Ric Wilding
Client Assets Policy
Prudential Banking and Investment Business Policy
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

30 June 2010

Dear Sir,

The CFA Society of the UK (CFA UK) welcomes the opportunity to comment on the Financial Services Authority's (FSA) consultation paper (10/9) on enhancing the client assets sourcebook.

CFA UK agrees that the events of the financial crisis and, in particular, the failure of Lehman Brothers International Europe exposed faults in the regulation relating to the management of client assets. CFA UK supports the FSA's intent to ensure that client monies are safeguarded through appropriate segregation and reporting. Many of our members act as portfolio managers. They understand well their fiduciary duties to their clients. Appropriate care of clients' assets is a clear responsibility and our members support reform to strengthen the regulatory framework in this area.

CFA UK's response is limited to the general questions listed in sections three and four of the consultation paper. While we are aware of the importance of ensuring sufficient care of client assets within hedge funds via prime brokerage arrangements, the society is not close enough to these technical issues to comment usefully.

We note that the FSA's paper does not tackle the issue of how to deal with client assets paid to firms but not yet segregated due to firm error. While we understand the limitation imposed by UK law regarding equal treatment of creditors at insolvency, we believe that protection of client money from firm error is important and should be addressed.

Responses

Q 9 Do you agree that we should impose a 20% maximum limit on intra-group client money deposits in client bank accounts and that we should change existing guidance into a rule? Do you have views on alternative limits?

The danger posed by custodians and prime brokers placing client monies with intra-group banks are now well-known and should probably have been identified and acted against earlier. Clearly, if one group entity becomes insolvent there is a significant risk of contagion and insolvency elsewhere in the group. The FSA's proposal – to limit intra-group holdings to 20% of total client money – would reduce this concentration risk. However, it would do so at a cost and in some cases this cost might be considerable. Custodians and prime brokers have been able to reduce the fee charged to clients because of the benefit that they receive from holding deposits for clients within their group. Requiring custodians to allocate client monies away from their group will generate costs to end clients through the due diligence required and higher fees. In addition, clients of highly-rated, relatively secure banks may see their overall risk increase as they are required to move deposits away from triple-A rated entities to less highly rated, non-group banks. Might it be more efficient to allow some flexibility within the proposals so that, where custodians and prime brokers can demonstrate a client's preference for maintaining a higher proportion of deposits at a group bank, they are allowed to meet that request? A maximum level of 50% of deposits held at group banks might perhaps be allowed if client awareness and acceptance of the risk is clear.

Q13: Do you agree that we should introduce a rule prohibiting the use of general liens in custodian agreements and amending existing guidance to clarify our requirements?

Our understanding is that general liens in custodial arrangements are relatively untested, but have been in place to provide custodians with security against possible client losses on transactions financed by the custodian. We understand the FSA's anxiety to prevent custodians and prime brokers from appropriating client monies. However, prohibiting general liens will likely encourage custodians to move to a system of formal, secured charges against assets for the lines of business that now typically draw general liens. This is a complex area where the FSA's proposed approach will likely reduce risk, but will likely do so at a direct cost to clients in terms of expense and/or reduced service provision. We recommend that the FSA should consult broadly with custodians, prime brokers and their clients on this issue before reaching a final decision on how to act.

Q16: Do you agree that we should establish the CASS oversight controlled function?

CFA UK supports the FSA's proposal to appoint a single individual with oversight responsibility. While the FSA has already acted to remind individuals holding significant influence of their joint accountability for the protection of client assets, it would be helpful to formalize these arrangements through the establishment of a CASS oversight function.

Q20: Do you agree with our proposal for the CMAR?

The society supports the proposal for the client money and assets return. It is important for firms to demonstrate their satisfactory handling of client assets and the reintroduction of a formal return is sensible. While some additional cost may arise, this is likely to be limited as the scope of the information required is reasonable as are the proposed reporting frequencies for different sizes of firm.

<u>About CFA UK</u>

The CFA Society of the UK (CFA UK) represents the interests of more than 9,000 leading members of the UK investment profession. The society, which was founded in 1955, is one of the largest member societies of CFA Institute and is committed to leading the development of the investment profession through the promotion of the highest ethical standards and through the provision of continuing education, advocacy, information and career support on behalf of its members. Most CFA UK members have earned the chartered financial analyst (CFA) designation, or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

CFA Institute is the global association for investment professionals. It administers the CFA and CIPM curriculum and exam programs worldwide; publishes research; conducts professional development programs; and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry. CFA Institute has more than 99,000 members in 139 countries, of whom more than 88,000 hold the Chartered Financial Analyst® (CFA®) designation.

Yours,

Natalie WinterFrost CFA FIA
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