Regulatory Policy Committee

Client money and unbreakable deposits

Financial Conduct Authority (FCA)

RPC rating: validated

Description of the measure

A rule contained in the Client Assets Sourcebook (CASS) currently prevents regulated firms, that hold client money in relation to investment business, from placing client money in bank accounts with unbreakable terms longer than 30 days. This was introduced so that firms can react to risks by withdrawing and relocating client money and so that client money is available for distribution back to clients as soon as is reasonably practical. However, the FCA received feedback that firms were finding it increasingly difficult to deposit this money in banks. Banks claimed that the cost of liquidity coverage ratio (LCR) was the main reason they refused to accept client money from firms. Banks, due to LCR, are required to hold highly liquid assets to cover 100% of potential net cash outflows over 30 days.

The FCA is proposing the following changes:

- Allowing a firm to deposit client money in client bank accounts with unbreakable terms of between 31 and 95 days (31-95 Day UDs).
- Requiring a firm that deposits client money in a 31-95 Day UD to comply with certain conditions. These include requiring firms to produce a written policy setting out the risks and maximum proportion of client money held in a 31-95 Day UD, managing risks, informing clients of the risks and reporting to the client money asset return (CMAR).
- Requiring firms governed by CASS to report client money held in 31-95 Day UD to CMAR.

Impacts of the measure

The assessment explains that the FCA expects the changes to affect all FCA-regulated firms holding client money in relation to designated investment business. The proposed changes will affect a total of 596 firms.

The FCA quantifies the following benefit to business of the proposed changes:

- Interest earned on client money – pre-consultation feedback indicates that the interest rate for a 30 Day UD is typically zero due to the liquidity requirements on banks associated with 30-day money and that this could increase by between 25 and 25 basis points for 31-95 Day UDs. The FCA in its original analysis[1] assumed firms would place 50% of client money in 31-95 Day UDs. After industry consultation this was changed to between 10% and 50%. Based on the assumption of between 25 and 35 basis points interest on all client money held in 31-95 Day UDs it estimates that the benefits to business will be between £29,733,300 to £208,133,100 per annum. For the business impact target, the FCA takes a mid-range value of £118,953,000 per annum. This change came into effect in January 2018, and the regulator has tested these estimates against actual benefits for the last six months. It finds that the benefits are broadly consistent with the estimates.

The assessment states that the FCA do not expect, extending the unbreakable term from 30 to 95 days, to impose any costs on firms. Feedback throughout the consultation indicated that firms would find it easier to place client money in banks. The costs presented here relate to the conditions attached to allowing a firm to place client money in 31-95 Day UDs. The FCA base all estimates on previous surveys, these include cost surveys, compliance surveys and CASS resolution pack cost surveys. All estimates attained through FCA surveys were tested against evidence received at consultation.

The main costs presented in the assessment are as follows…

- **Client disclosure** – The FCA estimates a one-off cost of £185,250
- **Producing a written policy document** – The FCA estimates one-off costs totalling £115,824
- **Adding a written policy document to the CASS resolution pack** – The FCA estimates one-off costs totalling of £16,640.
- **Reporting 31-95 Day UDs to the CMAR** – The FCA estimates ongoing costs totalling £226,560
- **Familiarisation Cost** –The FCA assumes 6, 4 and 2 staff and 4, 2, and 1 lawyers at large, medium and small firms respectively will need to familiarise themselves with 28 pages of text, 8 of which are complex legal text. Using

[1] Client money and unbreakable deposits – consultation paper – CP17/29

these assumptions together with standard data on reading speeds and industry wage data, it estimates a one-off cost of £352,000.

- **Requiring firms to take appropriate measures to manage the risk of being unable to access client money** – The FCA estimates that this cost is negligible and do not provide a figure. Feedback from firms indicated that they already have appropriate management to ensure they could handle client's request for money, it was also unchallenged at consultation.

Quality of submission

The FCA provides a clear breakdown of the one-off and ongoing costs and benefits of compliance from the changes and how they affect both large and small firms within the sector. The assessment states the costs to business do not derive from the change itself but rather the conditions attached to allowing firms to deposit client money in 31-95 Day UDs. All proposed conditions were put through the consultation process with the majority of respondents supporting them[2]. All costs presented in this assessment were put through the consultation process and were unchallenged. The RPC believes that the FCA has conducted a reasonable and proportionate assessment with support from industry throughout.

The regulator argues that requiring firms to take appropriate measures to manage risk will impose only a minimal cost on business. In particular, it notes that feedback from firms indicate that appropriate management systems are already in place to deal with this change and that there was no challenge to this assumption at consultation. The RPC believes, that the regulator has taken a reasonable and proportionate approach in this case.

The FCA estimates very considerable ongoing benefits to business (of £118,953,000 per annum). The regulator has also collected some initial data which indicates that the figure provided in the assessment may be a lower bound estimate. The RPC believes this is a sensible approach for FCA to refrain from updating and/or increasing its original estimate of possible benefits based on a small dataset. The FCA conducted an original cost-benefit analysis which was consulted on with input from industry. The regulator was open to feedback, for example, by changing its estimates of 50% of client money being placed in banks to a range of between 10% and 50%. Evidence received since January, when the changes were implemented, show that approximately 42% of client money has been held in 31-95 Day UDs. This would suggest that the benefits outlined in the assessment represent a conservative estimate. The RPC believes that the FCA has conducted a proportionate

[2] Client money and unbreakable deposits - Feedback to CP17/29 and final rules - Policy Statement PS18/2

assessment of the impacts of this proposal, which has been further supported by preliminary post-implementation evidence.

The regulator has included the impacts on investment firms of allowing them to deposit client money in 31-95 Day UDs in its analysis. However, the assessment does not consider the impacts on banks. Under the new proposal, banks will be holding more money in accounts with unbreakable terms longer than 30 days, and the assessment should include at least a qualitative description of the impacts on them of doing so. The RPC believes that in this case the FCA's decision not to quantify this impact is proportionate and the EANDCB is therefore not affected, but a qualitative description of any similar impacts should be included in future IAs.

Regulator assessment

Classification	Qualifying regulatory provision (OUT)
Equivalent annual net direct cost to business (EANDCB)	-£110.7 million
Business net present value	£953.0 million

RPC assessment

Classification	Qualifying regulatory provision (OUT)
EANDCB – RPC validated[3]	-£110.7 million
Business Impact Target (BIT) Score[3]	-£553.6 million

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[3] For reporting purposes, the RPC validates EANDCB and BIT score figures to the nearest £100,000.