Head of Client Assets Oversight (“HCAO”)

In the existing Client Asset Requirements (3.1.2(f)), an investment firm 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.

Under the proposed Client Asset Regulations, the Central Bank is proposing the introduction of two key risk management Regulations to further enhance the above:

- Appointment of a Head of Client Asset Oversight - Regulation 8.(1); and
- The maintenance of a Client Asset Management Plan (“CAMP”) - Regulation 8. (3) (see next section).

Regulation 8.(1) requires an investment firm to appoint an individual to a client asset oversight role that will be responsible for the investment firm’s compliance with the investment firm’s client asset obligations.

This individual will perform a controlled function in relation to client assets and will be subject to the prior approval of the Central Bank. Appointing a HCAO will not distract from the overall responsibility of the investment firm’s governing body to safeguard client assets. In most cases, the Central Bank will expect a director to be nominated for the HCAO position. Where an investment firm proposes to appoint

an individual who is not a director, e.g. in a large investment firm, the individual should be a senior manager with direct access to the Board in respect of the client assets function.

Reason for Amendment

Rigorous senior management oversight of the controls and processes in place to safeguard client assets is critical. Evidence has shown the responsibility of complying with the current Client Asset Requirements seems to fall across a number of functions within an investment firm, e.g. the Compliance function and/or the Finance function. This is not the ideal approach as there may be a lack of clarity as to who is responsible for what and staff may not have the appropriate experience to understand an investment firm's client asset obligations. There may also be a lack of understanding of an investment firm's business model and therefore staff cannot always assess how the business model may contribute to risks associated with safeguarding client assets. The introduction of the HCAO will ensure that there is one person within an investment firm who will be responsible for the oversight of client assets, thereby ensuring that key client asset related issues are given priority and are brought to the attention of the Board of the investment firm in a timely manner.

2. Principle of Risk Management- Client Assets Management Plan ("CAMP")

A key new provision is a Regulation that requires an investment firm to create and maintain a CAMP. Regulation 8.(3) requires an investment firm to have a CAMP in order to safeguard client assets. The main purpose of the CAMP is:

- a) to document an investment firm's business model and related risks in respect of the safeguarding of client assets and the controls in place to mitigate these;
- b) to demonstrate how an investment firm's systems and controls meet the principles of the client assets regime;
- c) to enable the Board to document and monitor material changes to an investment firm's business model, changes to controls and processes and therefore the changes in the associated risks to safeguarding client assets;
- d) to make information readily available to assist in the prompt distribution of client assets particularly in the event of the investment firm's insolvency.

Regulation 8.(6) sets out what should be included in the CAMP, it should be of sufficient detail to enable a reader to understand the business model, the resulting risks to safeguarding client assets and the mitigants in place to minimise the impact of these risks depending on the nature, scale and complexity of an investment firm's business model. The CAMP will be a 'live' working document overseen by the HCAO and approved by the Board of the investment firm.

Reason for Amendment

Evidence has shown a deficiency in detailed information held by an investment firm in respect of its client assets. There has been a lack of documentation on areas such as:

- an investment firm's business model;
- the risks to client assets,;
- the controls in place to mitigate these risks;
- the daily oversight and monitoring of these controls;
- who is responsible for the oversight and monitoring; and
- what level of oversight is being exercised by the Board or where applicable the partners of a firm.

The purpose of the CAMP is to capture such information. Also, in the event of an insolvency of an investment firm, an insolvency practitioner will need to know where the assets are and the type of client assets. The CAMP should be sufficiently detailed to enable the insolvency practitioner to understand the business model and controls for safeguarding client assets. The CAMP should contain sufficient information to enable the distribution of client assets to take place as quickly as possible with minimum cost and delay to clients. This information could also be required in the event that an investment firm is required to facilitate an orderly transfer of assets to another investment firm.

3. Principle of Client Disclosure and Client Consent

With the exception of two new material Regulations, the majority of the Regulations under this Principle exist in the current Client Asset Requirements. The two new material Regulations under this principle are:

- 1) An investment firm will now be required to provide its retail clients with a comprehensible standalone document known as a Client Asset Key Information Document ("CAKID") which

contains key information relating to an investment firm's arrangements for holding client assets. Regulations 7(19) sets out what should be contained in the CAKID. An investment firm will be required to make the CAKID available to all new retail clients prior to the retail client signing the investment firm's terms of business/investment agreement and in the case of existing retail clients: this can be provided on the investment firm's website. The CAKID will have to be kept up to date, and retail clients promptly informed of any material changes to the manner in which their client assets are held.

- 2) With the exception of providing of the above CAKID, there will be no distinction between professional and retail clients; regardless of what type of client, the Central Bank requires an investment firm to make the same disclosure to all clients and obtain client consents from all clients. While obtaining consent from clients is not a new concept, the Central Bank is now specifically requiring that an investment firm should obtain consent prior to receiving client assets from the client and it should be in writing.

Reason for Amendment

In practice, it has been found that an investment firm may not be providing all of the relevant information to its clients and such information may be provided infrequently, i.e. it may be provided before or after receiving client assets from the client. The Central Bank is proposing Client Disclosure and Client Consent Regulations under one core principle; with the exception of the provision of the CAKID, all clients will be treated equally in relation to providing information at the same time (prior to receiving the initial client assets) and in obtaining written client consent.

There is also concern that despite providing information, retail clients can sometimes struggle to understand or may overlook the technical text in a client document. In order to address this concern, the Central Bank will require an investment firm to provide the CAKID to its retail clients. The objective of having a CAKID is that it will inform a retail client, without the technical jargon, of how and where his/her assets are held, the resulting risks if any at each stage and what protection is available.