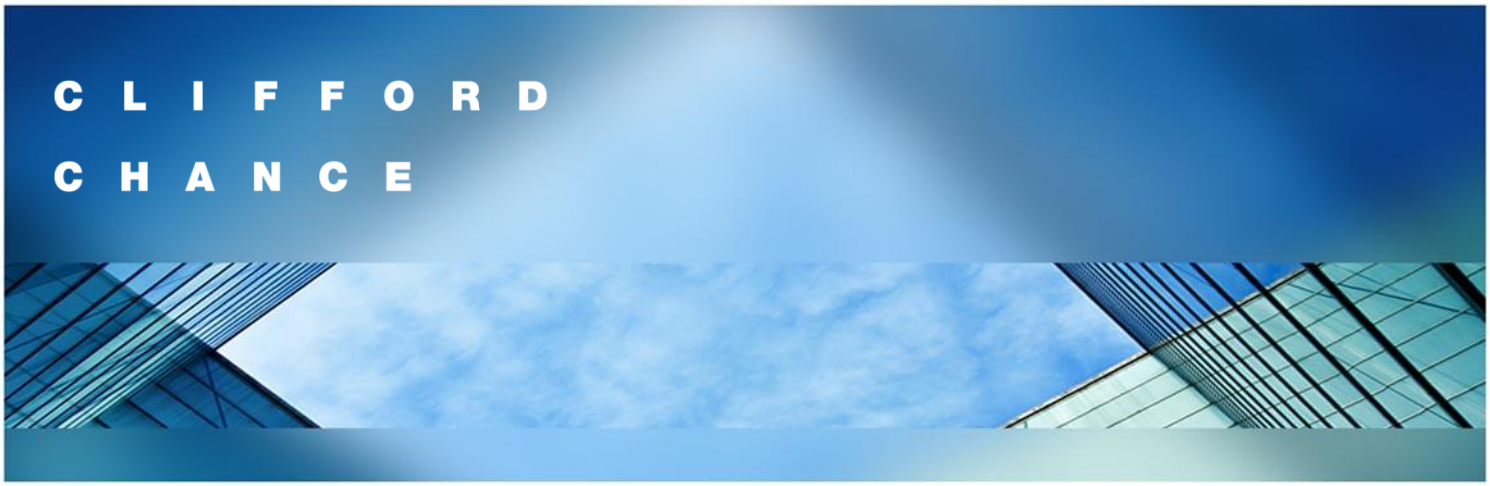

DORMANT ASSETS ACT 2022 AND CLIENT MONEY – DOES THIS HELP?

Dormant Assets Act 2022

The Dormant Assets Act 2022 (the "Act") was passed on 24 February 2022 at which date s.34 came into force (relating to application and citation). The Act was brought into force in full on 6 June 2022 by The Dormant Assets Act 2022 (Commencement) Regulations 2022, which were passed on 24 May 2022.

The Act establishes a dormant assets scheme which supersedes the scheme for dormant bank and building society accounts under the Dormant Bank and Building Society Accounts Act 2008 (the "2008 Act"), except that the earlier scheme remains in existence for amounts transferred into the scheme before the Act came into force, and payments from dormant bank and building society accounts continue to be subject to s.1 of the 2008 Act, and s.4 and s. 6 to 10 of the Act so far as relating to s.1, as well as the provisions of the Act (see s.1(7) of the Act). The dormant assets scheme under the Act does not apply to amounts transferred to an authorised reclaim fund under s.2 of the 2008 Act, where a smaller bank or building society transfers part of a dormant balance to an authorised reclaim fund and part to charity (see section 1(8)(b) of the Act).

The effect of the Act is that various types of assets, not just money in dormant bank and building society accounts, may (at the option of the person holding such assets, provided it has so agreed with an authorised reclaim fund) be paid to the authorised reclaim fund, following which the client for whom the assets were previously held ceases to have any right to claim such assets from the former holder and instead has a right to claim payment from the authorised reclaim fund. The test for whether assets are considered dormant varies, depending on the nature of the assets.

The dormant assets scheme under the Act does not apply where the amounts transferred to the authorised reclaim fund are "unwanted assets", meaning that the client otherwise entitled to payment has informed the bank or other entity which owes funds to it that the client wishes all or part of such amount to be paid to an authorised reclaim fund. In such case, following payment to the authorised reclaim fund, the client's right to payment is extinguished.

Application of the Act to client money

Although s.12 and 13 of the Act provide for payment of client money to an authorised reclaim fund, and such sections came into force on 6 June 2022, at that time the rules applicable to holding client money in the Client Money Rules of the handbook of the Financial Conduct Authority (the "**FCA**") in

Chapter 7 of the FCA's Client Asset sourcebook (the "**CMR**") did not permit payment of client money to an authorised reclaim fund under the Act.

Moreover, in the FCA's Consultation Paper CP 22/9 "Expansion of the Dormant Assets scheme", published by the FCA on 13 May 2022, the FCA specifically stated "As part of this proposed first phase of expansion, no assets that are client money under CASS will be transferred to the DAS. As noted in Chapter 2, we are working closely with HM Government, RFL and industry to facilitate further expansion of DAS in other asset classes (including client money) and will issue a further consultation in due course" (para 3.5).

Unclaimed client money

Under the CMR prior to 2 August 2024 (and such rules still apply), firms holding allocated but unclaimed client money (that is, client money where the firm knows for whom it holds, but is unable to contact that person and repay) are permitted to pay the unclaimed amount to a charity or charities selected by the firm, subject to certain conditions. In particular, where the firm pays client money to charity in accordance with the relevant rules, the firm (or a member of the same group) must give an undertaking to pay an amount equal to the amount paid to charity to the client if the client makes a claim in the future, and such undertaking must be legally enforceable by the client.

New FCA Policy Statement

As explained in the FCA's Policy Statement PS 24/10 "Expansion of the Dormant Assets Scheme – second phase" (published 2 August 2024) ("**PS 24/10**"), the FCA rules were amended with effect from 2 August 2024 for consistency with the Act, and such amendments included updates to the CMR.

Under the new CMR rules, a firm holding client money may, instead of complying with the CMR rules outlined above regarding payment to charity, choose to pay client money to a dormant fund assets operator under the applicable provisions of the Act.

Under both sets of CMR rules, the firm must, before making the payment to charity or the dormant fund assets operator, take reasonable steps to trace the client and return the balance. The rules in the CMR indicating what constitute reasonable steps are essentially the same for both arrangements, and in both cases include provision for fewer steps where the client money balance concerned is a minimal amount (GBP 25 or less if held for a retail client, and GBP 100 or less if held for a professional client) (see CASS 7.11.57R and 7.11.57BE).

Outstanding questions

In principle, the addition of another process for dealing with allocated but unclaimed client money is helpful, since it gives firms another option for dealing with the perennial problem of amounts which are client money, and respecting which CMR compliance is required, where the firm wishes to repay the client but is unable to do so.

However, certain questions remain, including the following.

Unallocated client money

Since both the CMR rules and the Act provisions cover the situation where a firm knows the identity of the client for whom it holds client money, although cannot contact such client, these rules and provisions do not assist with the situation where a firm holds client money but cannot identify the client for which it holds such money. Any solution to this problem would require further legislation and amendment of the CMR (the efficacy of any provision in the CMR in relation to unallocated client money held by a firm under the CMR prior to appropriate legislation may be open to doubt).

Choice of payment to charity or authorised reclaim fund

In the FCA's earlier Consultation Paper CP 23/12 "Expansion of the Dormant Assets scheme – second phase" (May 2023) ("**CP 23/12**"), the FCA proposed that any firm with an agreement with an authorised reclaim fund should be required to make payment of dormant client money to the authorised reclaim fund in accordance with the provisions of the Act, before seeking to pay such money to charity under the relevant CMR rules (see CP 23/12, para 5.4). In PS 24/10, the FCA states that it has "decided to not impose a requirement granting priority to the DAS [Dormant Assets Scheme] over the existing provision that allows an investment firm to pay away allocated but unclaimed client money to a registered charity", noting that "there may be circumstances where a participant firm has a valid reason for choosing to pay away client money to charity, even though it may meet the criteria for transfer to the DAS" (see FCA response to para 3.8).

However, the FCA also states that while the new rules "allow[ing] a participant firm to make its own choice between the two options", the FCA "expect that, when making this choice, firms should consider the impact on their clients, including the benefit offered by DAS in terms of allowing clients to reclaim their assets in perpetuity."

The comments from the FCA seem to suggest that, although a firm in principle has a choice of whether to make payment of unclaimed client money to charity or to an authorised reclaim fund, the FCA's view is that, where a firm has an agreement in place with an authorised reclaim fund, clients of such firm are generally in a better position where payment is made to the authorised reclaim fund. As a result, even though payment of unclaimed client money to either a charity or an authorised reclaim fund is optional for firms, and there is no obligation for a firm to have an agreement in place with an authorised reclaim fund for this purpose, firms who do have such an agreement in place may wish to consider how to evidence and justify payments of unclaimed client money to charity to minimise any risk of criticism for, perhaps, compliance with general regulatory obligations such as FCA Principle 6 (A firm must pay due regard to the interests of its customers and treat them fairly).

Definition of client money

For the purposes of the CMR, "client money" is defined in the FCA's Glossary as:

"money of any currency:

(a) that a firm receives or holds for, or on behalf of, a client in the course of, or in connection with, its MiFID business; or

(b) that, in the course of carrying on designated investment business that is not MiFID business, a firm holds for a client; or

(ba) that a firm receives or holds for, or on behalf of, a client in the course of, or in connection with, its stocks and shares ISA business; or

(bb) that a firm receives or holds for, or on behalf of, a client in the course of, or in connection with, its innovative finance ISA business; or

(bc) that a firm receives or holds for, or on behalf of, a client in the course of, or in connection with, its lifetime ISA business; or

(c) that a firm treats as client money in accordance with the client money rules."

In s.12(7) of the Act, "client money" is not defined by reference to the FCA definition, or as money held under the CMR, but is defined for the purposes of s.12(4) and (6) of the Act as "money held in trust for a person or treated by the investment institution holding it as client money". However, s.12(4) of the Act defines "eligible client money" (subject to an exception relating to lifetime ISAs) as "client money" which is "held by an investment institution which

(a) is held in the course of, or in connection with, the regulated activities covered by the institution's Part 4A permission, and

(b) is not money that could be transferred to an authorised reclaim fund as mentioned in section 2(1)(a), 5(1)(a), 8(1)(a), 14(1)(a) or 21(2)(b)."

Money held as client money under the CMR would satisfy the definition in the Act since it is "money held in trust" and is money "held in the course of, or in connection with, the regulated activities covered by the institution's Part 4A permission". However, the wording of s.12(4) and (7) seems to indicate that these provisions are not solely intended to cover client money held under the CMR, but it is unclear what other "money held in trust" these provisions might be intended to cover, and whether such a situation could arise in practice.

Different test for when amounts are dormant

Under the CMR, the provisions permitting payment to charity cannot apply unless the relevant client money has been held by the firm "for at least six years following the last movement on the client's account (disregarding any payment or receipt of interest, charges or similar items)" (CASS 7.11.50R(2)). In contrast, under the Act, payment of client money to an authorised reclaim fund is not permitted unless the firm "has received no communication from that person (or a person acting on behalf of that person) during" the specified period of 6 years (s.13(2), (3)).

Since these tests of when client money is to be regarded as dormant are different, it is important that firms who have an arrangement with an authorised reclaim fund, and therefore who may make a payment of unclaimed client money to charity under the CMR rules, or to the authorised reclaim fund under the Act, ensure that the relevant processes reflect the different preconditions appropriately.

Agreement with/notification to client required?

It is unclear if a firm is required to have notified, or agreed with, its clients that payment of unclaimed client money to an authorised reclaim fund is a possibility, and that such payment will result in the clients having a claim against the authorised reclaim fund instead of the firm.

It should be noted that under the CMR rules for payment to charity, there is some uncertainty as to whether such payment is permissible if not

contemplated by the client terms to which the relevant client has agreed. In CASS 7.11.50R, one of the conditions for payment to charity is that "this is permitted by law and consistent with the arrangements under which the client money is held". Prior to 1 December 2014 the CMR specifically required written agreement from the client, since the reasonable steps required to trace the client included the firm having a written agreement with the client "in which the client consents to the firm releasing, after the period of time specified in (b), any client money balances, for or on behalf of that client, from client bank accounts".

PS 24/10 is silent as to whether firms must agree with or notify clients that the firm may pay unclaimed client money to an authorised reclaim fund and the consequences of this. Given the FCA's comment in PS 24/10, para 3.8, regarding the choice of payment, as quoted above, the FCA evidently considers that payment of unclaimed client money to an authorised reclaim fund is generally better for clients because it gives clients the right "to reclaim their assets in perpetuity". However, there might be questions as to whether this is in fact better for clients in some circumstances, for example in the event of insolvency if there is any difficulty in locating records of the clients of the firm whose client money has been paid to, and who therefore must claim from, the authorised reclaim fund. (Note that the FCA has intentionally "not made provision for ongoing record-keeping requirements in the CASS rules as we understand RFL places contractual obligations on participating firms that are designed to ensure the necessary customer records are retained so that a reclaim can be processed".) It is unclear how clients whose client money has been paid to an authorised reclaim fund will know the entity from whom they can reclaim their money, or the amount of such claim.

By way of comparison, Chapter 2 of PS 24/10 considers amendments to the FCA's Collective Investment Schemes sourcebook ("COLL"), and here the FCA concludes that funds should not be required by COLL to treat possible payments to an authorised reclaim fund as a significant change, stating that "Notice to unitholders is effectively irrelevant to those unitholders who may be affected by the DAS rules." The reasoning seems to be that the unitholders entitled to unclaimed assets cannot be contacted, therefore cannot receive notice of a significant change therefore such notice is irrelevant. It was apparently suggested in responses to CP 23/12 that a general market notice might announce the possibility of payments to an authorised reclaim fund, but the FCA has not adopted this suggestion. The FCA reasoning seems odd, because arguably it is unitholders who are not yet affected who need to know that amounts which they would otherwise be able to claim from the fund may be paid to an authorised reclaim fund in future.

It might be argued that issues are unlikely to raise because, by definition, the persons entitled to unclaimed client money amounts have not been traced, therefore may be unlikely to appear in the future, and any such clients would not particularly care who they can recover from, so long as they can recover the relevant amount from someone.

However, the question remains as to whether a firm can pay a client's client money to an authorised reclaim without the client's agreement, or at least its knowledge. It might be argued that the permission to do so under the CMR, and the statutory ability to do so, resolve any concerns this, or that at the very least, if a client has agreed in its agreement with the firm that the firm holds client money subject to the CMR from time to time, the client has agreed to

payment to an authorised reclaim fund because this is permitted by the change to the CMR terms, but this is not beyond doubt.

In the Act, s.17 states that "(1) A transfer of an amount to an authorised reclaim fund as mentioned in a transfer provision does not itself— (a) constitute a breach of trust or fiduciary duty affecting the amount owing, or (b) give rise to any liability of any kind (whether against the transferring institution, the reclaim fund or any other person involved), other than the liability of the reclaim fund arising under the corresponding right to payment provision." This provision protects a firm against any claim by a claim of breach of trust, fiduciary duty or contract. However, it is not clear if a client might nonetheless be able to claim that it did not agree to a transfer of its money to an authorised reclaim fund, and that by choosing to make such payment the firm is in breach of, say, CASS 7.12.1R (A firm must, when holding client money, make adequate arrangements to safeguard the client's rights and prevent the use of client money for its own account) or Principle 6 (A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading), Principle 7 (A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading) or Principle 10 (A firm must arrange adequate protection for clients' assets when it is responsible for them.) However, in practice, it is difficult to think of any examples of situations where a client might consider it has been prejudiced by payment to an authorised reclaim fund.

Terminology

Although it seems clear that a firm holding client money can choose to make use of the process under the Act for unclaimed client money, and the FCA evidently thinks so, the wording of the Act is not as clear as it might be.

s.1(3)(a) of the Act states that one of the common features of the application of the dormant asset scheme under the Act is that "an institution transfers to an authorised reclaim fund, with its consent, an amount owing to a person which is dormant". An amount of client money held by a firm under the CMR is not an amount owed by the firm to its client, but is an amount held on trust by the firm for that client. A similar point arises from s.12(1)(a) which refers to "an investment institution" which "transfers to an authorised reclaim fund an amount of dormant eligible client money owing to a person". s.1(4) of the Act specifically states that "In subsection (3)(a) “amount owing” includes an amount available to be paid as benefits under a personal pension scheme" but there is no similar clarification for client money held under the CMR. This is odd, given that s.12(7) specifically refers to "money held in trust" (subject to the query about the meaning of money "treated by the investment institution holding it as client money"). It might be argued that, since the Act is clearly intended to apply to client money held under the CMR, this should not be an issue, but it would be a concern if it could be regarded as casting doubt on the application of the protection given by s.17 of the Act against breach of trust or fiduciary duty, or other liability, arising from payment to an authorised reclaim fund.

A similar point arises from s.12(2)(b) of the Act, which states that following the transfer of a client's client money to an authorised reclaim fund, the client "acquires against the reclaim fund whatever right to payment of the amount the person would have had against the institution if the transfer had not happened". This is curious, because in reality the client's claim against the

dormant asset fund is a statutory claim for payment, which is not the same as its former right against the firm which was a beneficial interest in cash held by the firm on trust under the CMR. It is unclear whether this change of the nature of a client's rights is likely to be an issue in practice, although it could be a concern if, for example, the relevant client was subject to a requirement to hold the funds with a third party as client money.

Conclusions?

The availability of the application of the dormant assets scheme under the Act may assist firms holding client money in that it provides another option for payment of allocated but unclaimed client money, and at least gives the benefit that future claims from clients would be made against the authorised reclaim fund rather than the firm (and does not need to be recorded in the books of the firm or relevant group member as an ongoing potential claim from a client). However, as outlined above, there remain a number of aspects which a firm would need to consider carefully, and firms must still consider how to deal with the problems arising from unallocated unclaimed client money remaining on their books.

CONTACTS

Monica Sah
Partner,
London

T +44 207006 1103
E monica.sah
@cliffordchance.com

Madeleine Yates
Special Regulatory
Advisor, London

T +44 207006 1455
E madeleine.yates
@cliffordchance.com