

## FINANCIAL REGULATION

# Central Bank consults on applying its Client Asset Requirements to Banks carrying out MiFID Investment Business

December 2020

The Central Bank of Ireland (the **Central Bank**), in a consultation paper published on 3 December 2020, is proposing to extend its Client Asset Requirements to banks carrying out MiFID investment business. It also plans to expand on five of the seven core principles set out in its related [Guidance](#).

## CLIENT ASSET REQUIREMENTS

The Client Asset Requirements are set out in Part 6 of the Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Investment Firms) Regulations 2017 (the **Investment Firms Regulations**).

They build on the client asset requirements already contained in the European Union (Markets in Financial Instruments) Regulations 2017 (the **Irish MiFID Regulations**) (which implement MiFID II in Ireland).

The Central Bank's March 2015 [Guidance on Client Asset Regulations for Investment Firms](#) (the **Guidance**) sets out the seven core principles of the Central Bank's client assets regime.

## CENTRAL BANK CONSULTATION

On 3 December 2020, the Central Bank launched a [consultation](#) on proposed enhancements to the Client Asset Requirements (the **Consultation**).

The Central Bank is proposing:

- legislative updates to the Investment Firms Regulations, including the extension of the Client Asset Requirements to credit institutions that carry out MiFID investment business; and
- that the Guidance be updated, including by enhancing existing obligations relating to some of the seven core principles set out in that Guidance.

These proposals are summarised below, and the Consultation will close on 10 March 2021.

In due course, the Central Bank will publish a Feedback Statement on the Consultation, setting out its final proposals. Once those proposals become law, the Central Bank plans to give in-scope regulated firms a 12-month transitional period to enable them to prepare for compliance with the enhanced Client Asset Requirements. The Central Bank expects that these firms will take preparatory steps during the transitional period to ensure that they are fully compliant with the revised Client Asset Requirements at the end of the transitional period.

## CREDIT INSTITUTIONS CARRYING OUT MiFID INVESTMENT BUSINESS

### Expanding the definition of "investment firm"

At the moment, the Client Asset Requirements apply to a range of regulated entities authorised under a number of different regimes. These include MiFID investment firms, non-MiFID investment business firms, UCITS management companies and alternative investment fund managers providing MiFID services.

Although credit institutions are currently subject to the safeguarding requirements under the Irish MiFID Regulations when holding client financial instruments, credit

institutions providing MiFID investment services are not currently subject to the Client Asset Requirements.

The Central Bank is proposing to remove this anomaly by expanding the definition of **"investment firm"** in the Investment Firms Regulations to include credit institutions authorised under Section 9 of the Central Bank Act 1971. This will mean that Irish credit institutions will be required to comply with the Client Asset Requirements when carrying out MiFID investment business.

### Additional disclosure obligations where the MiFID 'banking exemption' is used

At the moment, the Irish MiFID Regulations require investment firms, where they receive client funds, to promptly place those funds into one or more accounts opened with a central bank, a bank authorised under the Capital Requirements Directive, a bank authorised in a third country, or a qualifying money market fund.

Credit institutions are exempt from this requirement (this is known as the **'banking exemption'**).

The Central Bank is proposing to impose additional disclosure obligations on credit institutions where they, in the context of MiFID investment business, use the **'banking exemption'** and hold client money as a deposit. Under the Central Bank's proposal, prior to carrying out MiFID investment business, a credit institution

will be required to disclose in its terms of business:

- that the money is held and protected by the credit institution as a deposit, and not as client funds; and
- the circumstances (in respect of the MiFID investment business) if any, in which the credit institution will cease to hold money as a 'deposit', and will instead hold that money as client funds (to which the Client Asset Requirements apply).

At the moment, it is not clear how the proposed changes requiring credit institutions to comply with the Client Asset Requirements (i.e. the obligations applying to both cash and financial instruments) under the Investment Firms Regulations will apply vis-à-vis the application of the 'banking exemption' under the Irish MiFID Regulations. The Central Bank may further consider this point post-Consultation after considering views from stakeholders.

### Additional Implications

The proposed extension of the Client Asset Requirements to credit institutions, when enacted, will have additional knock-on implications for credit institutions, including:

- a requirement to pay a supplemental levy to the Investor Compensation Scheme; and
- a requirement to appoint a person to the Pre-Approval Controlled Function (PCF-45) role of Head of Client Asset Oversight (HCAO). The HCAO is obliged to, among other obligations, oversee the investment firm's arrangements for safeguarding client assets.

### ENHANCING EXISTING OBLIGATIONS

The Central Bank's client asset regime is based on the following seven core principles (set out in the Guidance):

1. segregation;
2. designation and registration;
3. reconciliation;
4. daily calculation;
5. client disclosure and consent;
6. risk management; and
7. client asset examination.

The Central Bank is proposing to enhance existing obligations in respect of five of these principles as set out below.

For the purposes of the proposals outlined below, any reference to an 'investment firm' includes a credit institution (on the basis that credit institutions carrying out MiFID investment business will be subject to the same enhanced proposals once they become law).

### Principle of Segregation

The principle of segregation is the cornerstone of the Irish client asset regime and facilitates the swift and full return of client assets if an investment firm becomes insolvent.

The Central Bank is proposing to clarify its expectation that client funds must be deposited directly into a third party client asset account (i.e. immediate segregation).

### Principle of Reconciliation

The Central Bank is proposing to strengthen and clarify the reconciliation processes performed by investment firms through a combination of:

- new requirements (such as 'internal' reconciliation of client financial instruments records and accounts on at least a monthly basis, and additional record-keeping obligations); and
- putting requirements currently contained in the Guidance on a legislative footing (such as 'external' reconciliation of financial instruments not deposited with a third party and physical client financial instrument reconciliation not deposited with a third party, on at least a monthly basis).

The overarching objective of these proposed enhancements is to ensure that investment firms maintain complete and accurate records, thereby ensuring that the correct amount of client assets is being held and safeguarded by investment firms on behalf of their clients.

### Principle of Daily Calculation

The Central Bank is proposing to align the process for the remediation of client fund differences or discrepancies, identified through the performance of the daily calculation, with the process for remediating reconciliation differences, as set out in Regulation 57(7) of the Client Asset Requirements.

In practical terms, this will require investment firms to:

- investigate, within one working day, the cause of any difference or discrepancy;
- identify the cause of the difference or discrepancy within five working days; and
- resolve the difference or discrepancy as soon as practicable.

### Principle of Client Disclosure and Consent

In recognition of the more complex business models operated by many firms now operating in Ireland and the increased use of title transfer collateral arrangements (TTCAs), the Central Bank is proposing to enhance existing obligations in relation to the principle of

client disclosure and consent. Among the proposals are:

#### • Evidence of prior express client consent

That investment firms evidence that prior express consent has been obtained from clients prior to an investment firm entering into securities financing or otherwise using a client's financial instruments.

#### • TTCAs

New documentary requirements in respect of the establishment and termination of TTCAs, with the objective of reducing the potential for disputes regarding the status of assets that are (or were) subject to TTCAs. This includes:

- a proposal that a TTCA be covered by a written agreement (setting out certain prescribed information) between the investment firm and the client - this can form part of the overall client agreement and does not need to be separately documented; and
- proposed requirements relating to the termination of a TTCA, including requirements relating to record-keeping, treatment of assets and client notifications.

#### • Regular reporting by investment firms providing prime brokerage services to clients

That investment firms which provide prime brokerage services to clients be required to provide clients with access to up-to-date information in the form of a statement containing prescribed information (unless a statement is already provided to a depository under Article 91 of the AIFMD Delegated Regulation).<sup>1</sup>

The provision of this statement will enable clients to manage their exposures, particularly when a client has given prior express consent to the use of its assets and given the frequent movement of assets associated with such services.

The Central Bank is proposing that the information in the statement be updated by the investment firm on a daily basis.

In addition, the Central Bank is proposing to require investment firms providing prime brokerage services to include an annex to the client agreement containing a summary of the key prime brokerage provisions contained in that client agreement.

#### • Transfer of business

In light of recent restructuring and consolidation in the Irish investment firm space, the Central Bank is

<sup>1</sup> Commission Delegated Regulation (EU) No 231/2013.

proposing to amend the Client Asset Requirements and Guidance to clarify its expectations regarding notifications to the Central Bank of any planned transfer of business, client disclosure and consent, and the treatment of client assets in the context of a transfer of business to another entity.

### Principle of Risk Management

This requires investment firms to develop and maintain a Client Asset Management Plan. As part of that Client Asset Management Plan, the Central Bank is proposing that investment firms be required to:

- develop and maintain a Client Asset Applicability Matrix; and
- embed that Client Asset Applicability Matrix in their risk management processes.

The purpose of the Client Asset Applicability Matrix is to ensure that the investment firm carries out a robust assessment of where client assets arise across its business lines and services.

The Client Asset Applicability Matrix should also provide an independent reader with a succinct overview of where and how client assets arise within an investment firm, so that it can be readily understood where client assets arise across product offerings (both new and existing) within each business line.

The Central Bank is also proposing that the Client Asset Management Plan include (among other matters):

- prescribed detail in respect of any outsourcing of reconciliations or daily

calculations; and

- in respect of any client asset breaches, the location of the client asset breach and the incident log.

### UPDATED GUIDANCE

As mentioned at the start of this briefing, the Central Bank will publish updated Guidance when the proposed amendments to the Client Asset Requirements are finalised after the Consultation ends.

In addition to the matters set out above, the updated Guidance is also expected to cover a variety of areas including transfer of business, prime brokerage services, client asset account flows, IT systems and controls, access to critical systems, operational and governance structure, books and records and compensation schemes.

### UPDATES TO THE TEMPLATE MONTHLY CLIENT ASSET REPORT

The Central Bank has also undertaken a review of its template Monthly Client Asset Report and proposes to amend the template to require investment firms to provide additional reporting information.

### OTHER EXPECTED CHANGES

Arising from its July 2017 consultation (**CP111**) on the Investment Firms Regulations (which included changes relating to MiFID II) (CP111 and the Central Bank's related Feedback Statement are available [here](#)), the Central Bank is also proposing limited amendments to the Investment Firms

Regulations relating to MiFID II systematic internalisers and position limit reporting. Please refer to the Consultation for further details on these proposed amendments.

If you have any questions on the Consultation, please reach out to the contacts below.

KEY CONTACTS

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