April 2023

New Client Asset Requirements to enter into force

On 27 January 2023, the <u>Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Investment Firms)</u>

Regulations 2023 [S.I. No. 10 of 2023] (Revised Investment Firms Regulations) were published in the Irish Statute Book. The Revised Investment Firms Regulations revoke and replace the Central Bank (Supervision and Enforcement) Act 2013 Section 48(1)) (Investment Firms) Regulations 2017 [S.I. No. 604 of 2017] (Existing Investment Firms Regulations). The Revised Investment Firms Regulations contain amendments to the Client Asset Requirements (CAR), contained in Part 6. This follows publication by the Central Bank of Ireland (Central Bank), on 23 June 2022, of the draft form of the Revised Investment Firm Regulations.

In June 2022, the Central Bank published a draft <u>Guidance Note on the Central Bank Client Asset Requirements</u> (**Guidance Note**). In February 2023, the Central Bank published a draft <u>Addendum to the Guidance Note on the Central Bank Client Asset Requirements</u> (**Addendum**). The Addendum includes guidance in respect of the transfer of client assets as part of a transfer of business. Both documents are expected to be published in final form shortly.

Scope of the Revised CAR

The current client assets rules apply to investment firms (including UCITS management companies/AIFMs with MiFID 'top-up' permissions in respect of those 'top-up' activities) which hold client assets. Significantly, the scope of the CAR has been extended to credit institutions carrying out MiFID activities.

Key Changes

Key changes to the CAR following the publication of the Revised Investment Firms Regulations, amongst others, include:

Segregation: The Central Bank has clarified its expectations as to how client funds should be segregated. The Guidance Note states that client funds should be deposited directly into a third party client asset account. In the limited circumstances For further information on any of the issues discussed in this article please contact:



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where this is not possible, these circumstances should be documented in the Client Asset Management Plan (CAMP). The Central Bank views immediate segregation as a key safeguard in the protection of client funds. The Central Bank expects firms to develop, implement and maintain systems and controls which are suitably designed to ensure that client funds are deposited in accordance with the CAR.

- Reconciliation Requirements: Firms are now obliged, at least monthly, to perform a reconciliation of client financial instruments not deposited with a third party. Firms are also now expressly obliged to conduct, at least monthly, a reconciliation of physical client financial instruments held by the firm. The revised CAR also provide that a firm may reconcile physical client financial instruments on a bi-annual basis where they are held on behalf of eligible counterparty clients.
- Calculation Requirements: The requirements around calculation and reconciliation of third-party client asset accounts, client assets and client financial instruments have been modified. The Central Bank has also clarified the processes on the treatment of client financial instrument shortfalls and excesses and record-keeping requirements in respect of client asset reconciliations.
- Client disclosure and client consent requirements: Firms must now provide information in their terms of business to clients, or potential clients, regarding their arrangements relating to transfer of business. Firms must now maintain, for a period of 6 years, a copy of all relevant material in order to evidence that express consent has been obtained from a client prior to the firm entering into arrangements for securities financing transactions, or otherwise using the client's financial instruments.

The revised CAR include new provisions regarding Title Transfer Collateral Arrangements (TTCAs). TTCAs must now be the subject of a written agreement between the firm and the client. Furthermore, amendments have been introduced regarding the notification and record-keeping requirements following the termination of a TTCA.

For credit institutions, the revised CAR include certain specific client disclosure obligations which must be met as well as new reporting obligations to the Central Bank.

- Prime Brokerage Services: For firms which comprise prime brokers, the revisions to the CAR include disclosure requirements to clients in relation to client assets and requirements to provide a Client Asset Annex to clients which must set out a summary of the key provisions within the prime brokerage agreement permitting the use of client financial instruments by the firm.
- Risk Management: The Central Bank has enhanced the CAR to require firms to develop and maintain a Client Asset Applicability Matrix (CAAM) within the CAMP. The purpose of the CAAM is to ensure that firms have carried out a robust assessment of where client assets arise across their business lines and services. The Central Bank expects firms to incorporate the CAAM into their risk management processes. The Guidance contains detail on the expected content of the CAAM. The CAMP must now also contain the location of the firm's internal client asset breach and incident log.

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Furthermore, where a firm outsources any activity relating to the safeguarding of client assets, the firm must now identify all such entities and clearly document the nature of the arrangement in the CAMP, including how the firm proposes to exercise oversight of the activities.

Reporting Requirements: The changes introduced by the CAR include a requirement to notify the Central Bank, through the Online Reporting System (ONR), of an intention to effect a material transfer of client assets to or from another entity as part of a transfer of business. Such notification shall be provided as soon as possible but no later than 3 months in advance of the transfer taking place.

Revised MCAR

In October 2022, the Central Bank published a revised Monthly Client Asset Report (MCAR) template in order to strengthen the MCAR as a supervisory tool and reflect the revisions to the CAR. The Central Bank has published the revised MCAR and accompanying guidance on its website, available here, to provide investment firms with the opportunity to prepare for the revised MCAR reporting. The revised MCAR requires firms to report additional information and includes a number of new reporting fields including a breakdown of client assets held by business line/activity, arrangements for depositing client assets, and outsourcing of client asset functions/activities. The Central Bank will advise investment firms of the date from which to start using the revised MCAR in due course.

Next Steps

In-scope firms should begin preparations to ensure they will be able to fully comply with the revised CAR.

The existing CAR will remain in force until repealed on 1 July 2023. A transitional period has been provided whereby; (i) in-scope investment firms have until 1 July 2023 to comply; and (ii) in-scope credit institutions have until 1 January 2024 to comply.

In the Guidance Note, the Central Bank reminds investment firms of their obligation to comply with the MiFID II safeguarding of client asset rules in addition to the CAR.

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