Appendix B. Feedback Statement

IOSCO Board Consultative Report - *Recommendations Regarding the Protection of Client Assets*[1]

Comments were submitted by the following organizations to the IOSCO Board in respect of the consultative report entitled *Recommendations Regarding the Protection of Client Assets* (the Consultative Report).[2]

1. Alternative Investment Management Association
2. French Association of Securities Professional / French Banking Federation (AFTI FBF)
3. Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)
4. BNP Paribas Securities Services (BNP Paribas)
5. Computershare
6. Deutsche Bank
7. European Banking Federation
8. EuropeanIssuers aisbl
9. Futures Industry Association
10. Futures and Options Association
11. German Banking Industry Committee
12. Gestora del Fondo General de Garantía de Inversiones, S.A.
13. Global Financial Markets Association
14. ICI Global
15. Institute of International Finance
16. Luxembourg Bankers' Association (ABBL)
17. National Futures Association
18. Securities & Exchange Commission of Pakistan
19. State Street Corporation (State Street)
20. SUNY Buffalo Law School
21. Unicredit

These comments were taken into account in the preparation of the final Recommendations Regarding the Protection of Client Assets (the Final Report). This feedback statement seeks to summarise the major issues covered by the comments and notes certain changes that have been made in the Final Report.

In general, the respondents were supportive of the objectives and content in the eight principles and accompanying means of implementation (the Principles) set out in the Consultative Report. Commenters sought further consideration of the following issues: the definition of client and client assets, the duties associated with client ownership status and the roles and responsibilities of intermediaries.

[1] CR02/13, published 8 February 2013.
[2] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD401.pdf.

Definition of Client

Several responses provided input regarding the definition of client and consequent protections based on such status, proposing fewer protections for institutional or wholesale clients versus protections for retail clients.[3]

While there may be arguments around the issue of prescribing the scope of duties owed by intermediaries to clients depending on the class of client, this level of granularity is beyond the scope of the Principles. Moreover, it may be difficult to find consensus on any language delineating such classes of client given that jurisdictions may have different definitions of "institutional", "wholesale", "professional" and/or "retail" clients.

The Final Report remains applicable to all clients, regardless of any distinction into classes by a jurisdiction but acknowledges that jurisdictions may consider whether further documentary requirements should be required for certain types of clients.[4]

Definition of Client Assets

Some commenters addressed the definition of client assets and whether further clarification was required in respect of how each principle would apply to the different types of client assets (*i.e.*, client funds and client securities).[5] Some commenters, noting that the status of client funds placed on deposit with a credit institution may, in certain jurisdictions, differ from the status accorded client securities, requested clarification of the applicability of the Principles in the Consultative Report in this context.[6] A further comment noted that it was unclear how derivatives would be characterized under the existing definition.[7]

It is the case that some jurisdictions prescribe different status for deposits (*i.e.*, money held at a financial institution where such depositor is a creditor of the bank) as opposed to a deposit of customer funds (labeled as such) by an intermediary at a financial institution. To address this point, the Final Report now includes additional language in the definition of client assets. The scope of client assets addressed in the Final Report includes assets the intermediary has an obligation to safeguard for its securities and derivatives clients. This context should be distinguished from obligations an intermediary (some of which may be banks) might have to, e.g., banking clients.

Client Ownership Status

Several commenters noted that in certain jurisdictions, ownership status is a civil law concept, not a regulatory law concept and that there would be limits as to the effectiveness of proposed regulatory principles in this context because the effect of any intermediary's actions on

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[3] Deutsche Bank letter at 6, German Industry Banking Committee letter at 7, Futures and Options Association letter at 3, European Banking Federation Letter at 3.

[4] *See, e.g.*, Principle 6, means of implementation 2.

[5] Deutsche Bank letter at 3, European Banking Federation Letter at 3, ABBL letter at 4, German Banking Industry Committee letter at 3.

6 Deutsche Bank letter at 3-4, German Banking Industry Committee letter at 3, ABBL letter at 4, State Street letter at 3.

[7] AFTI FBF letter at 5, BNP Paribas letter at 3.

ownership status would be limited.[8] Another commenter pointed out the practical difficulty in determining "ownership" due to chains of custody that may not reveal an ultimate client.[9]

The intent of the Consultative Report was that the intermediary should have records reflecting the ownership status of client assets it holds to the extent this is within the intermediary's knowledge or a result of the intermediary's own actions. The Final Report clarifies this both in the introductory language and in the means of implementation for Principle one, recognising that the Principles apply to modifications in ownership status that are initiated by or within the knowledge of the intermediary.

Roles and Responsibilities of Intermediaries

Type of Intermediary

Several commenters requested further clarification of the types of intermediaries within the scope of the Consultative Report and noted that the proposals did not sufficiently take into account the different services offered or roles played by various intermediaries (*e.g.*, execution only services, depository or custody services, advising on investments, management/administration of assets).[10]

The German Banking Industry Committee noted that different obligations should be required of intermediaries depending on the different services offered to clients.[11] Similarly, the European Banking Federation agreed with the comment that the definition of intermediaries should be clarified to reflect the specific types of intermediaries falling within the scope of the Principles.[12] State Street commented that where a custodian is acting as a directed agent without discretion over client assets and merely in accordance with instructions, the Principles regarding disclosure of risk should not be applicable to the intermediary.[13] Finally, Deutsche Bank noted that in some situations, prior disclosure to a client will not be possible – for example, many custodians only learn of transactions post trade.[14]

To address these concerns, language has been added to the Final Report to explain that the Principles apply to the particular intermediary performing the relevant services with associated responsibilities. Where there is more than one intermediary performing services for a single client, the responsibilities set forth in the Principles may apply to different intermediaries based on the specific services each provides to their client.

Recordkeeping

Several commenters thought the recordkeeping obligations on intermediaries would be too onerous. Specifically, the Futures Industry Association thought the requirements to keep records

[8] German Banking Industry Committee letter at 4, European Banking Federation letter at 4.
[9] Deutsche Bank letter at 6.
[10] AFTI FBF letter at 4, BNP Paribas letter at 3, State Street letter at 3, Deutsche Bank letter at 3, German Industry Banking Committee at 3.
[11] German Industry Banking Committee letter at 3-4.
[12] European Banking Federation letter at 3.
[13] State Street letter at 4.
[14] Deutsche Bank letter at 9.

reflecting each client's rights and each intermediary's obligations "at any time and without delay" could create a standard that would be impossible to meet.[15] Similarly, the Futures and Options Association thought this requirement was unduly burdensome and proposed that end of day information should be sufficient.[16] The ABBL proposed deletion of means of implementation four of principle one in its entirety since it could be too complex for an intermediary to complete.[17] To address these comments, the language in means of implementation four of principle one has been modified to provide for daily reconciliation.

Client Statements

Regarding the principle two requirements for intermediaries to provide client statements, there was discussion regarding what constituted a regular basis and how this should be balanced with a client's ability to request information on an ad hoc basis.

The Final Report retains the requirement that client statements be given to clients on a regular basis but provides that such statements may be provided reasonably promptly in response to a client request.

Risk Disclosures

The comments included extensive discussion of the circumstances in which an intermediary should be required to provide analysis along the lines of proposed principle five. The Futures Industry Association noted that these requirements could go beyond the scope of the duties an intermediary owes a client where the intermediary's role is not that of a legal advisor.[18] The National Futures Association proposed that means of implementation four of principle five be eliminated.[19]

The Final Report addresses these comments by modifying the language in means of implementation four of principle five. The means of implementation now require that intermediaries provide clients a general disclosure of risks associated with holding or placing client assets in a foreign jurisdiction.

Client Consent Documentation

Several commenters expressed concerns regarding the requirements of principle six. Specifically, Deutsche Bank noted that the requirement for a separate record of client consent would be a departure from current market practice.[20] The European Banking Federation wrote that a separate documentation requirement should not be applicable for professional clients.[21]

The Final Report continues to require that the intermediary retain a record of client consent but does not prescribe a specific legal requirement of form except to note that such record must qualify as evidence permissible under national law.

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[15] Futures Industry Association letter at 6.
[16] Futures and Options Association letter p. 4.
[17] ABBL letter at 4.
[18] Futures Industry Association letter at 5.
[19] National Futures Association letter at 3.
[20] Deutsche Bank letter at 10.
[21] European Banking Federation letter at 7.