

# CP12/22\*\*

Financial Services Authority

## Client assets regime: EMIR, multiple pools and the wider review



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The Financial Services Authority invites comments on this Consultation Paper.

Comments on Part I should reach us by 16 October 2012.

Comments on Part II and III should reach us by 30 November 2012.

Comments may be sent by electronic submission using the form on the FSA's website at: [www.fsa.gov.uk/Pages/Library/Policy/CP/2012/cp12-22-response.shtml](http://www.fsa.gov.uk/Pages/Library/Policy/CP/2012/cp12-22-response.shtml).

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A confidential response may be requested from us under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Tribunal.

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Copies of this Consultation Paper are available to download from our website – [www.fsa.gov.uk](http://www.fsa.gov.uk). Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

# Abbreviations used in this paper

<b>BIP</b>	Bank Insolvency Procedure
<b>CASS</b>	FSA's Client Assets sourcebook
<b>CBA</b>	Cost benefit analysis
<b>CCP</b>	A central counterparty, authorised under EMIR
<b>CMAR</b>	Client Money and Asset Report
<b>CP</b>	Consultation paper
<b>DP</b>	Discussion paper
<b>EMIR</b>	Regulation (EU) no 648/2012 on OTC derivatives, central counterparties and trade repositories, commonly referred to as the European Market Infrastructure Regulation
<b>FSA</b>	Financial Services Authority
<b>FSCS</b>	Financial Services Compensation Scheme
<b>FSMA</b>	Financial Services and Markets Act 2000
<b>IP</b>	Insolvency practitioner
<b>ISIN</b>	International Securities Identification Number
<b>LBIE</b>	Lehman Brothers International (Europe) Ltd
<b>MiFID</b>	Directive no. 2004/39/EC on markets in financial instruments, commonly referred to as the Markets in Financial Instruments Directive
<b>SAR</b>	Investment Banking Special Administration Regulations
<b>SCV</b>	Single Customer View
<b>SRR</b>	Special Resolution Regime
<b>TTCA</b>	Title transfer collateral arrangements



# 1

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## Overview

- 1.1 This paper is a combined Consultation and Discussion Paper. It consults on changes to the client assets regime necessary to adhere to a European regulation, proposes to introduce a radical change in the client money rules applicable to investment firms, and opens a discussion on the wider regime.
- 1.2 The paper is split into three parts:
- a) Part I outlines the segregation and porting measures in Articles 39 and 48 of the EU Regulation on OTC derivatives, central counterparties and trade repositories, commonly referred to as the European Market Infrastructure Regulation (EMIR)<sup>1</sup> and consequential changes to the client assets sourcebook (CASS).
  - b) Part II sets out our proposals for introducing multiple pooling. These proposals are partly born out of the changes outlined in Part I and could result in the most significant changes we have made to the client assets regime in over 20 years.
  - c) Part III is a discussion on the wider client assets review currently underway, which is focused on getting a better result in the context of client assets in a firm's insolvency.

### What is porting?

- 1.3 Pursuant to EMIR, when a clearing member firm becomes insolvent, the client transactions (also referred to as 'positions') it holds in client accounts at a central counterparty (CCP) and the margin supporting those transactions, may be transferred to another client account held by a back-up clearing member. This process is called 'porting' ('port' and 'ported' should be read accordingly). The margin may be client money.
- 1.4 Please note that this paper only deals with EMIR to the extent that it affects CASS and is separate from other changes being made to the FSA Handbook relating to EMIR. We will consult on these changes later this year.

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1 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:EN:PDF>

- 1.5 We are also still considering the impact of EMIR on the application of the margin transaction requirement in paragraph 14 of Annex 1 of CASS. If necessary, we may communicate later this year on the outcome of these considerations.

## **Part I: Changes to CASS required by EMIR (CP)**

- 1.6 When a clearing member defaults, one of the measures introduced by EMIR will require central counterparties (CCPs) to try to port the transactions of the failed clearing member's clients and associated margin to a back-up clearing member, or return any balance on the segregated accounts directly to the clients. Clearing members of CCPs will often be 'firms' as defined in the FSA Handbook, with permission to hold client money.
- 1.7 Under the current CASS rules, the failure of a firm triggers a primary pooling event. On a primary pooling event, all client money is pooled for distribution. To comply with EMIR we therefore propose to amend CASS to exclude client money that is held by a clearing member firm in a client transaction account at a CCP from the pooling that occurs if that firm becomes insolvent.
- 1.8 As a European Regulation, EMIR is directly applicable to CCPs and firms in the UK. We expect CCPs to be able to apply for authorisation under EMIR in early 2013 and CASS must accommodate the EMIR requirements by then. Aware of the short timetable for introducing the necessary changes, we propose to provide a six-week consultation period on the changes outlined in Part I of this CP, aiming to publish feedback and final rules in December 2012. These rules will come into force on 1 January 2013.

## **Part II: Introduction of multiple client money pools (CP)**

- 1.9 EMIR and the consequent changes to CASS explained in Part I will only allow a CCP to 'port' the margin it holds in clearing member's client transaction accounts, and not the client money margin the clearing member could be holding. The difference between the gross margin received by the clearing member from its clients and the net margin it places at the CCP in its net client transaction accounts, will be held by the clearing member and will remain subject to pooling following a primary pooling event.
- 1.10 To make porting net client transaction accounts a viable option we propose to introduce 'client money sub-pools' into the client assets regime. The proposed changes to CASS explained in Part II of this paper will allow firms to operate legally and operationally separate client money sub-pools. This would allow a clearing member firm to operate discrete sub-pools of client money comprising, for example, the margin held in a particular net client transaction account at a CCP and the client money the clearing member holds in relation to that transaction account. If the clearing member became insolvent and a CCP ported the positions to a backup clearing member, the insolvency practitioner would be



able to make the margin that the insolvent clearing member held as client money in relation to the transaction account available to facilitate porting.

- 1.11 Given the advantages that multiple pooling could provide and potential client demand for such arrangements, we propose to make multiple sub-pools available to other types of business. We are consulting on allowing firms the discretion to create specific sub-pools based, for example, on a class of clients or business lines. We will also discuss whether in addition to, or in the place of, this discretion to create sub-pools, we should require firms to have separate client money sub-pools; for example, for retail and non-retail clients or for margined and non-margined business.
- 1.12 Introducing client money sub-pools would be the most radical change that has been made to the client money regime in over 20 years. Since the mandatory segregation of client money into discrete pools was last considered by the industry, the financial markets, firms and their clients, financial products, the economic climate and technology have moved on dramatically. The implementation of EMIR against the backdrop of our commitment to a review of the wider client assets regime is a good opportunity to revisit this.

### **Part III: Client Assets Regime: Achieving better results (DP)**

- 1.13 Part III is a Discussion Paper (DP) that provides an overview of the fundamental review of the client money and custody assets regime. The fundamental review is focused at improving the regime to lead to better results if a firm that holds client money and/or custody assets becomes insolvent. The objectives of the review are to:
- improve the speed of return of client assets following the insolvency of an investment firm;
  - reduce the market impact of an insolvency of an investment firm that holds client assets; and
  - achieve a greater return of client assets to clients following the insolvency of an investment firm.
- 1.14 Part III explores these objectives, taking on board the lessons learnt from recent insolvencies, and we ask for your views to enable us to assess the industry's appetite for change.

### **Client Assets (EMIR) Advisory Group**

- 1.15 While preparing this paper, we convened a Client Assets (EMIR) Advisory Group, with representatives from clearing members of CCPs, industry associations, CCPs and insolvency practitioners to discuss the impact of EMIR on CASS. The feedback we received at these meetings has helped to shape the policy proposals in Parts I and II of this Consultation Paper.

- 1.16 We thank members of the Client Assets (EMIR) Advisory Group for their contributions in the discussions.

## Key proposals

- 1.17 Our key proposals in this CP are to:
- introduce changes to modify CASS to be compatible with Articles 39 and 48 of EMIR;
  - introduce multiple pooling; and
  - start a discussion on wider changes to the client assets regime.

## Who should read this CP?

- 1.18 Part I of this CP is relevant to regulated firms that are clearing members of CCPs, and will be of interest to CCPs.
- 1.19 Part II is relevant to all regulated firms that hold client money in relation to investment business, their clients and will be of interest to CCPs.
- 1.20 Part III is relevant to all regulated firms that hold client money and/or custody assets in relation investment business and their clients.

## Next steps

### Part I

- 1.21 Send us your comments on Part I by 16 October 2012. Please provide corroborating evidence for your views wherever possible.
- 1.22 We expect to publish a feedback statement and final rules in December 2012.

### Part II

- 1.23 Send us your comments on Part II by 30 November 2012. Please provide corroborating evidence for your views wherever possible.
- 1.24 Feedback from this CP and the results of our additional work will help to inform our decision on whether to make changes to our rules. We expect to publish our feedback to this consultation and final rules in the first half of 2013.

**Part III**

- 1.25** Send us your comments on Part III by 30 November 2012. Please provide corroborating evidence for your views wherever possible.
- 1.26** Feedback from this DP and the results of our additional work will help to inform our decision on the direction of changes we make to our rules and relevant feedback will be shared with the government to assist in the review of the Investment Banking Special Administration Regulations (SAR). We expect to publish our feedback to this discussion and consult on proposed rule changes in the first half of 2013.



Part I

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# Changes to CASS required by EMIR (CP)

# 2

## Changes to CASS required by EMIR

### EMIR

- 2.1** One of the aims of EMIR is to extend the benefits of CCP clearing to the underlying clients of CCPs' clearing members. Broadly speaking, the benefits include a reduction in counterparty risk and increased market stability.
- 2.2** To achieve this, EMIR requires CCPs to keep separate records and accounts so its clearing members can distinguish assets and positions:
- a) held for the clearing member from those of its clients (this is called 'omnibus client segregation'); and
  - b) held for one client from those held for other clients (this is called 'individual client segregation').
- 2.3** EMIR requires clearing members to offer these types of segregation to their clearing clients. Where a client chooses individual client segregation, their positions and margin will be recorded in an account at the CCP. According to EMIR, any margin received by a clearing member in excess of the client's requirement for positions recorded in an individually segregated account must be posted to the CCP.<sup>2</sup> In this paper we refer to this as a 'gross margining model'.
- 2.4** Where a client chooses omnibus segregation, its positions and margin will be held in an account at the CCP with that of other clients in that omnibus account. When a CCP calls margin to cover the positions in an omnibus account, it will normally call a net amount needed to support the net of all the positions. When a clearing member calls margin from its clients, however, it will normally call an amount of margin from each client to cover the

<sup>2</sup> Article 39(6) EMIR

client's positions. For omnibus segregated clients, the clearing member will be holding the difference between the margin it calls from clients and the margin placed with the CCP. In this paper we refer to this as a net margining model.

- 2.5 Under EMIR, in the event of the clearing member's default, a CCP must attempt to 'port' any client positions and associated margin held by a CCP to another, solvent clearing member (a backup clearing member). Where porting fails for any reason, any balance owed by the CCP shall be returned directly to clients or to the clearing member for the account of its clients.<sup>3</sup>

## CASS and EMIR

- 2.6 The client money distribution rules (CASS Chapter 7A) currently require that when a firm becomes insolvent, all client money held by the firm for its clients, including for example, cash in client money bank accounts and/or any client money margin in client transaction accounts at a clearing house, is notionally 'pooled'. This pool of client money is then distributed to clients in accordance with each client's client money entitlement. Any shortfall in the client money pool will be borne pro rata among the clients.
- 2.7 In relation to business subject to CASS, the clients' margin that a firm places with a CCP may be, or may include, client money as defined in the client money rules (CASS Chapter 7). The pooling requirement under the current CASS rules is incompatible with porting of any margin that is client money held at a CCP as it must be 'pooled' and distributed as explained above. This conflicts directly with the notion of porting or the return of money directly to clients as envisaged under EMIR.
- 2.8 The implementation timetable for EMIR is complex. Some provisions of the regulation came into force on 16 August 2012, but other provisions rely on the adoption of binding technical standards. We expect CCPs to be able to apply for authorisation under EMIR in early 2013 and the provisions of EMIR relevant to the segregation and portability of client positions and margin will apply as soon as the first CCP is authorised. EMIR is directly applicable to CCPs and firms in the UK. The CASS rules will need to accommodate EMIR by then.

## Changes to CASS required by EMIR

- 2.9 To accommodate the measures introduced by EMIR, we propose to modify CASS 7 and CASS 7A so that on a firm's insolvency:
- a) client money held as margin at a CCP can be 'ported' with cleared client positions, rather than pooled with the other client money held by the firm; and

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<sup>3</sup> Article 48(7) EMIR

- b) any balance owed by the CCP to the clearing member's clients can be returned to them.

2.10 We explain our proposals and the intended policy outcomes. In Appendix 1 there is a draft instrument showing the proposed new rules.

### **Changes to the Investment Business Client Money Distribution Rules (CASS 7A)**

2.11 As explained above, the client money distribution rules are incompatible with certain provisions in EMIR and must be amended accordingly.

2.12 Following the default of a clearing member, EMIR will require CCPs to commit to attempting to 'port' client margin and positions held in accounts at the CCP for the clients of that defaulted member. If it cannot do this, the CCP pays any balance owed to the clients directly back to the clients or to the insolvent clearing member for its clients' accounts. The following amendments will facilitate these requirements.

2.13 We propose to amend the *pooling and distribution* rules (CASS 7A.2.4R to 7A.2.6G) so that when there is a primary pooling event, where all client money of the firm is currently treated as pooled, money held at a client transaction account at a CCP will not be notionally pooled. This will allow such monies to be ported as contemplated by EMIR.

2.14 However, if porting is not possible, the CCP will close out the positions and attempt to return any balance owed directly to the clients. If the clients are not known to the CCP, the CCP will remit the balance owing on a client transaction account to the insolvent clearing member for the account of its clients. We propose to treat these monies in the following ways:

- a) If the monies remitted to the insolvent clearing member are for a client who has chosen individual client segregation, the firm should remit this back to the client as soon as possible. This money will be client money while held by the firm, but it will not become part of the notional pool.
- b) If the monies remitted to the insolvent clearing member are for an omnibus client account, the remittance will be client money and will be part of the notional pool for distribution to the firm's clients according to their respective entitlements.

2.15 We have proposed different treatment for amounts payable to clients where porting has not been carried out in the case of individual segregation and omnibus segregation, because in a net omnibus client transaction account it is not normally possible to allocate the total amount of margin to the clients whose positions comprise that account. The set-off between the different positions held in an omnibus account means that, to calculate an individual client entitlement, it is necessary to consider the position of each client separately, taking into account the aggregate amount of margin provided by the client to the firm for the relevant positions and the value of those positions on close-out.



**2.16** Net omnibus client transaction accounts that cannot be ported should be returned to the insolvent clearing member for the account of the clients and participate in the pool, as is currently the case. Such accounts may face some difficulties in porting, which we discuss in Part II.

**Q1:** Do you agree with the proposed changes to the distribution rules to permit porting? Do you agree with the treatment of balances returned to the clearing member for the account of its clients? If not, please explain why.

### **Changes to the Client Money Rules (CASS 7)**

**2.17** Under Article 39 of EMIR, if a client has chosen individual client segregation, any margin in excess of the client's requirement is to be posted to the CCP. Currently, under CASS 7.5.3G, a firm must not hold excess client money in its client transaction accounts. We propose to amend CASS 7.5.3G to clarify that a firm can hold excess client money in a client transaction account if required to do so by law, for example, as under Article 39 of EMIR.

**2.18** Under the client money rules, a firm discharges its client money responsibilities to its client when it has returned the client money to the client or to another party in accordance with the instruction of the client. We propose to amend the rules to permit a firm to discharge its client money responsibilities to its client if the money is ported or returned directly to clients by the CCP. Specifically a firm's fiduciary duty is discharged:

- a) if client money received by the firm and placed in a client transaction account with a CCP is ported by that CCP in accordance with Article 48 of EMIR to another member of that CCP; or
- b) if client money received by the firm and placed in a client transaction account with a CCP, any balance owing on that account is paid directly to the client by the CCP in accordance with Article 48 of EMIR.

**2.19** This means that a firm will no longer have responsibility for client money that is either ported or paid back directly to the client by the CCP. Clients who have the benefit of the protection of the client money regime may lose it after porting, e.g. if the clearing member to whom the positions and margin are transferred is not subject to CASS.

**2.20** We propose to amend the rules regarding the notification and acknowledgement of trust (or agent in Scotland) contained within CASS 7.8 so that when a firm's client chooses either omnibus client segregation or individual client segregation, the firm must only notify the CCP that the money to be held by the firm in the relevant client transaction account is client money, that can not be combined with any other account and nor can any right of set-off be exercised by the CCP against the money in the relevant client transaction account

for any sum owed on another account. This is a reduction of the existing requirements, which include the requirement to send a notification to, and to receive an acknowledgment from the CCP. The existing rules will still apply to all other types of intermediaries and counterparties.

**Q2:** Do you agree with our proposed amendments to the client money rules about discharge of client money responsibility, and amending the obligations for notification of trust (CASS 7.8)?

## **EMIR, CASS and title transfer collateral arrangements (TTCA)**

- 2.21** In response to questions received from the industry before this consultation, we do not believe the provisions of EMIR, in particular the requirements of Articles 39 and 48, will prevent the use of title transfer collateral arrangements (TTCA) between a clearing member and its client. Nor do we believe that EMIR will prevent a clearing member from providing margin to a CCP under TTCA.
- 2.22** EMIR will require firms to offer clients, at least, the choice between individual client segregation or omnibus client segregation. If a firm receives client money from a client and the client chooses individual client segregation then the firm must pay all margin it collects from the client for the relevant position, to the credit of that client's individual account at the CCP. If the firm receives client money and the client chooses net omnibus client segregation, the firm would use client money to pay the net amount required to support the positions in that account to the CCP. In either case, the firm must hold the money in client transaction accounts that are separate from its own house accounts.
- 2.23** If the firm conducts business with its clients on a TTCA basis (in accordance with the relevant provisions in CASS and Directive no. 2004/39/EC on markets in financial instruments (MiFID)<sup>4</sup>), for transactions which must be cleared as a result of EMIR, the firm must still offer the client the choice between individual and omnibus segregation at the CCP.
- 2.24** As money received or held by the firm on a TTCA basis belongs to the firm and the firm should not hold its own money in the same client account at the CCP as money received by the firm as client money, a firm will need to have separate client accounts at a CCP for positions held for its clients, but margined with its own money. In other words, a firm might have three types of account at a CCP: its own house account(s); client transaction accounts (individual or omnibus) holding client money; and client accounts (individual or omnibus) holding money received by firms from clients on a TTCA basis.

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<sup>4</sup> CASS 7.2.3R and 7.2.3A R, MiFID recital 27.

- 2.25** If a firm becomes insolvent, where a balance owing on a client account at a CCP that has been margined using the firm's own money is returned by the CCP to the firm for the account of its clients, this money is not client money for the purposes of CASS, but in accordance with EMIR must be held by the firm for the account of its clients.<sup>5</sup>

### **Timing**

- 2.26** Please send us your responses for Part I by 16 October 2012. We intend to consider the feedback and publish a feedback statement and final rules in December 2012.

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<sup>5</sup> Article 48(7) EMIR



## Part II

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# Introduction of multiple client money pools (CP)

# 3

## Introducing multiple client money pools

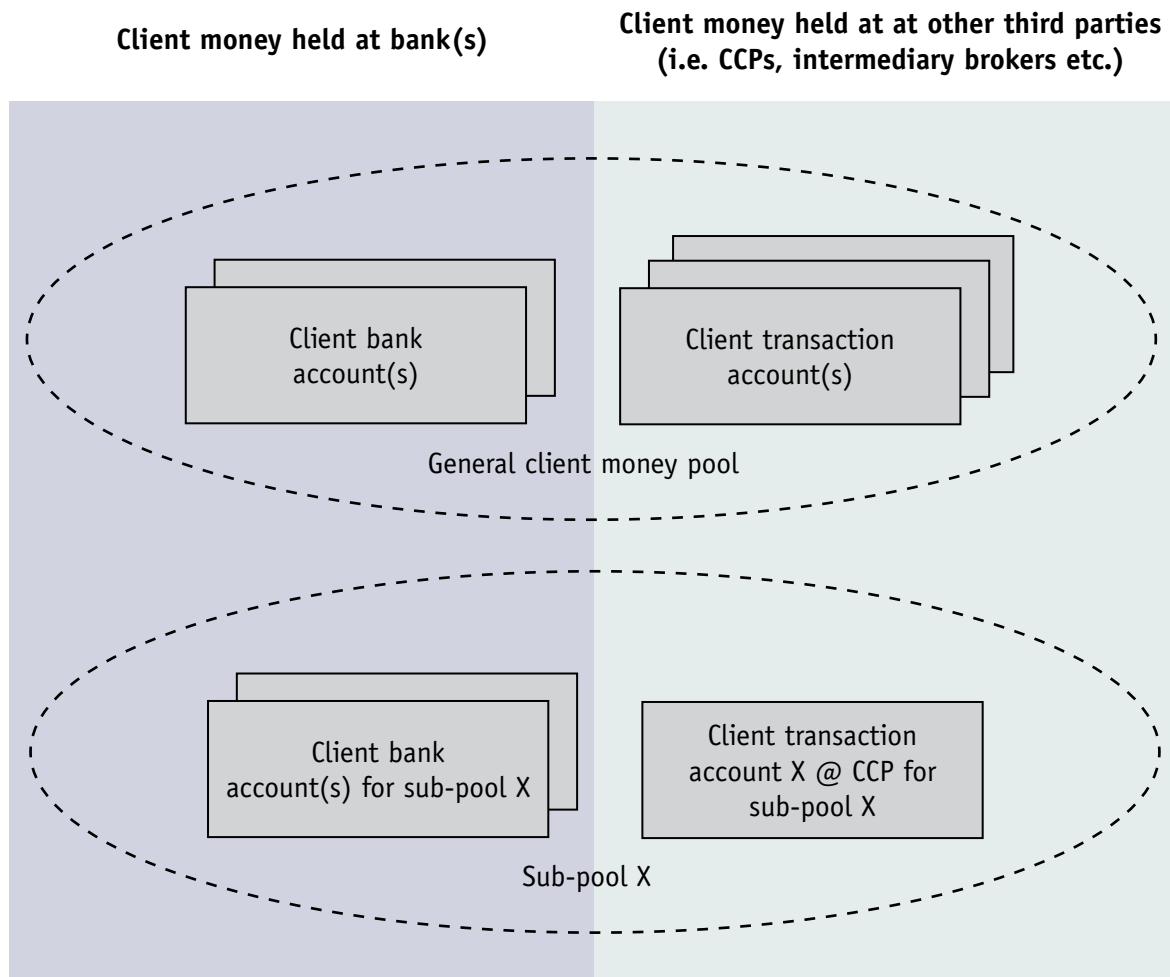
- 3.1 By requiring that clients be offered the choice between individual segregation and omnibus segregation, EMIR recognises a client's right to agree different levels of protection of their margin held in client transaction accounts at a CCP.
- 3.2 This chapter consults on the introduction of similar choice in the context of client money protection through the use of multiple client money pools. Currently, firms are unable to offer their clients any protection from the exposure to delays in the return of client money and the potential for shortfalls in the general client money pool that could be caused by, for example, complex business lines or other clients with a greater risk appetite than their own. Introducing multiple client money pools is a possible solution to this and would amount to the most significant change that has been made to the client money regime in over 20 years.
- 3.3 To date, references in CASS to a 'pool' of client money have been used most frequently in the context of a firm insolvency. This consultation and the draft rules in Appendix 2 use the concept of a 'pool' to refer to a discrete, segregated portion of client money held by a firm, both while the firm is a going concern and on its insolvency.
- 3.4 Further, in this chapter 'client margin' means client money provided as margin, unless otherwise stated.

### **Discretion to operate multiple client money pools**

- 3.5 As explained in Part I, in the context of net margining models, a proportion of client margin will be held by a clearing member. Under the existing client money rules, if the clearing member becomes insolvent, the proportion of client margin held by the clearing member will be pooled with all the other client money the firm holds, to form a single notional pool of which all client money claimants are beneficiaries.

- 3.6** Under EMIR the CCP will attempt to port the clients' positions with the margin it holds to a back-up clearing member. However, in the net margining model, the porting of client positions is likely to be possible only where the back-up clearing member is satisfied that it has sufficient margin to cover its exposure to each of the clients, not just the net exposure for all client positions. Without the client money held as margin by the insolvent firm, there would need to be a 'top up' of margin made to the back-up clearing member by the relevant clients, that is, requiring clients to 'double margin'.
- 3.7** We propose to amend the relevant provisions in the client money rules and the client money distribution rules to permit firms to create 'sub-pools' of client money that belong to a defined subset of client beneficiaries. This will allow clearing member firms to operate a discrete pool comprising the client money held by the clearing member for a particular net client transaction account. When the clearing member becomes insolvent, the insolvency practitioner can make the client money held for that sub-pool available as necessary to facilitate the porting of the client positions in the relevant net client transaction account. Where clearing member firms elect to operate such discrete client money sub-pools, the porting of net client transaction accounts is likely to be more feasible.
- 3.8** We do not propose to make the operation of such sub-pools mandatory, but to allow clients and firms to agree a level of protection. For example, where a firm offers omnibus client segregation according to EMIR, as a result of these proposed amendments to CASS, the firm will be able to further offer: (i) to keep any client money margin that it does not pass to the CCP in a separate pool of client money that it holds only for the benefit of the clients pertaining to the omnibus account in question; and (ii) in the event of its insolvency, this client money can be used to facilitate the porting of the positions in the relevant omnibus account, making porting more likely than if this margin were not available. See Figure 1.

**Figure 1 – Firm operating a general client money pool and one sub-pool**

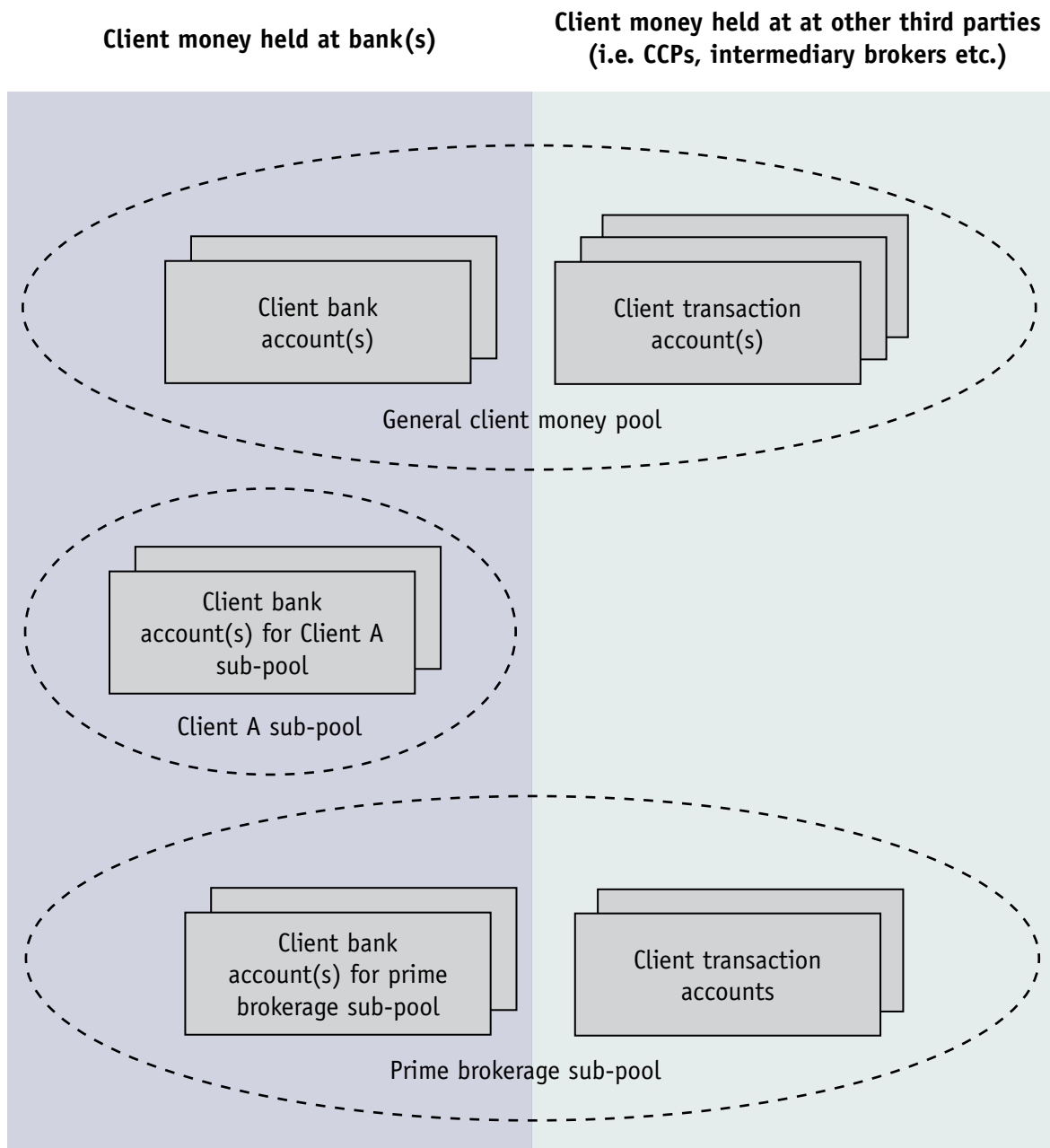


- Sub-pool X has been created by the firm to hold client money for a specified group of clients of the firm; each of the clients has entered into a derivatives transaction and wishes to clear this transaction through the firm; each of the clients has chosen omnibus client segregation; the firm has arranged for the CCP to provide omnibus client segregation for an account ('client transaction account X') held for all and only the clients of sub-pool X; the firm provides net margin in relation to the positions in client transaction account X. The firm holds the difference between the gross margin and the net margin in client bank accounts maintained exclusively for sub-pool X. In the event of the insolvency of the firm, the client money held by the firm in sub-pool X's client bank accounts can be made available to facilitate porting of positions in client transaction account X to a back-up clearing member.
- When the firm becomes insolvent, all other client money bank and transaction accounts are pooled in the general client money pool, with the clients having rateable claim on that pool.



- 3.9** The optional nature of the proposals also recognises that some omnibus transaction accounts will be unlikely to port for other reasons. For example, where a transaction account covers a large number of clients, obtaining all clients' consent to porting may be difficult and it may also be difficult to find a back-up clearing member with the capability and/or risk appetite to take on the account.
- 3.10** Splitting client money into discrete sub-pools provides a number of advantages, including:
- for client clearing, the advantages of porting include increasing market confidence through allowing clients' transactions to survive the insolvency of their clearing member firms and reducing the prospect of client money margin associated with such transactions from becoming tied up in ongoing proceedings over the distribution of the insolvent firm's general client money pool;
  - localising any client money shortfalls to a particular sub-pool, so that all the clients of a firm do not share all losses, thereby maximising client money return for some clients; and
  - allowing the distribution of client money from a particular sub-pool where no contentious issues have arisen in relation to that sub-pool, leading to a more rapid distribution of some client money.
- 3.11** We therefore propose to go beyond allowing sub-pools to facilitate the porting of cleared client positions, and permit firms to create multiple client money sub-pools in relation to any investment business, with the discretion left to the firm and the clients to determine the basis. For example, a firm may wish to create a separate client money sub-pool for its prime brokerage business, separating it from other parts of business. Alternatively, a client may agree with a firm to have only its own client money held in a client money sub-pool, separate from all other clients' money.
- 3.12** Under the proposed rules (contained in Appendix 2), using the prime brokerage example, a firm will be required to hold client money received from its prime brokerage clients in client money bank accounts, separate from its other client money bank accounts. The firm would be required to perform separate client money reconciliations in relation to that client money, and in the event of the firm's insolvency, that client money would form a separate client money pool to be distributed *pro rata* only to prime brokerage clients according to their respective interests.
- 3.13** Figure 2 shows a firm operating a general client money pool, a sub-pool for its prime brokerage business and an individual client money sub-pool.

**Figure 2 – Firm operating a general client money pool and two sub-pools**



- The prime brokerage sub-pool has been created to hold the client money that relates to its prime brokerage business.
- Client A sub-pool represents an individual's client money sub-pool which has been created to pool all client money belonging to a particular client across all the firm's business lines.
- On the firm's insolvency, for each sub-pool the client money is pooled separately. All other client money bank and transaction accounts are pooled in the general client money pool, with the relevant clients having a rateable claim on that pool.

3.14 However, multiple client money pools do potentially introduce different risks into the client money distribution regime, such as:

- a) the potential increased risk of litigation over the client money pools; for example, clients of one pool may contend that losses should have been allocated to a different sub-pool, or clients may claim that they should be beneficiaries of a different pool; and
- b) increased complexity of managing multiple sub-pools may lead to more operational errors; for example, placing money in the wrong account or giving clients incorrect account information.

3.15 These risks can be mitigated with appropriate operational controls, such as clearly defining the beneficiaries of the pool and clear regulation that considers the distribution cascade between pools.

3.16 On balance, with appropriate controls, in our view the ability for firms to create multiple client money sub-pools introduces flexibility into the client money regime, is likely to lead to an increase in the speed of return of some client money and makes porting client transaction accounts at CCPs a realistic possibility more widely across the market. It is also likely to increase client confidence in the client money regime as it will allow clients to approach firms for a bespoke arrangement to protect their client money.

**Q3:** Do you agree that we should introduce multiple client money pools to facilitate porting of cleared positions?

**Q4:** Do you agree that we should make the option of multiple client money pools available to other types of investment businesses?

### **Operation of client money sub-pools**

3.17 The proposed rules will allow firms to create multiple client money sub-pools for holding and protecting client money. In the event of a firm insolvency, each sub-pool will be treated as a legally distinct pool and will be distributed rateably to the beneficiaries of that sub-pool according to their respective interests. All client money that is not held in a sub-pool will form part of a general client money pool (in the way that it would under the current CASS rules), for those clients of the firm who are beneficiaries of a general pool.

### **Segregation, record keeping and reconciliations**

3.18 The proposed rules will require a firm to apply the provisions of CASS 7.4 (segregation) and CASS 7.6 (records, accounts and reconciliations) separately to the general pool and to

each sub-pool it creates. This is to ensure that each sub-pool is effectively segregated from the general pool and any other sub-pools, that a firm's accounts and records accurately reflect this segregation and that the balance on each pool is calculated and reconciled frequently. In the event of an insolvency, these requirements will ensure that it is clear to an insolvency practitioner which money belongs to which pool and the latest balance on each.

- 3.19** For example, CASS 7.4.9AR prevents firms from holding with group entities more than 20% of the balance at any time of client money in its aggregate general client money bank accounts or in each of its designated client bank accounts. This 20% limit will apply per sub-pool (e.g. 20% of the client money balance in aggregate for that sub-pool).
- 3.20** Similarly, firms will be required to perform separate internal and external reconciliations on each sub-pool.
- 3.21** Each client money sub-pool must have its own client money bank accounts and client transaction accounts (if applicable) and client money belonging to one pool (general pool or sub-pool) cannot be placed in client money accounts belonging to another client money pool.
- 3.22** The names of the accounts (bank accounts and transaction accounts) maintained for each sub-pool must contain a unique reference that enables the account to be identified as relating to that sub-pool.

### **Sub-pool terms**

- 3.23** A firm will be required to create sub-pool terms for each client money sub-pool it creates. The purpose of the sub-pool terms is to identify the beneficiaries of the sub-pool at any time and where the client money belonging to the beneficiaries of the sub-pool is held. Further, if the sub-pool is to be made available for porting client transactions, the sub-pool terms must make this clear by including a statement to this effect and identifying the relevant CCP and client transaction account.
- 3.24** We are proposing that the sub-pool terms should not include any more information than that specified in the rules. This is to ensure that the sub-pool terms do not become lengthy, thereby undermining the purpose of the document. The relevant sub-pool terms must be in place before a firm begins to hold client money in that pool and must be provided to us on request.

**Q5:** Do you think the sub-pool terms should include any further information?

**Q6:** Should firms be required to identify client money accounts in the sub-pool terms by account number or by name or both?

3.25 The proposed rules do not specify a template to use for the sub-pool terms, although we see advantages of clarity and consistency in providing such a template.

**Q7:** Do you think we should provide template sub-pool terms that can be completed by firms establishing new pools?

### **FSA notification requirements and disclosure to clients**

3.26 We propose that a firm will be required to notify us of its intention to establish a client money sub-pool not less than three months before the firm establishes a sub-pool. We propose that firms will be required to give us a copy of the sub-pool terms on request. In addition, a firm will be required to notify us not less than three months before implementing amendments to sub-pool terms. We will require firms to make these notifications to us so we are aware of the number and nature of sub-pools that firms are operating for monitoring and supervision purposes. A firm's CASS audit is required to confirm on an annual basis the firm's compliance with the client money rules, and this will include the proposed multiple pooling rules.

3.27 Under the proposals, a firm will be required to draft a sub-pool disclosure document for the beneficiaries of each sub-pool that it creates. The purpose of this document is to ensure that clients are made fully aware of the risks they face in putting their money in a particular sub-pool as a result of the purpose of the sub-pool and the other clients sharing in the sub-pool.

3.28 We propose that the sub-pool disclosure document must include:

- i) the identity of the sub-pool;
- ii) a description of the purpose of the sub-pool;
- iii) whether the clients in the sub-pool are retail<sup>6</sup> or non-retail clients or both;
- iv) the business line(s) to which the sub-pool relates;
- v) the principal advantages and risks to which the beneficiaries of the sub-pool are exposed;
- vi) a description of how the firm expects the sub-pool to be distributed in the event of the firm's insolvency;
- vii) if porting that sub-pool is permitted, a statement that the sub-pool is intended to facilitate the transfer of client money to effect or facilitate porting;
- viii) a description of how the beneficiaries can be identified at any time and any procedure the firm uses to confirm that a client is a beneficiary at any time; and

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<sup>6</sup> The definition of retail client as set out in article 4(1)(12) of MiFID is used in the proposed, relevant client money rules.

- ix) a statement that highlights that a client who is a beneficiary of one pool shall have no claim to or interest in the client money held in any other pool unless that client is also a beneficiary of it.

- 3.29** The sub-pool disclosure document would be required at all times to reflect the relevant sub-pool terms.
- 3.30** To ensure that the disclosure document is focused on the information that a client needs to know about a sub-pool, in our view the disclosure document should not include any further information than that specified in the new rules.
- 3.31** This document must be provided to a client before the firm receives or holds that client's money for a specific sub-pool and the client must provide a written acknowledgement of the sub-pool disclosure document and written consent to its money being held in the sub-pool. In addition, the firm must provide a copy of the sub-pool disclosure document at any time on a clients' request.
- 3.32** Three months before making any material amendments to the sub-pool (such as mergers of sub-pools, changes to beneficiaries, and changes to principal risks, etc), the firm must notify the clients of this proposed change, with a revised sub-pool disclosure document reflecting the changes. We believe giving three months' notice will allow clients to consider whether they are comfortable with the proposed changes, or make other arrangements for their client money.

**Q8:** Do you agree with the content of the sub-pool disclosure document? Do you think it should contain any further information?

**Q9:** Should we provide a template that can be completed by firms?

**Q10:** Do you agree that clients should be given one-way notification of any material amendments to a sub-pool three months before the proposed amendment?

### **Distribution from client money sub-pools**

- 3.33** Unless a client money sub-pool has been created to facilitate porting, in the event of a firm's insolvency, each client money sub-pool will be distributed rateably to its client beneficiaries according to their respective interests. Where there is any surplus client money in a sub-pool following the satisfaction of all the claims of the beneficiaries, this surplus will be contributed to the general client money pool.

- 3.34** The general client money pool will be formed from all client money held by the firm that is not part of a sub-pool. This pool will be distributed rateably to the beneficiaries of the general pool according to their respective interests. If there is any surplus client money in the general pool after all the claims of the general pool beneficiaries have been paid, this surplus will be contributed rateably to any shortfalls in the client money sub-pools.
- 3.35** To the extent that there is any surplus client money following the satisfaction of all sub-pool shortfalls, the surplus will be given to the firm.

**Q11:** Do you agree that the surpluses from the sub-pools and the general pool, if there are any, should be used to cover any shortfalls in other pools in the manner proposed?

### **Mandating certain client money pools**

- 3.36** We are considering whether or not to mandate the separation of client money along certain lines. For example, mandating that firms should create at least two client money pools, one for retail<sup>7</sup> clients and one for non-retail clients.
- 3.37** We have included draft rules in this consultation that demonstrate our thinking to date on this. We also propose that a firm that establishes a retail pool and a separate non-retail client money pool could then exercise its discretion to operate further sub-pools of client money within these, as set out above.
- 3.38** Mandating the separation of client money along specific lines addresses the potential lack of incentive for firms to create multiple pools but means that at least some of the benefits of multiple pools are achieved.
- 3.39** Generally speaking, wholesale clients have a higher risk appetite than retail clients, leading to investment in more volatile products, where the client money holdings for a client materially vary from day to day. Retail clients may not be aware of the types of business that a firm undertakes for wholesale clients, nor the risks associated with these types of business and the impact that they might have on the return of their client money in the event of a firm's insolvency.
- 3.40** Separating retail and wholesale client money means that retail clients' money is not exposed to the risks taken by wholesale clients. Mandating the division of retail and non-retail client money may allow more rapid distribution of the client money from the retail pool if fewer or no contentious issues have arisen in relation to that pool.

**Q12:** Do you agree that these benefits would result from the segregation of retail and non-retail client money?

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<sup>7</sup> The definition of retail client as set out in article 4(1)(12) of MiFID is used in the proposed, relevant client money rules.

**3.41** Alternatively, client money could be separated based on business activities and we are considering mandating the division of client money in this way. The clearest method would be requiring firms to hold the client money in relation to their margined business separately from their non-margined business. The reasoning for this is that margined business deals with volatile trades, so splitting out the riskier business may cause fewer contentious issues and some client money may be returned quicker.

**Q13:** Do you agree that these benefits would result from the segregation of business into margined and non-margined business?

**3.42** We expect operating multiple pools of client money to be costly for firms (which is ultimately a cost for clients) and not all firms and clients will see the same benefits from segregating client money along the same lines. Both firms and their clients might gain a greater net benefit from firms determining bespoke ways to carve out their client money pools (e.g. splitting their wealth management business from their perceived riskier prime brokerage business).

**Q14:** Do you think we should mandate the division of client money on this basis? If not, why not?

**Q15:** If we were to mandate the division of client money into sub-pools (for example, a pool for retail client money and a pool for non-retail client money) do you agree that we should also allow firms to create further sub-pools within each? If not, why not?

**Q16:** Do you think that any mandating of certain client money pools should be dependent on complexity, size of client money holding and/or type of firm? (For example, should we mandate segregation only for investment banks or large brokers?)

**Q17:** Do you think there is a way of dividing client money into more than one pool that delivers greater net benefits for firms and clients?

**3.43** Alternatively, rather than mandating certain pools, the use of sub-pools can be incentivised by requiring firms to make their clients aware of the risks associated with the general client money pool and the sub-pooling options available to them in the market.



**Q18:** Should we incentivise the use of sub-pools by requiring firms to notify their clients of the risks associated with the general client money pool and the sub-pool options available?

**3.44** Should the outcome of this consultation conclude that mandating of client money pools is a reasonable policy outcome, we will (subject to the feedback we receive) seek to consult further on specific matters relating to scope and type of mandated pools before we introduce final rules that require certain client money pools.

### **Interaction of these proposals with designated client accounts**

**3.45** Under the existing client money regime, clients can agree with firms that their client money be held in ‘designated client bank accounts’ or ‘designated client fund accounts’. Clients may choose to place their client money in such designated accounts at a particular bank (bank A), in part to avoid the risks they perceive with placing their client money in accounts at another bank (bank B). If bank A fails, triggering a secondary pooling event:

- a) the client money held in all general client bank accounts and client transaction accounts of a firm are pooled, clients whose money is held in any of these accounts share rateably in any shortfall and new client entitlements are calculated;
- b) the client money held in each designated account at bank A is notionally pooled, the clients holding money in that account share rateably in any shortfall and new client entitlements are calculated; and
- c) the client money held in designated accounts at bank B or any other banks is not pooled with any other client money.

However, in the insolvency of the regulated firm, a primary pooling event, under the current client money rules (and subject to the proposals in Part I) all client money held by the firm is pooled, including any client money held in designated client bank accounts and designated client fund accounts.

**3.46** We are not intending to amend the existing concepts of designated client bank or fund accounts or their use in a secondary pooling event, as set out in CASS 7A.3, as a result of these proposals.

**3.47** A client whose money is held in the general client money pool or a particular sub-pool by a firm may elect to have some of its client money held in a designated client bank account(s) or designated client fund account(s) at a specific bank.

**Q19:** Do you agree that the existing concept of designated client bank accounts and their use in a secondary pooling event should remain unchanged?

### **Timing**

- 3.48** Send us your responses for Part II by 30 November 2012. We intend to consider the feedback and publish a response in the first half of 2013.

## Part III

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# Client Assets Regime: Achieving better results (DP)

# 4

## Client assets regime: achieving better results

### Introduction

- 4.1 We are undertaking a fundamental review of the client money and custody assets (collectively ‘client assets’) regime, as set out in our Business Plan 2012/13, which is focused on improving the regime to lead to better results in the insolvency of an investment firm. Our review builds on developments of the regime already introduced in the past couple of years, such as prime brokerage reporting<sup>8</sup>, the CASS Resolution Pack<sup>9</sup>, and the introduction of CMAR.<sup>10</sup> However, this review is more holistic in its approach, considering some of the fundamental issues drawn out from the administration of Lehman Brother International (Europe) Ltd (LBIE) and subsequent firm insolvencies that have led to material delays and loss for clients. We deferred our review until after the Supreme Court decision on LBIE as the issues being considered there had an impact on the scope and content of our review.
- 4.2 We are trying to achieve better results for clients whose client assets are placed with a firm that enters insolvency. We expect this to lead to a more robust market place. The objectives of the review are to:
- improve the speed of return of client assets following the insolvency of an investment firm;
  - reduce the market impact of an insolvency of an investment firm that holds client assets; and

<sup>8</sup> Daily reporting on client money and assets holdings to all prime brokerage clients. These rules are set out in CASS chapter 9.

<sup>9</sup> Requirements to ensure that information and records that would help an insolvency practitioner return client money and assets more quickly are more readily and reliably accessible following the firm’s failure. The rules come in to effect on the 1 October 2012, in CASS chapter 10.

<sup>10</sup> CASS medium and large firms must submit their Client Money and Asset Report (CMAR) to the FSA every month.

- achieve a greater return of client assets to clients after an investment firm has become insolvent.
- 4.3 These objectives are interconnected, and are often (but not always) complementary – for example, speeding up the release of client assets will reduce the market impact of a firm insolvency. The speed of release is also likely to be inversely related to the accuracy of return. In this chapter, we explore these objectives and the possible tradeoffs between them, using the lessons learnt from recent insolvencies. We ask questions throughout to assess the industry’s appetite for change and the direction of change sought.
- 4.4 The current client assets distribution regime effectively prioritises accuracy over speed – aiming to ensure a fair and accurate return to a client claimant (often with a court blessing). We consider whether we have got this balance right and whether, for example, there is an appetite to prioritise speed which will inevitably lead to some loss to accuracy (and arguably fairness) unless a mechanism is created to compensate or mitigate this risk. Any such mechanism will come at a cost, either to the regulated firm, the industry, to clients or creditors. However, it is worth noting that there are costs including litigation and opportunity costs under the current system.
- 4.5 As discussed below, our client assets rules are built on a framework of primary and secondary legislation (including the relevant insolvency and company law). Some of the issues relating to the prompt return of client assets relate to the overall legislative insolvency framework. The government, in accordance with the Banking Act 2009, has started a review of the regime created by the Investment Bank Special Administration Regulations 2011 (SAR), and is due to report to Parliament by February 2013. The government also intends to take the opportunity to look at broader issues arising from the MF Global Ltd special administration, in particular, the obstacles to the timely return of client assets to investors. The SAR review will run at the same time as this review of the client assets regime, and we will share the feedback we receive with those conducting the review.
- 4.6 While this review looks at the return of client assets if a firm becomes insolvent, we note that the Treasury recently published a consultation document<sup>11</sup> on a non-bank resolution regime applicable to systemic firms. Some investment firms clearly have the potential to be systemic due to the impact their insolvency could have on the wider industry. The intention is to have a resolution regime allowing the authorities to exercise the same broad suite of stabilisation powers for systemic investment firms that exist with the Special Resolution Regime (SRR) for deposit-takers.
- 4.7 In addition to the recent insolvencies, our supervisory experiences have also raised other matters relating to the client money and custody rules (CASS chapters 7 and 6, respectively) that we are considering (such as the banking exemption, the alternative approach, and trust letters, etc.). We intend to consider these matters as part of this fundamental review and our

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11 Financial Sector Resolution: Broadening the Regime 1 Aug 2012  
[www.hm-treasury.gov.uk/consult\\_financial\\_sector\\_resolution\\_broadening\\_regime.htm](http://www.hm-treasury.gov.uk/consult_financial_sector_resolution_broadening_regime.htm)

expectation is to include these matters in a consultation on improvements to CASS in the first half of 2013.

- 4.8 Throughout the remainder of this chapter, unless otherwise indicated, the term ‘client assets’ refers to both client money and custody assets.

## Background

- 4.9 The client assets regime applies to firms that carry on investment business and hold their clients’ assets in relation to that activity. The regime requires firms to establish appropriate arrangements to safeguard their clients’ assets to minimise the risk of loss or misuse while the firm is a going concern, and safeguard clients’ rights to their assets, as separate from those of the firm’s general estate, if the firm becomes insolvent.
- 4.10 EU legislation (MiFID for investment business) requires Member States to place organisational requirements on firms to minimise the risk of loss or diminution of clients’ assets. EU legislation establishes high-level client assets requirements, leaving Member States to establish the details (in part because client assets requirements must conform to the home state company and insolvency laws so they work if the firm becomes insolvent). There is other EU legislation, notably EMIR, which will also shape the UK’s client assets regime.
- 4.11 The client assets rules are built around the UK’s primary and secondary legislative framework, including the Financial Services and Markets Act 2000 (FSMA), trust law<sup>12</sup>, insolvency and companies legislation. Insolvency legislation establishes the parameters of how an Insolvency Practitioner (IP) can act on behalf of the entity in administration. IPs have personal liability for their actions in office, and have limited ways to mitigate this liability.
- 4.12 Following lessons learnt from LBIE’s insolvency, the government introduced the SAR in February 2011. It gives an IP three specific objectives: ensuring the return of client assets as soon as reasonably practicable; timely engagement with market infrastructure bodies and the authorities; and the rescuing or winding up of an investment bank in the best interests of the creditors. We can direct an IP to prioritise one of these objectives over another.
- 4.13 The SAR was first used in the failure of MF Global Ltd and subsequently in the cases of Pritchard Stockbrokers Ltd and WorldSpreads Ltd. In these cases, in relation to the return of client assets, the SAR has been a qualified success as it has enabled the FSA to have a clear mandate with the IPs, and MF Global Ltd’s IPs has been able to use the custody assets bar date<sup>13</sup> enabling the return of client assets to claimants with good title within ten months of the insolvency.

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12 Client money is protected under a statutory trust, established through FSA rules.

13 There are other aspects to the SAR, such as the interaction between the IP and infrastructure i.e. exchanges which are not directly relevant to the client assets distribution regime therefore are not discussed here. Generally these were seen working positively in MF Global. The SAR does not provide a bar date for client money claims.

- 4.14 Many of the specific issues relating to the return of client assets from LBIE were identified very quickly in its aftermath.<sup>14</sup> They included insufficient and inadequate record-keeping, inadequate trust letters, excessive use of group banks to hold client money, failure to segregate for affiliates and insufficient importance placed on client assets issues by senior firm management. These deficiencies were subsequently identified frequently in firms across the industry and are being tackled via enhanced FSA supervision, more effective independent auditing<sup>15</sup>, increased senior management accountability<sup>16</sup> for client money issues and new regulations, including restrictions on placing client money with group banks, introduction of the CASS Resolution Pack, restrictions on general liens in custody agreements.
- 4.15 Following the introduction of the SAR and the developments in the client assets regime there was an expectation of significantly improved speed of return of client assets. However, in the case of MF Global Ltd the UK regime has at times, rightly or wrongly, been compared unfavourably to the US regime where, for example, nearly all securities customers of MF Global Inc. received 60% or more of their account value within a month of the firm's insolvency.<sup>17</sup>
- 4.16 More needs to be done if there is a desire to increase the speed of return of client assets, reduce the market impact, and improve the return to clients. In the remainder of this chapter, for each of the objectives of the review, we explore the issues and lessons learnt, drawing on these recent insolvencies.

### Improving the speed of return of client assets

- 4.17 Generally speaking, it often takes a matter of months and in some cases, such as LBIE, years for client money and custody assets to be returned. Experience has shown that the speed of return of client assets is proportional to the complexity and issues involved with the firm at the time of its failure and also the quality of its compliance with the CASS rules. Delays also have an impact on the return to clients due to continuing IP fees, warehousing costs, legal fees and other such costs being paid for from client assets (see 'Achieving a greater return for clients' on page 39).
- 4.18 A firm that is operating multiple business lines, across multiple platforms and market venues will take time to unravel. With the additional issues and risks, such as significant nominal open house and client positions<sup>18</sup>, disputed claims or poor record keeping, one can

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14 Client Money and Asset Report January 2010 [www.fsa.gov.uk/pubs/other/cass\\_risk.pdf](http://www.fsa.gov.uk/pubs/other/cass_risk.pdf)

15 Auditor's Client Assets Report March 2011 [www.fsa.gov.uk/pubs/policy/ps11\\_05.pdf](http://www.fsa.gov.uk/pubs/policy/ps11_05.pdf)

16 CF10a CASS Operational Oversight Function.

17 However, clients with commodities accounts did not receive a quick payout and are not eligible for SIPC compensation. [http://dm.epiq11.com/MFG/Project#Section4\\_4](http://dm.epiq11.com/MFG/Project#Section4_4)

18 The risk exposures of open house and client positions can be significant for an insolvent investment firm and, in dealing with these the administrators are exposed personally to much larger sums than they would in the administration of a non investment firm. [www.hm-treasury.gov.uk/d/consult\\_investmentbank161209.pdf](http://www.hm-treasury.gov.uk/d/consult_investmentbank161209.pdf)

see under the current regime that the IP is likely to be cautious and take a long period to be in a position of certainty to permit the return of client money and assets. IPs will only return assets where title is established to a high degree of certainty because of their personal liability.

- 4.19** Given the trade-off between speed and accuracy, we are considering how far to go to speed up the return of client assets, and whether the treatment should be different for different classes of clients (i.e. retail and wholesale clients).
- 4.20** The Banking Act 2009 introduced the SRR which provides for the FSA to make a determination that a deposit taker should be placed in the SRR. At this point, the Bank of England then has a number of tools it can use to resolve a deposit taker before the point of insolvency<sup>19</sup> but also the option to close the deposit taker and deliver fast payout of compensation (by triggering the Banking Insolvency Procedure (BIP)) to give depositors certainty and confidence. Faster payout was considered appropriate in the context of the SRR and BIP because retail clients need to have access to their operating bank accounts to function in their daily lives (buy their weekly food, pay bills, collect wages, etc).
- 4.21** Since 31 December 2010, the Financial Services Compensation Scheme (FSCS) aims to pay compensation to the majority of eligible depositors within a target of seven days following a bank's insolvency (and in any case within 20 days). A move to faster payout was not possible without placing a requirement on all deposit takers to develop a single customer view (SCV).<sup>20</sup> Implementing the SCV requirements came at a significant cost to the industry and the FSCS, which also had to develop systems capable of using firms' SCVs. As the FSCS only raises levies when it is required (or expects) to pay compensation, fast payout targets also have cash flow implications for the FSCS.
- 4.22** By contrast, it is arguable that such fast access to client assets held by a firm in relation to investment business for retail clients is not necessarily required in the event of investment firm insolvency. In consideration of the cost benefit analysis of any proposals to speed up the return of client assets, it could be argued that the average retail client would be comfortable with the certainty of having all their assets back in a 'reasonable period' – and certainly not as fast as the BIP and FSCS regime applicable to deposits – given the costs of speed and the trade-off with accuracy.
- 4.23** However, the client assets regime equally applies to wholesale clients. As shown in the case of recent insolvencies, an investment firm's insolvency can have a material impact on other regulated firms whose assets are tied up in the insolvent firm. In these scenarios, speed is important to ensure the integrity of the other firms and the confidence of the market they operate in. To have something quickly, if not near immediately, could be balanced with the costs of achieving that speed and of the trade-off with accuracy.

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<sup>19</sup> For example, transfer to a private sector purchaser; transfer temporarily to a bridge bank owned and controlled by the Bank of England; and the Bank Insolvency Procedure. Subject to a higher threshold for action, the Treasury can use the temporary public ownership tool.

<sup>20</sup> The provision of a SCV provides the FSCS with the information required to make a fast payout.



### Box 1 – The role of the FSCS in an investment firm insolvency

The FSCS is the UK's compensation scheme of last resort when UK-authorized financial services firms are unable, or likely to be unable, to pay claims against it.

Once an investment firm is declared insolvent the IP generally gives the FSCS the information it needs to assess claims for client assets and money, including the amount of money each client had with the failed firm. If the normal conditions for FSCS payment are met, the FSCS can pay this amount – up to the limit of £50,000 per person per firm – to investors that meet the FSCS' eligibility criteria and who have valid claim.<sup>21</sup>

Where the failure involves a loss of client money, the cost of compensation paid by the FSCS before any distribution from the pool, and for any shortfall up to the limit, is met through levies on authorized firms. Firms are currently allocated to one of nine funding classes on the basis of the regulated activities they undertake. When the FSCS is required (or expects) to pay compensation, it allocates the cost to the class that corresponds to the regulated activity that gave rise to those costs. Each has a limit (or threshold) on what it can be required to contribute to compensation claims in each year, costs beyond which must be met by other industry participants.

The costs of compensation may, however, be offset by the extent to which the FSCS can pursue recoveries from the estate of the failed firm. This is because, when it pays compensation, the FSCS will generally take an assignment of the claimant's rights against the firm. This enables the FSCS to stand in the shoes of the claimant and receive the distribution of client money in accordance with client money rules.<sup>22</sup>

Our rules for the FSCS currently require that the FSCS must be in a position to pay an eligible claimant's investment claim as soon as possible and at the latest within three months of the establishment of the claimant's eligibility<sup>23</sup> (this could be some time after the date of the firm's insolvency). This reflects the target set under the Investor Compensation Scheme Directive (ICD) which requires all EEA Member States to establish a scheme to provide a minimum level of protection for return of client money and instruments.

**Q20:** Do you agree it is important to have speedy return of client assets following a firm's insolvency? Please explain your answer.

21 Broadly speaking, the FSCS can accept claims from individuals and small companies, but large companies and overseas financial services institutions are excluded.

The detailed eligibility criteria are contained in 4.2 of the COMP Rules.

22 If the FSCS recovers an amount from the client money pool or from the general estate that exceeds the compensation it has paid to the claimant, the FSCS must pay this to the claimant, after deduction of the reasonable costs of recovery and of distribution.

23 Unless the FSA has granted the FSCS an extension of up to a further 3 months.

- Q21:** Does the status quo strike the right balance between speed and accuracy? Please explain your answer.
- Q22:** Given the potential trade off between costs and speed, how fast do you think client assets should be returned to retail clients following an insolvency and, as a percentage, what loss should a retail client be prepared to incur to have client assets back in that time period?
- Q23:** Given the potential trade off between costs and speed, how fast do you think client assets should be returned to wholesale clients following an insolvency and, as a percentage, what loss should a wholesale client be prepared to incur to have client assets back in that time period?
- Q24:** Should retail clients and wholesale clients be treated differently in respect of client assets protection and distribution? Please explain your answer.

**4.24** Following the failure of LBIE, we have increased the number of staff dedicated to client assets from around four individuals in 2009 to more than 40 today in the form of the Client Assets Unit. The Unit is a multi-disciplinary specialist unit with risk, policy and supervision specialists focused on the client assets regime. The Unit has had material successes in identifying and resolving client assets failings in firms (some of this is made public in the form of enforcement actions but a lot is not made public). The Unit's work is leading to significant increases in the general level of client assets regime compliance in firms, forcing client assets to be at the top of the agenda of many firms. The work with the auditors' standard setting body, the Financial Reporting Council, and our public criticism of auditors has led to a significant increase in the quality of review by auditors in this area in the last year, leading to more client assets compliance issues being identified and resolved in firms. It is important that this work continues and it should lead to further improvements in the management and protection of client assets, which should have a real impact in the event of insolvency.

**4.25** Improvements in the level of client assets regime compliance by firms should mean that, when a firm becomes insolvent, there will be fewer disputes and/or losses incurred through shortfalls. However, there will never be 'absolute or perfect compliance' and anything short of that leads to delays and further losses given the current legislative and regulatory regime.

- 4.26 In the insolvency of MF Global Ltd, irrespective of the supervisory and remedial actions taken leading up to the firm's failure, a few issues have meant that to date the IP has only been able to return client money at 26% of agreed claims for some clients.<sup>24</sup> It should be noted that, in accordance with a recent MF Global Ltd press release, one possible scenario has MF Global Ltd paying out on client claims at 100% if the issues conclude as the administrators believe they could.<sup>25</sup> Nevertheless, this kind of return could be after a lot of protracted (and expensive) legal proceedings and court cases to provide the administrators with the certainty they need to act given their personal liability.
- 4.27 We therefore recognise that without changes to the wider framework that supports the client assets regime to enable prompt decisions and actions to be taken, any changes we introduce may only marginally speed up the return of client assets. This review will assess what further improvements could result from the actions we could take. We will also understand from the responses to this discussion, the appetite and desire for change sought by the industry. As noted earlier, the government is reviewing the SAR and we will share the feedback from this discussion with them.
- 4.28 As part of this fundamental review, we are considering what regulatory changes, within our remit, we should introduce to further reduce the occurrence of client assets issues that could impact the speed of return of client assets in insolvency of a firm. In Box 2, we set out some of the concepts we are currently considering in this area.

#### Box 2 – Measures to improve the speed of return

We are considering establishing a requirement for regular client statements, similar to those requirements currently applicable to prime brokers. This will require firms to provide regular statements setting out the clients' money and asset balances with the firm and any right of use granted over those assets, which will reduce the likelihood of discrepancies between the firms' records and clients' expectations.

The current client assets regime is focused on protecting in insolvency all clients who 'should' have received client money protection and requires IPs to consider tracing of client money held in the firm's accounts. We are currently considering whether to amend this by establishing a regime that places more emphasis on actual segregation and firms' records, where entitlement to a client money pool is based on the firm's specific records of segregated client money or assets. This proposal will need to be implemented in combination with regular statements provided to clients.

24 In February 2012 the administrators made a payment of 26c in the \$1 to clients by way of an interim distribution. The administrators identify that one major hurdle in making further payments is the appeal by the Chapter 11 Trustee of MF Global Finance USA Inc, against the administrators' rejection of its net \$418m claim.

25 [www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/NewsReleases/Pages/mf-global-estimated-outcomes.aspx](http://www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/NewsReleases/Pages/mf-global-estimated-outcomes.aspx)

We are also looking at exclusions in the client assets regime, and considering whether we should introduce additional requirements that limit their use or provide greater transparency. For example, we are considering what additional disclosure requirements should be provided to clients when they have consented to absolute title transfer of their assets to the firm.<sup>26</sup> Prime brokerage disclosure annexes currently explain to clients the risk of firm failure to their rehypothecated assets (becoming a general creditor for their claim). We are also considering establishing lock-in or cooling-off periods to reduce the switching<sup>27</sup> that could occur in the days leading up to the failure of the firm.

Some investment firms do not always need to hold their client's assets, rather can operate via mandates (authorities) given to the firm by clients to instruct the clients' custodians or move monies from a client's own bank account (e.g. direct debits). The clients' assets are not affected by a firm's insolvency if the firm was operating on this basis. We are considering how we can incentivise greater use of operating via mandates. However, the use of mandates is not feasible in all businesses (i.e. margin transactions where assets need to be placed at a third party by the firm on behalf of the client).

IPs perform comprehensive reconciliations of assets to understand the beneficial owners and their apportionment of any losses. IPs in other jurisdictions may liquidate all assets and all share in the shortfall (both client money and custody assets) equally.<sup>28</sup> This exercise is also quicker and less expensive for the IP, and can be seen as more equitable as all clients share equally in the event of a firm's failure. We are considering whether a similar approach could benefit the UK's client assets regime.

We are also looking at the inappropriate use of term deposits by some firms, where client money is placed at a particular bank for extended periods without any recourse for the firm (or IP) to request this money back before the term has ended. In addition to the delay in distributing this client money upon the failure of the firm, this lock-up also exposes the client money to increased risks of the default of the bank (because the firm or IP will not be able to recall the monies immediately when the bank's credit worthiness slips below acceptable levels) and also the risk that the client money could become subject to disputed claims as it is outside the IP's immediate control for an extended duration.

**Q25:** Are there any other impediments that impact on the speed of return of client assets not identified above?

<sup>26</sup> Our expectation is that MiFID will prohibit all forms of absolute title transfer for retail clients. There is also other international work looking at rehypothecation and firm's use of client assets.

<sup>27</sup> Clients attempt to switch their assets from non-segregated to segregated (client asset protection) when they begin to fear insolvency of a firm. Large numbers of clients switching in the very final days of a firm before it becomes insolvent can lead to backlogs and confusion in operational and legal areas resulting in incomplete documentation, mismatches between client expectation and the firm's records and legal claims.

<sup>28</sup> Trustees in the US may use this approach.

**Q26:** Are there any other potential measures (not identified above) that you think should be considered to increase the speed of return of client assets?

## **Reducing the market impact of an insolvency of a firm that holds client assets**

- 4.29** The failure of an investment firm holding client assets can have an impact on the market place, as shown by LBIE and, to a lesser extent though still material, MF Global Ltd. For example, the failure of a clearing broker with a large number of wholesale clients could affect stability of the segment of the market they operate in due to significant delays and or haircuts imposed in the return of client assets, and the liquidation of positions. The current client assets regime is focused on freezing client assets (to protect clients) and returning those assets to clients, rather than continuing service or investment positions.
- 4.30** MF Global Ltd was a broker providing clients with access to a large number of trading venues, markets and clearing houses. Its default meant that the clearing houses liquidated many of MF Global Ltd's client positions. A limited number of clients' positions were ported, where those clients had been willing to double margin (by replacing the margin caught up in the insolvent estate to transfer their positions).
- 4.31** The changes proposed in Parts I and Parts II will allow some client money to be ported with the client positions following a failure of a clearing member. We believe this will go some way into reducing market impact on the insolvency of a clearing member.
- 4.32** However, porting will not be possible in all scenarios, and the failures of other types of investment firms can have a material impact on the market place (though not necessarily systemic) – for example, asset managers and platforms with material retail client assets holdings.
- 4.33** In Box 3 we set out some of concepts we are considering to minimise the market impact of a firm that holds client assets becoming insolvent. We also recognise that the Treasury are currently consulting on a non-bank resolution regime that would be applicable for investment firms that are considered systemic. However, the SAR, which will still be applicable to the majority of applicable investment firms, is not currently a resolution regime and does not give any special tools to the authorities. For example, included in the resolution powers of being consulted on for non-bank systemic firms, is the ability for the resolution authority to transfer all or some business of firm to a commercial purchaser (to enable continuity of business), but no such powers currently exist in the SAR.

### Box 3 – Measures to minimise the market impact

In addition to the proposals to allow for porting, we are considering whether, for example, to dislocate ‘primary pooling event’ and firm failure. Allowing the IP to have the option not to constitute the client money pool and distribute client money and custody assets immediately, will potentially allow the IP to sell the business post failure so that clients could be less affected by the failure of the firm as their business would continue as normal.

Similar to the changes currently being consulted on in the client money rules relating to insurance mediation activity (CASS chapter 5), we are considering whether it is appropriate to allow for firms to gain client pre-consent to the transfer of their client assets to enable, at a later date, the transfer of their business to other firms while still a going concern.

**Q27:** Are there any other potential measures (not identified above) that you think should be considered to reduce the market impact of an insolvency of a firm that holds client assets?

## Achieving a greater client assets return

- 4.34** Client assets are held by a firm on behalf of its client(s), where the client has retained proprietary interest in those assets.
- 4.35** As custody assets are not pooled (unlike client money) the return to clients will often vary between clients of a firm. For example, where an IP can establish that particular stocks (with corresponding ISIN/relevant reference) are held on behalf of particular clients, the IP can distribute those assets back to them whole.<sup>29</sup> However, where there are discrepancies between the firm’s and the custodian’s records, disputes between the firm’s records and clients’ expectations, the clients return will not be whole, or at worst they will become general creditors for their entire claim.
- 4.36** As client money is pooled, clients are entitled to a share of the client money pool rateable to their entitlement – and any excess in the pool over and above the clients’ total claims is repayable to the firm. However, if the pool suffers a loss, or if the pool is not sufficient to meet all client entitlements, then all clients will share that loss. To the extent of loss, clients will be able to claim on the firm’s estate as general creditors and may also be able to claim on the Financial Services Compensation Scheme (FSCS) if they meet the requirements for an eligible claimant.

<sup>29</sup> Although potentially subject to an indemnity, with the client agreeing to return the assets if there are competing claims about title and a requirement to hold funds in escrow in relation to costs.

- 4.37 Furthermore, under the current client assets regime there will nearly always be some loss, if only because of the IP's expenses in relation to distribution are due from the client assets.<sup>30</sup> Any delays in the return of client assets will mean increasing IP costs, asset warehousing costs and other costs paid for from client assets.
- 4.38 If the regime moves to increased speed in the return of client assets this may come at the cost of accuracy and therefore loss to some clients. Alternatively, looking at it another way, speedy return of client assets or transfer of business with client assets can be more promptly achieved if the IP can take such actions with the knowledge that any shortfalls discovered at later stage can be made good.
- 4.39 In Box 4 we set out some of the concepts we are currently considering to enable a greater return of client assets to clients, to reduce the impact of such losses.

#### **Box 4 – Measures to achieve a greater return**

Firms could be required to hold a 'buffer' in client bank accounts to cover the costs of distribution (by the IP) and/or potentially losses by the firm's failings. This would come at a cost to firms, but ensure a greater return to clients.

Alternatively, or in addition, we could compel firms to seek private sector mutual insurance so that losses in client assets are covered. However, this will come at materially higher costs to the industry than the status quo.

Under the alternative approach there is a possibility of losses of money held in the firm account because of the period between the last reconciliation/segregation controls operated and the time of the failure of the firm (even if this is an intra-day risk). We are looking at the alternative approach to client money segregation, and whether we should prohibit or limit its use or potentially increase the controls around it. For example, we could clarify or mandate the use of the existing prudent segregation rules to ensure firms hold in client bank accounts an amount of money equivalent to the approximation of the monies at risk in house accounts.

Currently all client claimants are treated equally regardless of their category (retail, professional, affiliates, etc) or the business they undertake with the firm. In Part II we consult on whether firms should be able to establish multiple pools which could split clients into different categories. However, the client assets rules can potentially go further and prioritise one set of clients over another, potentially leading to any shortfalls to be borne by those categories of clients lower down the prioritisation.

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<sup>30</sup> In accordance with the SAR para 135 and CASS 7.7.2R (4) costs properly attributable to the distribution of client assets can be paid for from the client assets.

**Q28:** Are there any other potential measures (not identified above) that you think should be considered to achieve a greater return of client assets?

### **Timing**

**4.40** Send us your responses for Part III by 30 November 2010. We intend to consider the feedback and publish a response, potentially in the form of a Consultation Paper, in the first half of 2013. As set out in paragraph 4.7 above, our response will also include other matters relating to the client money and custody rules (CASS chapters 7 and 6, respectively).



## Annex 1

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# Cost benefit analysis and compatibility statement

### **Cost benefit analysis**

1. When proposing new rules, we must (under section 155 of the Financial Services and Markets Act 2000 (FSMA)) publish a cost benefit analysis (CBA), unless we expect there to be no costs or only a minimal increase. As a matter of policy, we also provide a CBA for significant proposed guidance relating to rules. The CBA is an estimate of the costs and an analysis of the benefits of the proposals. It is a statement of the differences between the baseline (broadly speaking, the current position) and the position that will arise if we implement the proposals.
2. This CBA relates to Parts I and II of this CP. The CBA as it relates to Part II draws on a survey of a sample of firms in July 2012 (CBA Survey). The firms who responded to the survey are all large or medium CASS firms. Most of the respondents act as clearing members of central counterparties (CCPs). There is no CBA for Part III of this paper as we are not proposing new rules. Part III is a discussion paper that seeks industry feedback. We will consult on any proposals that we take forward, accompanied by draft rules with a CBA.

### **Who will these proposals affect?**

3. The Part I proposals will affect firms that hold client money and act as clearing members of CCPs. Any effect will only materialise in the event of such a firm's insolvency. The Part II proposals could potentially affect any firm that can hold client money, but these firms will only be affected if they choose to create multiple client money pools.

## Market/regulatory failure analysis

4. Currently, if a firm becomes insolvent, CASS requires that all client money held by the firm (including client money margin held in client transaction accounts at a CCP) is pooled and distributed rateably to those clients entitled to share in the pool. If there is a shortfall in the pool, the clients share this rateably.
5. Recent firm insolvencies have highlighted a number of difficulties with this:
  - a) A shortfall in the client money pool can cause delays in its return to the clients. An IP can have difficulty calculating entitlements to the client money pool if the firm's records are incomplete or extremely complex. In addition, if there is any litigation over clients' entitlements, this can lead to further delays. The most widely known example of this is the collapse of Lehman Brothers, which went into insolvency in September 2008 and resulted in court hearings at which client entitlements were contested, and there has not yet been a full distribution of the client money.
  - b) The inability to port client transactions with supporting margin is likely to result in some of those transactions being terminated. If a firm becomes insolvent, client money posted as margin to a CCP must be included in the general client money pool. In the collapse of MF Global Ltd, a CCP was prevented from porting the margin associated with MF Global Ltd's underlying clients' transactions as this money had to be contributed to MF Global Ltd's general client money pool. If the affected clients wish to quickly enter into economically equivalent transactions with another firm, they are likely to have to pay supporting margin for those transactions before receiving a distribution from the failed firm (for the reasons of delay explained in (a)). In addition, these clients may not get all their client money back from the pool as they will share in any shortfalls.
6. In the event of a shortfall, issues such as complex or incomplete firm records or litigation over clients' entitlements to the general pool can lead to delays in the return of client money. Such delays may have an impact on clients' ability to continue operating where they have significant amounts of client money with the clearing member (e.g. it could have an impact on the client's ability to meet their financial obligations as they fall due). The more clients of a failed firm that are affected in this way, the wider the market impact will be. In addition, such delays reduce clients' confidence in the UK market.
7. When a client enters into a relationship with a firm, it is unlikely to have oversight of the issues that can cause a shortfall in the client money pool or a delay in distribution in the event of the firm's insolvency. For example, high-risk or volatile trading by some clients could lead to a shortfall in the client money pool, but clients do not have sight of other clients' trading activities. A client cannot therefore assess all the risks of placing its client money with a firm, while the firm itself will have a much better picture of these overall risks to the client.

8. If porting clients' transactions and supporting margin is not achieved, those transactions are terminated and the clients must margin new transactions with another firm. Depending on the volume of transactions each client has placed and the amount of margin paid to support them, on termination of their positions, a client's solvency may be affected. The larger the number of clients with cleared positions that are affected by a firm failure, the wider the market impact.

### **Changes to CASS required by EMIR (Part I)**

9. The rule changes to CASS in Part I will ensure compliance with the segregation and porting requirements in EMIR.

#### *Benefits*

10. In the event of a firm insolvency, any client money margin held by a CCP in individually segregated client transaction accounts is not contributed to the client money pool, but can be made available for porting. For omnibus-segregated client transaction accounts, margin is still made available for porting as per EMIR, but may face difficulty in porting without the additional margin needed to support the positions, held by the clearing member. If monies are ported or returned directly to the client by the CCP, we believe this may lead to a small reduction in the costs of the insolvency. It may also lead to a small reduction of the market impact associated with the insolvency of a firm.

#### *Costs*

11. The changes proposed are changes required to ensure that the client money rules are compatible with EMIR. We do not believe the proposed amendments to the client money rules will change firm behaviour and therefore we do not believe they will place additional costs on firms while they are going concerns. The changes will affect the actions undertaken by the IP during insolvency, in so far as the IP will not seek to recover any client monies that have been ported or returned directly to the client by the CCP in accordance with EMIR.

### **Introduction of multiple pools (Part II)**

#### **Optional multiple pools**

12. The rule changes in Part II will provide an option to firms to form client money sub-pools that do not have to be contributed to the general client money pool if a firm becomes insolvent. For example, a firm may create a sub-pool to contain margin relating to

transactions cleared for clients and held in an omnibus client transaction account at a CCP (as explained in paragraph 3.7). Our changes to CASS mean that such a sub-pool could be used to facilitate the porting of those transactions.

### *Benefits*

13. The rule changes increase the likelihood that omnibus-segregated client transaction accounts can be ported, making porting available to more clients. This increases the likelihood that transactions will not be terminated in the case of a firm's insolvency and that the client will not be forced to margin new transactions with another firm and suffer the consequent financial impact.
14. Alternatively, a firm may create a sub-pool(s) to reflect the risk appetite of clients. For example, it may choose to create a sub-pool that segregates client money associated with high-risk or volatile trading business from other client money. In this way, any client money losses resulting from that business can be ring-fenced in that sub-pool meaning that other clients will not share those losses in the event of the firm's insolvency.
15. Creating multiple sub-pools is also likely to reduce delays, resulting from client money shortfalls, to the return of client money for some clients. For example, instead of all client money being held up due to litigation or lack of certainty in the client records, delays resulting from these factors will only affect the distribution of client money held in sub-pools subject to litigation or affected by uncertain client records. If one pool does not face any litigation, uncertainty over claimants and/or the extent of their claims, it could be quickly distributed or ported (where applicable). The extent to which this proposal is successful at reducing delays for clients depends on effective segregation and the firm's compliance with the rules.
16. Creating multiple client money pools is optional to firms. The benefit is therefore dependant on whether firms choose to create and operate multiple client money pools, and whether they do so in compliance with the proposed rules. The greater the uptake of these proposals by firms, the greater the combined benefits are likely to be.

### *Costs*

#### Direct costs to the FSA

17. Direct costs to the FSA as a result of the proposals are expected to be minimal. The proposals introduce requirements for firms to make notifications to the FSA, but these notifications will fit into existing FSA processes and the volume of notifications will depend on the number of pools that firms choose to create.

### Compliance costs to firms

18. Only four CBA Survey responses provided cost estimates. In addition, the bases for costs calculation in the responses differed greatly. The analysis set out below is based on the information gathered.
19. This proposal is optional (firms do not have to establish sub-pools) and firms can exercise their discretion over the complexity and number of sub-pools they create. Firms are unlikely to incur any costs if they choose not to create multiple client money pools.
20. Firms considered the costs associated with creating multiple client money pools include record-keeping requirements (including client documentation, client onboarding, account set up, client reporting and additional staff required to carry out these processes), updating policies and procedures and systems and controls (initial and subsequent systems building and upgrades to allow and staff to operate these). Other costs firms expect to incur are legal costs, staff training costs, internal and external audit costs and project management costs.
21. Respondents to the CBA Survey reported one-off costs of establishing a first pool in a range from around £30,000 to £5,500,000. They reported ongoing costs of that pool in a range from around £60,000 to £300,000. One-off costs appear to be greater for firms as they move towards offering more bespoke client money sub-pools, such as a sub-pool for each individual client.
22. Respondents also indicated that the one-off costs of establishing subsequent pools may be between zero and £1,400,000. They reported that the ongoing costs of operating subsequent pools would range from £7,000 to £230,000.
23. If firms choose to operate sub-pools, the proposed rules require them to provide a disclosure document to clients participating in the sub-pool. We estimate that the one-off costs to firms of preparing such a document will be between £1,000 and £2,000.
24. The costs to firms will be dependent on how they exercise the discretion to establish sub-pools (i.e. decide not set them up, only provide to a discrete number of clients, apply to business lines, etc).

**Q29:** Are the costs for establishing multiple pools realistic?  
Please provide any explanations or quantitative evidence  
you have to support your view.

### *Requiring firms to create separate client money pools*

25. In paragraphs 3.36-3.44, we discuss whether we should require firms to establish client money pools, for example one for retail clients and one for wholesale clients, or one for margin business and a separate pool for non-margin business.

### *Benefits*

26. As set out in paragraphs 3.39-3.40, mandating the use of a retail client money pool and a non-retail client money pool would help to address the asymmetry of information between the clients and the firms that arises from the fact that clients may not be aware of the types of business that a firm undertakes for wholesale clients, nor the risks associated with these types of business and the impact that they might have on the return of their client money in the event of a firm's insolvency. Also, as set out in paragraph 3.41, if we required firms to hold the client money in relation to their margined business separately from their non-margined business, this separation of the riskier margined business may provide for fewer contentious issues and the more prompt return of some client money.
27. Under the proposals, firms could then exercise their discretion to operate further sub-pools of client money within these.

### *Costs*

28. We expect the costs of establishing and operating mandated pools to be within the range of costs to establish multiple client money pools identified in paragraphs 18-24 above. Subject to whether the consultation concludes that mandatory pooling is a reasonable policy outcome, we will consider revisiting the costs estimates for the particular type of mandated pools being required.

**Q30:** What are your views on the benefits and costs of the policy measures to mandate certain pools?

### **Compatibility statement**

29. In this section we set out our views on how the proposals and draft rules in this CP are compatible with our general duties under Section 2 of the Financial Services and Markets Act 2000 (FSMA) and our regulatory objectives set out in Sections 3 to 6 of FSMA. This section also outlines how our proposals are consistent with the principles of good regulation (also in Section 2 of FSMA) to which we must have regard.

### **Compatibility with our statutory objectives**

30. Our proposed amendments to CASS relate mainly to our market confidence and consumer protection objectives. Based on our understanding of EMIR and our understanding of how the market operates, we believe that our proposals are the most appropriate for achieving our objectives, and also expect them to have a positive impact.
31. By amending our pooling and distribution rules to facilitate porting and repaying the margin back to clients in the event of clearing member default, we believe our proposals amend CASS in the way that is most efficient in facilitating EMIR and we also consider

that the further changes on multiple pooling address our market confidence and consumer protection objectives appropriately.

### **Compatibility with the principles of good regulation**

32. Section 2(3) of FSMA requires that, in carrying out our general functions, we have regard to the principles of good regulation. In formulating these proposals we have had regard to the following principles.

#### **The need to use our resources in the most efficient and economic way**

33. We believe that the proposals in this CP will have minimal impact on our resources.

#### **The principle that a burden or restriction which is imposed should be proportionate to the benefits**

34. Part I of the CP implements the changes to CASS we are required to make as a consequence of EMIR. The proposals in Part II provide firms with the option to set up multiple client money pools. This means that both costs and benefits are dependant on whether firms choose to create and operate multiple client money pools. Should we consider mandating multiple pooling as outlined in paragraphs 3.36-3.44 of the CP, we will consider revisiting the cost estimates for the type of mandated pools required.

#### **The desirability of facilitating innovation and facilitating competition**

35. Providing firms with the possibility to offer multiple pools enables them to carry out their business in different ways. It will also enable firms to compete on this aspect of their service offering. In our view it is unlikely that the proposals will have adverse impacts on competition.





## Annex 2

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# List of consultation questions

### **Part I - Changes to CASS required by EMIR (responses due by 16 October 2012)**

- Q1:** Do you agree with the proposed changes to the distribution rules to permit porting? Do you agree with the treatment of balances returned to the clearing member for the account of its clients? If not, please explain why.
- Q2:** Do you agree with our proposed amendments to the client money rules about discharge of client money responsibility, and amending the obligations for notification of trust (CASS 7.8)?

### **Part II – Introducing multiple client money pools (responses due by 30 November 2012)**

- Q3:** Do you agree that we should introduce multiple client money pools to facilitate porting of cleared positions?
- Q4:** Do you agree that we should make the option of multiple client money pools available to other types of investment businesses?
- Q5:** Do you think the sub-pool terms should include any further information?

- Q6:** Should firms be required to identify client money accounts in the sub-pool terms by account number or by name or both?
- Q7:** Do you think we should provide template sub-pool terms that can be completed by firms establishing new pools?
- Q8:** Do you agree with the content of the sub-pool disclosure document? Do you think it should contain any further information?
- Q9:** Should we provide a template that can be completed by firms?
- Q10:** Do you agree that clients should be given one-way notification of any material amendments to a sub-pool three months before the proposed amendment?
- Q11:** Do you agree that the surpluses from the sub-pools and the general pool, if there are any, should be used to cover any shortfalls in other pools in the manner proposed?
- Q12:** Do you agree that these benefits would result from the segregation of retail and non-retail client money?
- Q13:** Do you agree that these benefits would result from the segregation of business into margined and non-margined business?
- Q14:** Do you think we should mandate the division of client money on this basis? If not, why not?
- Q15:** If we were to mandate the division of client money into sub-pools (for example, a pool for retail client money and a pool for non-retail client money) do you agree that we should also allow firms to create further sub-pools within each? If not, why not?

- Q16:** Do you think that any mandating of certain client money pools should be dependent on complexity, size of client money holding and/or type of firm? (For example, should we mandate segregation only for investment banks or large brokers?)
- Q17:** Do you think there is a way of dividing client money into more than one pool that delivers greater net benefits for firms and clients?
- Q18:** Should we incentivise the use of sub-pools by requiring firms to notify their clients of the risks associated with the general client money pool and the sub-pool options available?
- Q19:** Do you agree that the existing concept of designated client bank accounts and their use in a secondary pooling event should remain unchanged?

### **Cost benefit analysis and compatibility statement – questions relate to Part II (responses due by 30 November 2012)**

- Q29:** Are the costs for establishing multiple pools realistic? Please provide any explanations or quantitative evidence you have to support your view.
- Q30:** What are your views on the benefits and costs of the policy measures to mandate certain pools?

### **Part III – Client Assets Regime: achieving better results (response due by 30 November 2012)**

- Q20:** Do you agree it is important to have speedy return of client assets following a firm's insolvency? Please explain your answer.
- Q21:** Does the status quo strike the right balance between speed and accuracy? Please explain your answer.

- Q22:** Given the potential trade off between costs and speed, how fast do you think client assets should be returned to retail clients following an insolvency and, as a percentage, what loss should a retail client be prepared to incur to have client assets back in that time period?
- Q23:** Given the potential trade off between costs and speed, how fast do you think client assets should be returned to wholesale clients following an insolvency and, as a percentage, what loss should a wholesale client be prepared to incur to have client assets back in that time period?
- Q24:** Should retail clients and wholesale clients be treated differently in respect of client assets protection and distribution? Please explain your answer.
- Q25:** Are there any other impediments that impact on the speed of return of client assets not identified above?
- Q26:** Are there any other potential measures (not identified above) that you think should be considered to increase the speed of return of client assets?
- Q27:** Are there any other potential measures (not identified above) that you think should be considered to reduce the market impact of an insolvency of a firm that holds client assets?
- Q28:** Are there any other potential measures (not identified above) that you think should be considered to achieve a greater return of client assets?

## Appendix 1

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# Draft Handbook text – Part I

## CLIENT ASSETS SOURCEBOOK (PORTING) INSTRUMENT 2012

### Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000:
- (1) section 138 (General rule-making power);
  - (2) section 139 (Miscellaneous ancillary matters);
  - (3) section 156 (General supplementary powers); and
  - (4) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

### Commencement

- C. This instrument comes into force on [•] 2013.

### Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Client Assets sourcebook (CASS) is amended in accordance with Annex B to this instrument.

### Citation

- F. This instrument may be cited as the Client Assets Sourcebook (Porting) Instrument 2012.

By order of the Board  
[date]

## Annex A

### Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Insert the following new definitions in the appropriate alphabetical order. The text is not underlined.

*authorised central counterparty* a CCP authorised under *EMIR*.

*CCP* a legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer, as defined in article 2(1) of *EMIR*.

*EMIR* Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories also known as the European Markets Infrastructure Regulation.

*individual client account* a *client transaction account* maintained by a *firm* with an *authorised central counterparty* for a *client* of the *firm* in respect of which the *authorised central counterparty* provides *individual client segregation*.

*individual client segregation* as defined in article 39(3) of *EMIR*.

*omnibus client account* a *client transaction account* maintained by a *firm* with an *authorised central counterparty* for more than one *client* of the *firm* in respect of which the *authorised central counterparty* provides *omnibus client segregation*.

*omnibus client segregation* as defined in article 39(2) of *EMIR*.

*porting* means, in respect of the assets and positions recorded in a *client transaction account* in the name of the *firm* at an *authorised central counterparty*, the transfer of those assets and positions by that *authorised central counterparty* in accordance with article 48 of *EMIR* to another clearing member designated by the *individual client* (in the case of an *individual client account*) or designated by all of the *clients* for whom the account is held (in the case of an *omnibus client account*).

Amend the following as shown.

*clearing house* a clearing house through which transactions may be cleared and for the

purposes of CASS 7 and CASS 7A, includes a CCP.



## Annex B

## Amendments to the Client Assets sourcebook (CASS)

In this Annex, underlining indicates new text and striking through indicates deleted text.

## 7 Client money rules

...

### 7.2 Definition of client money

...

- 7.2.5 G Where a *firm* has received full title or full ownership to *money* under a collateral arrangement, the fact that it has also ~~taken~~ granted a security interest over its obligation to repay that *money* to the *client* would not result in the *money* being *client money*. This can be compared to a situation in which a *firm* ~~takes~~ grants a charge or other security interest over *money* held in a *client bank account*, where that *money* would still be *client money* as there would be no absolute transfer of title to the *firm*. However, ~~if that~~ where a *firm* has received *client money* under a security interest and the security interest includes a “right to use arrangement”, under which the *client* agrees to transfer all of its rights to *money* in that account to the *firm* upon the exercise of the right to use, the *money* may cease to be *client money*, but only once the right to use is exercised and the *money* is transferred out of the ~~account~~ *client bank account* to the *firm*.

...

#### Discharge of fiduciary duty

- 7.2.15 R *Money ceases to be client money (having regard to CASS 7.2.17R where applicable) if it is paid:*
- (1) *it is paid* to the *client*, or a duly authorised representative of the *client*; or
  - (2) *it is paid* to a third party on the instruction of the *client*, unless it is transferred to a third party in the course of effecting a transaction, in accordance with CASS 7.5.2R (Transfer of client money to a third party); or
  - (3) *it is paid* into a bank account of the *client* (not being an account which is also in the name of the *firm*); or
  - (4) ~~*to the firm itself, when*~~ *it is due and payable to the firm (see in accordance with CASS 7.2.9R (Money due and payable to the firm);*  
or

- (5) it is paid to the firm itself, when it is as an excess in the client bank account (see CASS 7.6.13R(2) (Reconciliation discrepancies)); or
- (6) it is ported by an authorised central counterparty in accordance with CASS 7.2.15AR; or
- (7) it is paid directly to the client by an authorised central counterparty in accordance with CASS 7.2.15BR.

7.2.15A R Client money received or held by the firm and placed in a client transaction account with an authorised central counterparty ceases to be client money for that firm if, as part of the default management process of that authorised central counterparty in respect of a default by the firm, it is ported by the authorised central counterparty in accordance with article 48 of EMIR.

7.2.15B R Client money received or held by the firm and placed in a client transaction account with an authorised central counterparty ceases to be client money if, as part of the default management process of that authorised central counterparty in respect of a default by the firm, it is paid directly to the client by the authorised central counterparty in accordance with article 48 of EMIR.

...

## **7.5 Transfer of client money to a third party**

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7.5.3 G A Unless required by law, a firm should not hold excess client money in its client transaction accounts with intermediate brokers, settlement agents and OTC counterparties; it should be held in a client bank account. For example, under article 39 of EMIR, if a client opts for individual client segregation, any margin in excess of the client's requirement is to be posted to the authorised central counterparty.

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## **7.8 Notification and acknowledgement of trust**

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Exchanges, clearing houses, intermediary brokers or OTC counterparties

7.8.2 R Subject to CASS 7.8.3R:

- (1) A a firm which undertakes any contingent liability investment for clients through an exchange, clearing house, intermediate broker or OTC counterparty must, before the client transaction account is opened with the exchange, clearing house, intermediate broker or OTC counterparty:

- (a) notify the *person* with whom the account is to be opened that the *firm* is under an obligation to keep *client money* separate from the *firm's* own *money*, placing *client money* in a *client bank account*;
  - (b) instruct the *person* with whom the account is to be opened that any *money* paid to it in respect of that transaction is to be credited to the *firm's client transaction account*; and
  - (c) require the person with whom the account is to be opened to acknowledge in writing that the *firm's client transaction account* is not to be combined with any other account, nor is any right of set-off to be exercised by that *person* against *money* credited to the *client transaction account* in respect of any sum owed to that person on any other account.
- (2) If the exchange, *clearing house*, *intermediate broker* or *OTC* counterparty does not provide the required acknowledgement within 20 *business days* of the dispatch of the notice and instruction, the *firm* must cease using the *client transaction account* with that *broker* or counterparty and arrange as soon as possible for the transfer or liquidation of any open positions and the repayment of any *money*.  
~~31/12/2008 is the last day this material was in force~~

7.8.3     **R**     If a *firm*:

- (1) undertakes a *contingent liability investment* for its *client* through an *authorised central counterparty*;
- (2) intends to use *client money* to meet that *client's* obligation to provide margin for the *contingent liability investment*; and
- (3) arranges for either *omnibus client segregation* or *individual client segregation* at the *authorised central counterparty*;

then the *firm* must, before the *client transaction account* is opened, notify that *authorised central counterparty* that the money to be held by the *firm* as trustee in the relevant *client transaction account* is held for and on behalf of the *firm's clients* and is not to be combined with any other account, nor is any right of set-off to be exercised by that *authorised central counterparty* against *money* credited to the relevant *client transaction account* in respect of any sum owed on any other account, but the *firm* is not required to obtain an acknowledgement of such terms from that *authorised central counterparty*.

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**7A**     **Client money distribution**

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## 7A.2 Primary pooling events

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### Pooling and distribution

7A.2.4 R If a *primary pooling event* occurs:

- (1) all client money held in each client money account of the firm is treated as pooled (forming a notional pool) except for client money held in a client transaction account at an authorised central counterparty; and
- (2) the firm must distribute that client money comprising the notional pool in accordance with CASS 7.7.2R, so that each client receives a sum which is rateable to the client money entitlement calculated in accordance with CASS 7A.2.5R; and
- (3) if client money is remitted directly to the firm from an authorised central counterparty, then:
  - (a) any such remittance in respect of an individual client account must be distributed to the relevant client subject to CASS 7.7.2R(4); and
  - (b) any such remittance in respect of an omnibus client account must form part of the notional pool under CASS 7A.2.4(R)(1), subject to distribution in accordance with CASS 7A.2.4R(2).

7A.2.4A G (1) Under EMIR, where a firm that is a clearing member of an authorised central counterparty defaults, the authorised central counterparty may:

- (a) port client positions where possible;
- (b) liquidate positions, and
  - (i) return any balance due directly to those clients for whom the positions are held, if they are known to the authorised central counterparty; or
  - (ii) remit the balance to the firm for the account of its clients if the clients are not known to the authorised central counterparty.

Where the money remitted directly from an authorised central counterparty to a firm is client money, CASS 7A.2.4R(3) provides for the distribution of remittances from either an individual client account or an omnibus client account.

- (2) Remittances received by the firm falling within CASS 7A.2.4R(3)(a) should not be pooled with client money held in any client bank

account operated by the firm at the time of the primary pooling event. Those remittances should be segregated and promptly distributed to the individual client on whose behalf the individual client account was held.

- (3) The firm's obligation to its client in respect of client money held in a client transaction account at an authorised central counterparty is discharged where the authorised central counterparty either transfers that client money as part of porting the client's positions in accordance with CASS 7.2.15R(6) or, if applicable, returns it directly to the client, in accordance with CASS 7.2.15R(7).

...

- 7A.2.6 G Without prejudice to any claim of a client on whose behalf the firm has received client money from an authorised central counterparty in respect of an individual client account, a client's main claim is for the return of client money held in a client bank account. A client may be able to claim for any shortfall against money held in a firm's own account. For that claim, the client will be an unsecured creditor of the firm.

Client money received after failure of the firm

- 7A.2.7 R Client money received by the firm after a primary pooling event from a person other than an authorised central counterparty must not be pooled with client money held in any client money account operated by the firm at the time of the primary pooling event. It must be placed in a client bank account that has been opened after that event and must be handled in accordance with the client money rules, and returned to the relevant client without delay, except to the extent that:

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## Appendix 2

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# Draft Handbook text – Part II

**CLIENT ASSETS SOURCEBOOK (OPTIONAL MULTIPLE SUB-POOLS)  
INSTRUMENT 2012**

**Powers exercised**

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
  - (2) section 139 (Miscellaneous ancillary matters);
  - (3) section 156 (General supplementary powers); and
  - (4) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

**Commencement**

- C. This instrument comes into force on [•] 2013.

**Amendments to the Handbook**

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Client Assets sourcebook (CASS) is amended in accordance with Annex B to this instrument.

**Citation**

- F. This instrument may be cited as the Client Assets Sourcebook (Optional Multiple Sub-Pools) Instrument 2012.

By order of the Board  
[date]



## Annex A

### Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Insert the following new definitions in the appropriate alphabetical order. The text is not underlined.

*authorised central counterparty* a CCP authorised under *EMIR*.

*CCP* a legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer, as defined in article 2(1) of *EMIR*.

*EMIR* Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories, also known as the European Markets Infrastructure Regulation.

*general pool* a legally discrete pool of *client money* held for all those *clients* of the *firm* for whom the *firm* receives or holds *client money* other than in respect of a *sub-pool*.

*individual client account* a *client transaction account* maintained by a *firm* with an *authorised central counterparty* for a *client* of the *firm* in respect of which the *authorised central counterparty* provides *individual client segregation*.

*individual client segregation* as defined in article 39(3) of *EMIR*.

*omnibus client account* a *client transaction account* maintained by a *firm* with an *authorised central counterparty* for more than one *client* of the *firm* in respect of which the *authorised central counterparty* provides *omnibus client segregation*.

*omnibus client segregation* as defined in article 39(2) of *EMIR*.

*pool* either a *sub-pool* or a *general pool* as the context requires.

*porting* means, in respect of the assets and positions recorded in a *client transaction account* in the name of the *firm* at an *authorised central counterparty*, the transfer of those assets and positions by that *authorised central counterparty* in accordance with article 48 of *EMIR* to another clearing member designated by the *individual client* (in the case of an *individual client account*) or designated by all of the *clients* for whom the account is held (in the case of an *omnibus client account*).

<i>sub-pool</i>	a discrete pool of <i>client money</i> established pursuant to <i>sub-pool terms</i> in accordance with CASS 7.10.
<i>sub-pool disclosure document</i>	a document prepared by a <i>firm</i> containing the information required by CASS 7.10.13R.
<i>sub-pool terms</i>	a set of terms which satisfy the requirements of CASS 7.10.5R; in summary, a set of terms applicable to a <i>sub-pool</i> which: <ul style="list-style-type: none"> <li>(a) identify that <i>sub-pool</i>;</li> <li>(b) identify the beneficiaries of that <i>sub-pool</i>;</li> <li>(c) identify the <i>client bank accounts</i> and /or <i>client transaction accounts</i> in which <i>client money</i> is held or received in respect of that <i>sub-pool</i>; and</li> <li>(d) if applicable, direct the <i>firm</i> to use its reasonable efforts to effect <i>porting</i> of the assets and positions held for the beneficiaries of that <i>sub-pool</i>.</li> </ul>

Amend the following definitions as shown.

<i>clearing house</i>	a clearing house through which transactions may be cleared <u>and for the purposes of CASS 7 and CASS 7A, includes a CCP.</u>
<i>client money rules</i>	(1) [deleted]; (2) (in CASS 5) CASS 5.1 to CASS 5.5; (3) (in CASS 3, CASS 6, CASS 7, CASS 7A, UPRU and COBS) CASS 7.1 to 7.8 <u>and 7.10.</u>

## Annex B

### Amendments to the Client Assets sourcebook (CASS)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

#### 7 Client money rules

##### 7.2 Definition of client money

...

- 7.2.15 R *Money ceases to be client money (having regard to CASS 7.2.17R where applicable) if ~~it is paid~~:*
- (1) it is paid to the *client*, or a duly authorised representative of the *client*; or
  - (2) it is paid to a third party on the instruction of the *client*, unless it is transferred to a third party in the course of effecting a transaction, in accordance with CASS 7.5.2R (Transfer of client money to a third party); or
  - (3) it is paid into a bank account of the *client* (not being an account which is also in the name of the *firm*); or
  - (4) ~~to the *firm* itself, when~~ it is due and payable to the *firm* (see in accordance with CASS 7.2.9R (Money due and payable to the firm)); or
  - (5) it is paid to the *firm* itself, ~~when it is~~ as an excess in the *client bank account* (see CASS 7.6.13R(2) (Reconciliation discrepancies)); ~~or~~
  - (6) it is ported by an authorised central counterparty in accordance with CASS 7.2.15AR; or
  - (7) it is paid directly to the *client* by an authorised central counterparty in accordance with CASS 7.2.15BR; or
  - (8) it is transferred by the *firm* to effect porting in accordance with CASS 7.2.15CR.
- 7.2.15A R *Client money received or held by the *firm* and placed in a *client transaction account with an authorised central counterparty* ceases to be *client money* for that *firm* if, as part of the default management process of that *authorised central counterparty* in respect of a default by the *firm*, it is ported by the *authorised central counterparty* in accordance with article 48 of *EMIR*.*
- 7.2.15B R *Client money received or held by the *firm* and placed in a *client transaction**

account with an authorised central counterparty ceases to be client money if, as part of the default management process of that authorised central counterparty in respect of a default by the firm, it is paid directly to the client by the authorised central counterparty in accordance with article 48 of EMIR.

- 7.2.15C R Where a firm receives or holds client money in respect of a sub-pool which is subject to sub-pool terms that provide for the transfer of client money to effect or facilitate porting by an authorised central counterparty, then the firm discharges its obligations to its client under the client money rules and the money ceases to be client money for that firm to the extent that such client money is transferred by the firm to an authorised central counterparty or a member of an authorised central counterparty to effect or facilitate porting.

...

#### 7.4 Segregation of client money

- 7.4.-1 R Where a firm establishes one or more sub-pools, the provisions of CASS 7.4 (Segregation of client money) are to be construed as being applicable to the firm's general pool and each sub-pool individually in accordance with CASS 7.10.2R and CASS 7.10.3R.

...

#### 7.5 Transfer of client money to a third party

...

- 7.5.3 G A Unless required by law, a firm should not hold excess client money in its client transaction accounts with intermediate brokers, settlement agents and OTC counterparties; it should be held in a client bank account. For example, under article 39 of EMIR, if a client opts for individual client segregation, any margin in excess of the client's requirement is to be posted to the authorised central counterparty.

...

#### 7.6 Records, accounts and reconciliations

- 7.6.-1 R Where a firm establishes one or more sub-pools, the provisions of CASS 7.6 (Records, accounts and reconciliations) are to be construed as being applicable to the firm's general pool and each sub-pool individually in accordance with CASS 7.10.2R and CASS 7.10.3R.

...

#### 7.7 Statutory trust

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- 7.7.2 R A *firm* receives and holds *client money* as trustee (or in Scotland as agent) on the following terms:
- (1) for the purposes of and on the terms of the *client money rules* and the *client money distribution rules*;
  - (2)
    - (a) where a firm maintains a *general pool* and only a *general pool* of *client money*, subject to (4), for the *clients* (other than *clients* which are *insurance undertakings* when acting as such ~~with~~ in respect of *client money* received in the course of *insurance mediation activity* and that was opted in to this chapter) for whom that *money* is held, according to their respective interests in it;
    - (b) where a *firm* has established one or more *pools of client money*, subject to (4):
      - (i) the *general pool* is for all the *clients* of the *firm* according to their respective interests in it (other than *clients* which are *insurance undertakings* when acting as such in respect of *client money* received in the course of *insurance mediation activity* and that was opted in to this chapter), for whom the *firm* receives or holds *client money* which is not received or held in respect of a *sub-pool*;
      - (ii) each *sub-pool* is for the *clients* of the *firm* (according to their respective interests) who are, in accordance with the relevant *sub-pool terms*, beneficiaries of the *sub-pool* in question, provided that where the applicable *sub-pool terms* express an intention to transfer *client money* held in respect of that *sub-pool* to facilitate *porting* by an *authorised central counterparty*, the *firm* holds that *money* for the beneficiaries of that *sub-pool* to facilitate *porting*;
      - (iii) after all valid claims in (ii) have been met in respect of a *sub-pool*, any surplus in an individual *sub-pool* will form part of the *general pool* for the *clients* who are beneficiaries of the *general pool* to the extent all valid claims under (i) are not satisfied; and
      - (iv) after all valid claims in (iii) have been met in respect of the *general pool*, any surplus in the *general pool* will be for clients of each *sub-pool* rateably according to the amount by which all valid claims of the beneficiaries of that *sub-pool* under (ii) are not satisfied;
  - (3) after all valid claims in (2) have been met, for *clients* which are *insurance undertakings* ~~with~~ in respect of *client money* received in the course of *insurance mediation activity* according to their respective interests in it;

- (4) ~~on failure of the firm~~, for the payment of the costs properly attributable to the distribution of the *client money* in accordance with (2) if such distribution takes place following the failure of the firm; and
- (5) after all valid claims and costs under (2) to (4) have been met, for the *firm* itself.

...

## 7.8 Notification and acknowledgement of trust

...

### 7.8.2 R Subject to CASS 7.8.3R:

- (1) ~~A~~ a firm which undertakes any *contingent liability investment* for *clients* through an exchange, *clearing house*, *intermediate broker* or *OTC* counterparty must, before the *client transaction account* is opened with the exchange, *clearing house*, *intermediate broker* or *OTC* counterparty:

...

...

### 7.8.3 R If a firm:

- (1) undertakes a *contingent liability investment* for its *client* through an *authorised central counterparty*;
- (2) intends to use *client money* to meet that *client's* obligation to provide margin for the *contingent liability investment*; and
- (3) arranges for either *omnibus client segregation* or *individual client segregation* at the *authorised central counterparty*;

then the *firm* must, before the *client transaction account* is opened, notify that *authorised central counterparty* that the money to be held in the relevant *client transaction account* is held for and on behalf of the *firm's* *clients* and is not to be combined with any other account, nor is any right of set-off to be exercised by that *authorised central counterparty* against money credited to the relevant *client transaction account* in respect of any sum owed on any other account, but the *firm* is not required to obtain an acknowledgement of such terms from that *authorised central counterparty*.

After CASS 7.9 insert the following new section. The text is not underlined.

## 7.10 Segregation of client money in sub-pools

- 7.10.1 G (1) Under CASS 7.7.2R(2), a *firm* acts as trustee (or in Scotland, as agent) in respect of all *client money* received or held by it for the benefit of the *clients* for whom that *client money* is held according to their respective interests.
- (2) There are circumstances in which a *firm* may wish to hold *client money* belonging to a particular *client* or a class of *clients* specifically for the benefit of that individual *client* or for the members of that class of *client*. For example, the *firm* may wish to segregate and hold *client money* to insulate certain *clients* from (or expose only those *clients* to) the risks or volatility associated with a line of business, or according to the complexity of the products offered, or where that segregation might facilitate other *client* protection, such as the *porting* of *client* positions held with an *authorised central counterparty*. To hold *client money* (that would otherwise be held in a *general pool*) for a specific *client* or class of *clients*, a *firm* may, in accordance with these rules, create one or more *sub-pools* of *client money*.
- (3) Each *sub-pool* and the *general pool* are separate *pools* of *client money*. Upon the occurrence of a *primary pooling event*, the *client money* in respect of each *pool* should be distributed rateably to the beneficiaries of that *pool* according to their respective interests under CASS 7A.2.4R.
- (4) All *client money* is received or held by the *firm* as trustee (or in Scotland, as agent) for the *clients* of the *firm*, but a *firm* may organise its affairs (with the consent of the relevant *clients*) in such a way that those *clients* need not share in a *general pool* of *client money* following a *primary pooling event*.
- 7.10.2 R A *firm* wishing to establish a *sub-pool* must:
- (1) establish and maintain adequate *internal controls* necessary to comply with the *firm's* obligations under CASS 7 both in respect of its *general pool* and each *sub-pool* that it may establish;
- (2) adopt *pool terms* in relation to each *sub-pool* and maintain and operate the *internal controls* necessary to comply with those terms;
- (3) prepare a *sub-pool disclosure document* in respect of each *sub-pool*; and
- (4) maintain, as part of the *firm's client money* records, an up-to-date list of each *sub-pool* referencing the applicable *sub-pool terms*.
- 7.10.3 R The provisions of CASS 7 apply to all *client money* received or held by a *firm*, but where a *firm* establishes one or more *sub-pools*, the provisions of CASS 7.4 (Segregation of client money) and CASS 7.6 (Records, accounts and reconciliations) are to be construed as being separately applicable in

respect of the *firm's general pool* and each *sub-pool* individually.

- 7.10.4 G A *firm* that establishes one or more *sub-pools* must establish and maintain adequate *internal controls* to conduct internal and external reconciliations in respect of each *sub-pool* and the *general pool* individually.
- 7.10.5 R The *sub-pool terms* in respect of each *sub-pool* must:
- (1) identify the *sub-pool* to which the *sub-pool terms* apply;
  - (2) be sufficient to identify at all times all and only the intended beneficiaries of the *sub-pool* either by name or other unique identifier, or according to criteria which identify at all times all and only the intended beneficiaries of the *sub-pool*;
  - (3) be sufficient to identify at all times the specific *client bank accounts* and/or *client transaction accounts* in which *client money* belonging to the beneficiaries of the relevant *sub-pool* (and only the beneficiaries of that *sub-pool*) is to be received or held; and
  - (4) contain a statement, if applicable, to the effect that the beneficiaries of that *sub-pool* direct the *firm* to use its reasonable efforts to effect *porting* of positions held for those *clients* in an account at an *authorised central counterparty*, together with a reference to the identity of the *authorised central counterparty* and the relevant account subject to *porting*.
- 7.10.6 G *Firms* may comply with CASS 7.10.5R(3) either by specifying the accounts or specify a naming convention or other method to be used by the *firm* to identify those (and only those) accounts.
- 7.10.7 G
- (1) Where a *sub-pool* is established to effect or facilitate *porting*, the *sub-pool terms* should contain a statement or indication as to how that purpose is to be effected. For example, the *sub-pool terms* should identify the *authorised central counterparty* and reference the relevant account maintained by the *firm* with that *authorised central counterparty* that is intended to be *ported*.
  - (2) *Firms* are reminded that if they wish to provide for *porting* of *client* positions referable to a net *omnibus client account* held with an *authorised central counterparty*, *porting* is more likely to be achieved if the *firm* were to establish a *sub-pool* of *client money* specifically for the benefit of the *clients* for whom the net *omnibus client account* is held (and only those *clients*).
- 7.10.8 R
- (1) A *firm* must not hold *client money* in respect of a *sub-pool* in a *client bank account* or a *client transaction account* used for holding *client money* in respect of any other *sub-pool* or the *general pool*.
  - (2) A *firm* that establishes a *sub-pool* must ensure that the name of each *client bank account* and each *client transaction account* maintained in



respect of that *sub-pool* includes a unique identifying reference or descriptor that enables the account to be identified with that *sub-pool* and that the *sub-pool terms* applicable to that *sub-pool* make reference to, or describe, that identifying reference or descriptor.

- (3) Where a *client* of the *firm* is a beneficiary of the *general pool* and wishes to become a beneficiary of a *sub-pool*, the *firm* must not transfer *client money* from a *client bank account* maintained in respect of the *general pool* to a *client bank account* maintained in respect of a *sub-pool* unless the amount of *client money* held in respect of the *general pool* is sufficient, immediately after that transfer, to satisfy the claims of all remaining beneficiaries of the *general pool*, and must conduct the necessary reconciliations in accordance with CASS 7.6 to verify compliance with this rule.

7.10.9 R Pursuant to the requirements to segregate *client money* in accordance with CASS 7.4 a *firm* operating the normal approach that receives a remittance that is part *client money* for one *pool* and part *client money* for another *pool* must:

- (1) pay the full sum into a *client bank account* in respect of one of the relevant *pools* to which the remittance relates promptly, and in any event, no later than the next *business day* after receipt; and
- (2) pay the *money* that is not *client money* in respect of that *pool* out of the *client bank account* promptly, and in any event no later than one *business day* after the day on which the *firm* would normally expect the remittance to be cleared and into a *client bank account* maintained in respect of the appropriate *pool*.

7.10.10 R Subject to the exception referred to in CASS 7.10.12R(2), a *client* for whom a *firm* receives or holds *client money* in the *general pool* has no claim to or interest in *client money* received or held in any *sub-pool* unless that client is a beneficiary of that *sub-pool* in accordance with the applicable *sub-pool terms*.

7.10.11 R A *client* for whom a *firm* receives or holds *client money* in respect of a *sub-pool* has no claim to or interest in *client money* received or held in respect of the *general pool* or any other *sub-pool* unless:

- (1) that client is a beneficiary of another *sub-pool* in accordance with the applicable *sub-pool terms*; or
- (2) the *firm* receives or holds *client money* for that *client* in respect of other business but not in respect of any other *sub-pool* (and thus the *client* is a beneficiary of the *firm's general pool*).

7.10.12 R (1) A *client* for whom a *firm* receives or holds *client money* in more than one *pool* as described in either of the cases in CASS 7.10.11R(1) or (2) has a separate and distinct claim in respect of each such *pool* in which that *client* has an interest.

- (2) A *client's* claim in respect of a *pool* is to be satisfied from, and only from, the *client money* held or received in respect of the relevant *pool*, save to the limited extent that the distribution rules in CASS 7.7.2R provide for the application of an excess in one *pool* to cover a *shortfall* in another.

7.10.13 R The *sub-pool disclosure document* must contain the following items of information:

- (1) the identity the *sub-pool* to which the disclosure relates;
- (2) a general description of the purpose for which the *sub-pool* is established;
- (3) whether the *clients* of the *sub-pool* are *retail clients* or *non-retail clients* or a mix of both;
- (4) the business line (or lines) to which the *sub-pool* relates;
- (5) the principal advantages for the *client* and principal risks to which the *client* is exposed by virtue of being a beneficiary of the *sub-pool* in question, including a description of how the *firm* expects *client money* held for the beneficiaries of the *sub-pool* to be distributed on the *failure* of the *firm*;
- (6) a description of how the beneficiaries of the *sub-pool* are to be identified at any given time together with any procedure operated by the *firm* for confirming to a *client* that it is a beneficiary of the *sub-pool* in question at any given time;
- (7) whether the *sub-pool* is intended to facilitate the transfer of *client money* to effect or facilitate *porting* by an *authorised central counterparty*; and
- (8) a statement reminding the *client* that in the event of the *firm's failure*, the beneficiaries of the *sub-pool* will have a claim against the *client money* held in respect of that *sub-pool* (according to their respective interests), but no claim on any other *pool* of *client money* save to the extent that the *client* is also a beneficiary of that other *pool* (or to the limited extent that the distribution rules in CASS 7.7.2R provide for the application of an excess in one *pool* to cover a *shortfall* in another).

7.10.14 R (1) To the extent that the *sub-pool disclosure document* includes information which also forms part of the *sub-pool terms*, the *sub-pool disclosure document* must at all times be an accurate reflection of those *sub-pool terms*.

- (2) Before making a material amendment to the *sub-pool disclosure document*, a *firm* must notify the then current beneficiaries of that *sub-pool* in accordance with CASS 7.10.20R.

- 7.10.15 G The *FSA* would normally consider an amendment to any of the items referred to in *CASS* 7.10.13R(1) to (8) to be a material amendment.
- 7.10.16 R A *firm* that wishes to establish a *sub-pool* of *client money* must notify the *FSA* in writing not less than three months prior to the date on which the *firm* intends to receive or hold *client money* in respect of that *sub-pool*. A *firm* that wishes to amend *sub-pool terms* must notify the *FSA* not less than three months prior to the *firm* implementing such amendment. Upon request, a *firm* must deliver to the *FSA* a copy of the *sub-pool terms*.
- 7.10.17 R Upon request, a *firm* must deliver to the *FSA* a copy of the *sub-pool disclosure document* in respect of any *sub-pool* established by the *firm*.
- 7.10.18 R (1) Before receiving or holding *client money* for a *client* in relation to a *sub-pool*, a *firm* must
- (a) provide to the *client* a copy of the *sub-pool disclosure document* applicable to that *sub-pool*;
  - (b) obtain a written acknowledgement from the *client* that it has received a copy of the applicable *sub-pool disclosure document*; and
  - (c) obtain the written consent of the *client* to the *firm* receiving and holding that *client's* money in the relevant *sub-pool*.
- (2) A *firm* must provide the beneficiary of a *sub-pool* with a copy of the *sub-pool disclosure document* applicable to that *sub-pool* upon the beneficiary's request.
- 7.10.19 R A *sub-pool* may become part of the *firm's* *general pool*, and a *sub-pool* may merge with another *sub-pool* to form a single separate *sub-pool*, if, in either case, the *firm*:
- (1) provides written disclosure to the beneficiaries of the *sub-pool* (or *sub-pools*) in question setting out the risks and consequences for the beneficiaries of that *sub-pool* becoming part of the *general pool* or merging with another *sub-pool*;
  - (2) notifies all the beneficiaries of the relevant *sub-pool* (or *sub-pools*) in accordance with *CASS* 7.10.20R;
  - (3) amends the *sub-pool terms* (where applicable) to reflect the information required under *CASS* 7.10.5R in respect of any *sub-pool* resulting from a merger of *sub-pools*; and
  - (4) amends the applicable *sub-pool terms* to reflect the date on which the merger is to become effective and notifies the *FSA* in accordance with *CASS* 7.10.16R.
- 7.10.20 R (1) If a *firm* is required to give notice under either:

- (a) CASS 7.10.14R(2) (material amendment to sub-pool disclosure document); or
- (b) CASS 7.10.19R (merger of pools);

it must give written notice to the *clients* affected by such a proposal no later than three months before the date on which the proposal is to take effect.

(2) The notification must:

- (a) explain the proposal fully;
- (b) state that the *client* will be deemed to have accepted the proposal and the proposal will be carried out by the *firm* if the *client* does not, before the proposed date of implementation of the amendments or the merging of pools (as the case may be), notify the *firm* that it wishes to terminate its *client* relationship with the *firm* in respect of the relevant *pool* in accordance with (c); and
- (c) state that the *client* has the right to terminate its *client* relationship with the *firm* in respect of the relevant *pool* immediately and without charge before the proposed date of implementation of the proposals, but subject to settling any loss or gain on any *investments* held by the *firm* on the *client's* behalf to the extent that such *investments* are liquidated as part of terminating that *client* relationship.

7.10.21 R *Sub-pool terms* are a record of the *firm* that must be kept in a durable medium for a period of not less than 5 years following the date on which *client money* was last held by the *firm* in relation to a *sub-pool* to which those terms applied.

7.10.22 R A *firm* must inform the *FSA* in writing without delay if it has not complied with the requirement to give notice in accordance with CASS 7.10.14R or has not complied with any of the requirements in CASS 7.10.18R.

Amend the following as shown.

**7A Client money distribution**

...

**7A.2 Primary pooling events**

...

Pooling and distribution

- 7A.2.4 R If a *primary pooling event* occurs, then:
- (1) in respect of either the *general pool* or a *sub-pool*, *client money* held in each ~~*client money*~~ account in each account of the *firm* relating to that *pool* is treated as ~~pooled~~ a single notional *pool* of *client money* for the beneficiaries of that *pool*, but excluding from that notional *pool*, *client money* held in *client transaction accounts* at an *authorised central counterparty*; ~~and~~
  - (2) the *firm* must distribute that *client money* comprising the notional *pool* in accordance with CASS 7.7.2R, so that each ~~*client*~~:
    - (a) each *client* who is a beneficiary of that *pool* receives a sum which is rateable to the *client money* entitlement calculated in accordance with CASS 7A.2.5R; or
    - (b) (where applicable) *client money* comprising that *pool* is transferred by the *firm* to effect or facilitate *porting of positions* held for the *clients* who are beneficiaries of that *pool*; and
  - (3) if *client money* is remitted directly to the *firm* from an *authorised central counterparty*, then:
    - (a) any such remittance in respect of an *individual client account* is to be promptly distributed to the relevant *client*, subject to CASS 7.7.2 R (4); and
    - (b) any such remittance in respect of an *omnibus client account* is to form part of the *firm's general pool* to be distributed in accordance with CASS 7A.2.4R(2), unless the remittance is in respect of an *omnibus client account* linked to a *sub-pool*, in which case that remittance is to form part of that *sub-pool* to be distributed in accordance with CASS 7A.2.4R(2).
- 7A.2.4A G (1) Under *EMIR*, where a *firm* that is a clearing member of an *authorised central counterparty* defaults, the *authorised central counterparty* may:
- (a) *port client* positions where possible;
  - (b) liquidate positions and
    - (i) return any balance due directly to those *clients* for whom the positions are held, if they are known to the *authorised central counterparty*; or
    - (ii) remit the balance to the *firm* for the account of its *clients* if the clients are not known to the *authorised central counterparty*.

Where the money remitted directly from an *authorised central*

counterparty to a firm is client money, CASS 7A.2.4R(3) provides for the distribution of remittances from an individual client account or an omnibus client account.

- (2) Remittances received by the firm in accordance with CASS 7A.2.4R(3)(a) should not be pooled with client money held in any client bank account operated by the firm at the time of the primary pooling event. Those remittances should be segregated and promptly distributed to the individual client on whose behalf the individual client account was held.
- (3) The firm's obligation to its client in respect of client money held in a client transaction account at an authorised central counterparty is discharged where the authorised central counterparty either transfers that client money as part of porting the client's positions in accordance with CASS 7.2.15R(6) or, if applicable, returns it directly to the client, in accordance with CASS 7.2.15R(7).
- (4) The firm's obligation to its client in respect of client money held in a client bank account in respect of a sub-pool that is subject to sub-pool terms which provide for porting is discharged where the firm transfers that client money for that purpose in accordance with CASS 7.2.15R(8).

- 7A.2.5 R (1) When, in respect of a client who is a beneficiary of a pool, there is a positive individual *client* balance and a negative *client equity* balance, the credit must be offset against the debit reducing the individual *client* balance for that *client*.
- (2) When, in respect of a client who is a beneficiary of a pool, there is a negative individual *client* balance and a positive *client equity* balance, the credit must be offset against the debit reducing the *client equity* balance for that *client*.
- 7A.2.6 G Without prejudice to any claim of a client on whose behalf the firm has received client money from an authorised central counterparty in respect of an individual client account, a client's main claim is for the return of client money held in a client bank account. A client may be able to claim for any shortfall against money held in a firm's own account. For that claim, the client will be an unsecured creditor of the firm.

#### Client money received after failure of the firm

- 7A.2.7 R Client money received by the firm after a primary pooling event in respect of a pool from a person other than an authorised central counterparty must not be pooled with client money held in any client money account operated by the firm either in respect of that pool or any other pool at the time of the primary pooling event. It must be placed in a client bank account that has been opened after that event and must be handled in accordance with the client money rules, and returned to the relevant client without delay, except to the extent that:

...

### 7A.3 Secondary pooling events

...

7A.3.4 G When a bank *fails* and the *firm* decides not to make good the *shortfall* in the amount of *client money* held at that bank, a *secondary pooling event* will occur in accordance with CASS 7A.3.6R. The *firm* would be expected to reflect the *shortfall* that arises at the *failed* bank for the *pool* or *pools* affected in its records of the entitlement of *clients* and of *money* held with third parties.

...

7A.3.6 R If a *secondary pooling event* occurs as a result of the *failure* of a bank where one or more *general client bank accounts* are held in respect of one or more *pools*, then, in respect of each *pool*:

- (1) in relation to every *general client bank account* of the *firm* maintained in respect of that *pool*, the provisions of CASS 7A.3.8R, CASS 7A.3.13R and CASS 7A.3.14R will apply;
- (2) in relation to every *designated client bank account* held by the *firm* with the *failed* bank in respect of that *pool*, the provisions of CASS 7A.3.10R, CASS 7A.3.13R and CASS 7A.3.14R will apply;
- (3) in relation to each *designated client fund account* held by the *firm* with the *failed* bank in respect of that *pool*, the provisions of CASS 7A.3.11R, CASS 7A.3.13R and CASS 7A.3.14R will apply;
- (4) any *money* held at a bank, other than the bank that has *failed*, in *designated client bank accounts* in respect of that *pool*, is not pooled with any other *client money*; and
- (5) any *money* held in a *designated client fund account* in respect of that *pool*, no part of which is held by the bank that has *failed*, is not pooled with any other *client money* held in respect of that *pool* (or any other *pool*).

7A.3.7 R If a *secondary pooling event* occurs as a result of the *failure* of a bank where one or more *designated client bank accounts* or *designated client fund accounts* are held in respect of a *pool*, then:

- (1) in relation to every *designated client bank account* held by the *firm* with the *failed* bank in respect of that *pool*, the provisions of CASS 7A.3.10R, CASS 7A.3.13R and CASS 7A.3.14R will apply; and
- (2) in relation to each *designated client fund account* held by the *firm* with the *failed* bank in respect of that *pool*, the provisions of CASS 7A.3.11R, CASS 7A.3.13R and CASS 7A.3.14R will apply.

- 7A.3.8 R *Money held in each general client bank account and client transaction account of the firm must be treated as pooled and:*
- (1) any *shortfall* in *client money* held, or which should have been held, in *general client bank accounts* in respect of that pool and *client transaction accounts*, that has arisen as a result of the *failure* of the bank, must be borne by all the *clients* of that pool whose *client money* is held in either a *general client bank account* or *client transaction account* of the *firm*, rateably in accordance with their entitlements;
  - (2) a new *client money* entitlement must be calculated for each *client* of that pool by the *firm*, to reflect the requirements in (1), and the *firm's* records must be amended to reflect the reduced *client money* entitlement;
  - (3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed* bank until the *client* is repaid; and
  - (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), for the purposes of reconciliations pursuant to CASS 7.6.2R (Records and accounts) in respect of that pool, and where relevant SYSC 4.1.1R (General organisational requirements) and SYSC 6.1.1R (Compliance).

...

- 7A.3.10 R For each *client* with a *designated client bank account* maintained by the firm in respect of a pool and held at the *failed* bank:
- (1) any *shortfall* in *client money* held, or which should have been held, in *designated client bank accounts* for specific clients of that pool that has arisen as a result of the *failure*, must be borne by all the *clients* of that pool whose *client money* is held in a *designated client bank account* of the *firm* at the *failed* bank, rateably in accordance with their entitlements;
  - (2) a new *client money* entitlement must be calculated for each of the relevant *clients* of that pool by the *firm*, and the *firm's* records must be amended to reflect the reduced *client money* entitlement;
  - (3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed* bank until the *client* is repaid; and
  - (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), for the purposes of reconciliations pursuant to CASS 7.6.2R (Records and accounts) in respect of that pool, and where relevant SYSC 4.1.1R (General organisational requirements) and SYSC 6.1.1R (Compliance).

- 7A.3.11 R *Money held* for specific clients of a pool in each *designated client fund account* with the *failed* bank must be treated as pooled with any other



*designated client fund accounts* of the *firm* which contain part of the same designated fund and:

- (1) any *shortfall* in *client money* held, or which should have been held, in *designated client fund accounts* in respect of that *pool* that has arisen as a result of the *failure*, must be borne by each of the *clients* of that *pool* whose *client money* is held in that designated fund, rateably in accordance with their entitlements;
- (2) a new *client money* entitlement must be calculated for each *client* of that *pool* by the *firm*, in accordance with (1), and the *firm's* records must be amended to reflect the reduced *client money* entitlement;
- (3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed* bank until the *client* is repaid; and
- (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), for the purposes of reconciliations pursuant to CASS 7.6.2R (Records and accounts) in respect of that *pool*, and where relevant SYSC 4.1.1R (General organisational requirements) and SYSC 6.1.1R (Compliance).

...

#### Client money received after the failure of a bank

7A.3.13 R *Client money* received by the *firm* after the failure of a bank, that would otherwise have been paid into a *client bank account* at that bank in respect of a *pool*:

...

7A.3.14 R If a *firm* receives a *mixed remittance* after the *secondary pooling event* for the beneficiaries of a *pool* which consists of *client money* that would have been paid into a *general client bank account*, a *designated client bank account* or a *designated client fund account* maintained at the bank that has *failed*, it must:

- (1) pay the full sum into a *client bank account* other than one operated at the bank that has *failed* for the beneficiaries of that *pool*; and

...

...

#### Failure of an intermediate broker, settlement agent or OTC counterparty: Pooling

7A.3.16 R If a *secondary pooling event* occurs as a result of the *failure* of an *intermediate broker*, *settlement agent* or *OTC counterparty*, then in relation to every *general client bank account* and *client transaction account* of the *firm* maintained in respect of a *pool*, the provisions of CASS 7A.3.17R and

CASS 7A.3.18R will apply.

7A.3.17 R *Money held in each general client bank account and client transaction account of the firm for the clients of a pool must be treated as pooled and:*

- (1) any *shortfall* in *client money* held, or which should have been held, in *general client bank accounts* and *client transaction accounts* in respect of that pool, that has arisen as a result of the *failure*, must be borne by all the *clients of that pool* whose *client money* is held in either a *general client bank account* or a *client transaction account* of the *firm*, rateably in accordance with their entitlements;
- (2) a new *client money* entitlement must be calculated for each *client* who is a beneficiary of that pool by the *firm*, to reflect the requirements of (1), and the *firm's* records must be amended to reflect the reduced *client money* entitlement;

...

Client money received after the failure of an intermediate broker, settlement agent or OTC counterparty

7A.3.18 R *Client money* received by the *firm* after the *failure* of an *intermediate broker*, *settlement agent* or *OTC counterparty*, that would otherwise have been paid into a *client transaction account* at that *intermediate broker*, *settlement agent* or *OTC counterparty* in respect of the relevant pool:

...

...

## Schedule 1 Record keeping requirements

...

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
...				
CASS 7.6.7R	...			
CASS 7.10.21R	<i>Sub-pool terms</i>	Details required under CASS 7.10.5R	Prior to establishing relevant <i>sub-pool</i>	5 years following the date on which <i>client money</i> was last held by the <i>firm</i> in relation to a <i>sub-pool</i> to which those terms

				applied
...				

...

## Schedule 2 Notification requirements

...

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
...				
CASS 7.6.16R(2)	...			
CASS 7.10.16R	Establishment of <i>sub-pool</i> or amendment of <i>sub-pool terms</i>	Written notice that the <i>firm</i> intends to receive or hold <i>client money</i> in respect of a <i>sub-pool</i> or to amend <i>sub-pool terms</i>	The <i>firm</i> intending to establish a <i>sub-pool</i> or amend <i>sub-pool terms</i>	No later than 3 months prior to the date on which the <i>firm</i> intends to receive or hold <i>client money</i> in respect of a <i>sub-pool</i> or prior to the date of implementation of an amendment to <i>sub-pool terms</i>
CASS 7.10.17R	Copy of <i>sub-pool disclosure document</i>	The relevant <i>sub-pool disclosure document</i>	Request by the FSA	As soon as reasonably practicable
CASS 7.10.19R(3) and (4)	Amendment of <i>sub-pool terms</i>	Written notice that the <i>firm</i> intends to amend <i>sub-pool terms</i>	The <i>firm</i> intending to amend <i>sub-pool terms</i>	No later than 3 months prior to the date of implementation of an amendment to <i>sub-pool terms</i>
CASS 7.10.22R	Non-compliance with the requirements in CASS 7.10.14R (notification to beneficiaries of amendments to the <i>sub-pool disclosure document</i> ) or	The fact that the <i>firm</i> has not complied with the requirements of CASS 7.10.14R or CASS 7.10.18R (as applicable)	Non-compliance with the applicable requirement	Without delay

	CASS 7.10.18R (providing a copy of the <i>sub-pool disclosure document</i> to clients, obtaining acknowledgement from <i>client</i> and obtaining consent of <i>client</i> )			
...				

## CLIENT ASSETS SOURCEBOOK (MANDATORY POOLS) INSTRUMENT 2012

### Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
  - (2) section 139 (Miscellaneous ancillary matters);
  - (3) section 156 (General supplementary powers); and
  - (4) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

### Commencement

- C. This instrument comes into force on [•] 2013.

### Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Client Assets sourcebook (CASS) is amended in accordance with Annex B to this instrument.

### Citation

- F. This instrument may be cited as the Client Assets Sourcebook (Mandatory Pools) Instrument 2012.

By order of the Board  
[date]

## Annex A

## Amendments to the Glossary of definitions

Insert the following new definitions in the appropriate alphabetical order. The text is not underlined.

<i>authorised central counterparty</i>	a CCP authorised under <i>EMIR</i> .
<i>CCP</i>	a legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer, as defined in article 2(1) of <i>EMIR</i> .
<i>EMIR</i>	Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories, also known as the European Markets Infrastructure Regulation.
<i>general non-retail pool</i>	a discrete pool of <i>client money</i> held for all the <i>clients</i> of the <i>firm</i> other than <i>retail clients</i> .
<i>general retail pool</i>	a discrete pool of <i>client money</i> held for all the <i>retail clients</i> of the <i>firm</i> .
<i>individual client account</i>	a <i>client transaction account</i> maintained by a <i>firm</i> with an <i>authorised central counterparty</i> for a <i>client</i> of the <i>firm</i> in respect of which the <i>authorised central counterparty</i> provides <i>individual client segregation</i> .
<i>individual client segregation</i>	as defined in article 39(3) of <i>EMIR</i> .
<i>omnibus client account</i>	a <i>client transaction account</i> maintained by a <i>firm</i> with an <i>authorised central counterparty</i> for more than one <i>client</i> of the <i>firm</i> in respect of which the <i>authorised central counterparty</i> provides <i>omnibus client segregation</i> .
<i>omnibus client segregation</i>	as defined in article 39(2) of <i>EMIR</i> .
<i>pool</i>	(in <i>CASS 7</i> and <i>CASS 7A</i> ) either the <i>general retail pool</i> or the <i>general non-retail pool</i> as the context requires.
<i>porting</i>	means, in respect of the assets and positions recorded in a <i>client transaction account</i> in the name of the <i>firm</i> at an <i>authorised central counterparty</i> , the transfer of those assets and positions by that <i>authorised central counterparty</i> in accordance with article 48 of <i>EMIR</i> to another clearing member designated by the individual <i>client</i> (in the case of an <i>individual client account</i> ) or designated by all of the <i>clients</i> for whom the account is held (in the case of an <i>omnibus client account</i> ).

## Annex B

## Amendments to the Client Assets sourcebook (CASS)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

## 7 Client money rules

...

... Discharge of fiduciary duty

- 7.2.15 R *Money ceases to be client money (having regard to CASS 7.2.17R where applicable) if ~~it is paid~~:*
- (1) it is paid to the *client*, or a duly authorised representative of the *client*; or
  - (2) it is paid to a third party on the instruction of the *client*, unless it is transferred to a third party in the course of effecting a transaction, in accordance with CASS 7.5.2R (Transfer of client money to a third party); or
  - (3) it is paid into a bank account of the *client* (not being an account which is also in the name of the *firm*); or
  - (4) ~~to the *firm* itself, when~~ it is due and payable to the *firm* (see in accordance with CASS 7.2.9R (Money due and payable to the firm)); or
  - (5) it is paid to the *firm* itself, ~~when it is~~ as an excess in the *client bank account* (see CASS 7.6.13R(2) (Reconciliation discrepancies)); ~~or~~
  - (6) it is ported by an authorised central counterparty in accordance with CASS 7.2.15AR; or
  - (7) it is paid directly to the *client* by an authorised central counterparty in accordance with CASS 7.2.15BR.
- 7.2.15A R *Client money received or held by the *firm* and placed in a *client transaction account* with an authorised central counterparty ceases to be *client money* for that *firm* if, as part of the default management process of that authorised central counterparty in respect of a default by the *firm*, it is ported by the authorised central counterparty in accordance with article 48 of EMIR.*
- 7.2.15B R *Client money received or held by the *firm* and placed in a *client transaction account* with an authorised central counterparty ceases to be *client money* if, as part of the default management process of that authorised central counterparty in respect of a default by the *firm*, it is paid directly to the*



client by the authorised central counterparty in accordance with article 48 of EMIR.

...

#### 7.4 Segregation of client money

7.4.-1 R Where a firm establishes a general retail pool and a general non-retail pool, the provisions of CASS 7.4 (Segregation of client money) are to be construed as being applicable to each pool individually in accordance with CASS 7.11.4R and CASS 7.11.5R.

...

#### 7.5 Transfer of client money to a third party

...

7.5.3 G ~~A~~ Unless required by law, a firm should not hold excess client money in its client transaction accounts with intermediate brokers, settlement agents and OTC counterparties; it should be held in a client bank account. For example, under article 39 of EMIR, if a client opts for individual client segregation, any margin in excess of the client's requirement is to be posted to the authorised central counterparty.

...

#### 7.6 Records, accounts and reconciliations

7.6.-1 R Where a firm establishes a general retail pool and a general non-retail pool, the provisions of CASS 7.6 (Records, accounts and reconciliations) are to be construed as being applicable to each pool individually in accordance with CASS 7.11.4R and CASS 7.11.5R.

...

#### 7.7 Statutory trust

...

7.7.2 R A firm receives and holds client money as trustee (or in Scotland as agent) on the following terms:

- (1) for the purposes of and on the terms of the *client money rules* and the *client money distribution rules*;
- (2) (a) where a firm maintains a general retail pool of client money, subject to (4), for the retail clients of the firm (other than clients which are insurance undertakings when acting as such with respect of client money received in the course of insurance mediation activity and that was opted in to this chapter) for whom that money is held, according to their respective interests

in it;

- (b) where a firm maintains a general non-retail pool of client money, subject to (4), for the clients of the firm other than its retail clients (other than clients which are insurance undertakings when acting as such in respect of client money received in the course of insurance mediation activity and that was opted in to this chapter) according to their respective interests in it;
- (3) after all valid claims in (2) have been met, for *clients* which are *insurance undertakings* ~~with in~~ respect of *client money* received in the course of *insurance mediation activity* according to their respective interests in it;
- (4) ~~on failure of the firm,~~ for the payment of the costs properly attributable to the distribution of the *client money* in accordance with (2) if such distribution takes place following the failure of the firm; and
- (5) after all valid claims and costs under (2) to (4) have been met, for the *firm* itself.

...

## 7.8 Notification and acknowledgement of trust

...

Exchanges, clearing houses, intermediary brokers or OTC counterparties

### 7.8.2 R Subject to CASS 7.8.3R:

- (1) ~~A~~ a *firm* which undertakes any *contingent liability investment* for *clients* through an exchange, *clearing house*, *intermediate broker* or *OTC* counterparty must, before the *client transaction account* is opened with the exchange, *clearing house*, *intermediate broker* or *OTC* counterparty:
  - (a) notify the *person* with whom the account is to be opened that the *firm* is under an obligation to keep *client money* separate from the *firm's* own *money*, placing *client money* in a *client bank account*;
  - (b) instruct the *person* with whom the account is to be opened that any *money* paid to it in respect of that transaction is to be credited to the *firm's* *client transaction account*; and
  - (c) require the *person* with whom the account is to be opened to acknowledge in writing that the *firm's* *client transaction account* is not to be combined with any other account, nor is any right of set-off to be exercised by that *person* against *money* credited to the *client transaction account* in respect of

any sum owed to that person on any other account.

- (2) If the exchange, *clearing house*, *intermediate broker* or *OTC* counterparty does not provide the required acknowledgement within 20 *business days* of the dispatch of the notice and instruction, the *firm* must cease using the *client transaction account* with that *broker* or counterparty and arrange as soon as possible for the transfer or liquidation of any open positions and the repayment of any *money*.

7.8.3      R      If a firm:

- (1) undertakes a *contingent liability investment* for its *client* through an *authorised central counterparty*;
- (2) intends to use *client money* to meet that *client's* obligation to provide margin for the *contingent liability investment*; and
- (3) arranges for either *omnibus client segregation* or *individual client segregation* at the *authorised central counterparty*;

then the *firm* must, before the *client transaction account* is opened, notify that *authorised central counterparty* that the money to be held in the relevant *client transaction account* is held for and on behalf of the *firm's clients* and is not to be combined with any other account, nor is any right of set-off to be exercised by that *authorised central counterparty* against *money* credited to the relevant *client transaction account* in respect of any sum owed on any other account, but the *firm* is not required to obtain an acknowledgement of such terms from that *authorised central counterparty*.

After CASS 7.10 insert the following new section. The text is not underlined.

**7.11      Mandatory segregation of retail and non-retail client money**

7.11.1      R      Where applicable, a *firm* must maintain a *general retail pool* and a *general non-retail pool*.

- 7.11.2      R      (1) A *firm* that has *retail clients* must receive or hold *client money* for those *clients* in *client bank accounts* maintained in relation to the *general retail pool*.
- (2) A *firm* that has *non-retail clients* must receive or hold *client money* for those *clients* in *client bank accounts* maintained in relation to the *general non-retail pool*.
- (3) *Client money* received or held for *retail clients* must not be held in *client bank accounts* used for holding *client money* received or held for *non-retail clients*, and *client money* received or held for *non-retail clients* must not be held in *client bank accounts* used for holding *client*

*money received or held for retail clients.*

- 7.11.3 R Pursuant to the requirements to segregate *client money* in accordance with CASS 7.4, a *firm* operating the normal approach that receives a remittance that is part *client money* for the *general retail pool* and part *client money* for the *general non-retail pool* must:
- (1) pay the full sum into a *client bank account* in respect of either the *general retail pool* or the *general non-retail pool* promptly, and in any event, no later than the next *business day* after receipt; and
  - (2) pay the *money* that is not *client money* in respect of that *pool* out of the *client bank account* promptly, and in any event, within one *business day* of the day on which the *firm* would normally expect the remittance to be cleared and into a *client bank account* maintained in respect of the other *pool*.
- 7.11.4 R A *firm* must have the systems and controls necessary to comply with the *firm's* obligations under CASS 7 in respect of each of the *general retail pool* and the *general non-retail pool*.
- 7.11.5 R The provisions of CASS 7 apply to all *client money* received or held by a *firm*, but where a *firm* establishes a *general retail pool* and a *general non-retail pool*, the provisions of CASS 7.4 (Segregation of client money) and CASS 7.6 (Records, accounts and reconciliations) are to be construed as being applicable to each *pool* individually.

Amend the following as shown.

## 7A Client money distribution

...

### 7A.2 Primary pooling events

...

Pooling and distribution

- 7A.2.4 R If a *primary pooling event* occurs, then:
- (1) in respect of either the *general retail pool* or the *general non-retail-pool*, *client money* held ~~in each *client money* account~~ in each account of the *firm* relating to that *pool* is treated as ~~pooled~~ a single notional *pool* of *client money* for the beneficiaries of that *pool*, but excluding from that notional *pool*, *client money* held in *client transaction accounts* at an *authorised central counterparty*; ~~and~~
  - (2) the *firm* must distribute ~~that~~ *client money* comprising the notional *pool* in accordance with CASS 7.7.2R, so that each *client* who is a beneficiary of that *pool* receives a sum which is rateable to the *client*

*money entitlement calculated in accordance with CASS 7A.2.5R;*

- (3) if client money is remitted directly to the firm from an authorised central counterparty, then:
- (a) any such remittance in respect of an individual client account must be promptly distributed to the relevant client, subject to CASS 7.7.2R(4); and
  - (b) any such remittance in respect of an omnibus client account must form part of the firm's general retail pool (if the omnibus client account is held in respect of retail clients), or the firm's general non-retail pool (if the omnibus client account is held in respect of clients other than retail clients) to be distributed in accordance with CASS 7A.2.4R(2).

7A.2.4A G (1) Under EMIR, where a firm that is a clearing member of an authorised central counterparty defaults, the authorised central counterparty may:

- (a) port client positions where possible;
- (b) liquidate positions; and
  - (i) return any balance due directly to those clients for whom the positions are held, if they are known to the authorised central counterparty; or
  - (ii) remit the balance to the firm for the account of its clients if the clients are not known to the authorised central counterparty.

Where the money remitted directly from an authorised central counterparty to a firm is client money, CASS 7A.2.4R(3) provides for the distribution of remittances from an individual client account or an omnibus client account.

- (2) Remittances received by the firm in accordance with CASS 7A.2.4R(3)(a) should not be pooled with client money held in any client bank account operated by the firm at the time of the primary pooling event. Those remittances should be segregated and promptly distributed to the individual client on whose behalf the individual client account was held.
- (3) The firm's obligation to its client in respect of client money held in a client transaction account at an authorised central counterparty is discharged where the authorised central counterparty transfers that client money as part of porting the client's positions in accordance with CASS 7.2.15R(6) or, if applicable, returns it directly to the client, in accordance with CASS 7.2.15R(7).

7A.2.5 R (1) When, in respect of a client who is a beneficiary of a pool, there is a positive individual client balance and a negative client equity balance,

the credit must be offset against the debit reducing the individual *client* balance for that *client*.

- (2) When, in respect of a *client* who is a beneficiary of a pool, there is a negative individual *client* balance and a positive *client equity balance*, the credit must be offset against the debit reducing the *client equity balance* for that *client*.

- 7A.2.6 G Without prejudice to any claim of a client on whose behalf the firm has received client money from an authorised central counterparty in respect of an individual client account, a client's main claim is for the return of client money held in a client bank account. A client may be able to claim for any shortfall against money held in a firm's own account. For that claim, the client will be an unsecured creditor of the firm.

Client money received after failure of the firm

- 7A.2.7 R Client money received by the firm after a primary pooling event in respect of a pool from a person other than an authorised central counterparty must not be pooled with client money held in any client money account operated by the firm either in respect of that pool or any other pool at the time of the primary pooling event. It must be placed in a client bank account that has been opened after that event and must be handled in accordance with the client money rules, and returned to the relevant client without delay, except to the extent that:

...

...

### 7A.3 Secondary pooling events

...

- 7A.3.4 G When a bank *fails* and the *firm* decides not to make good the *shortfall* in the amount of *client money* held at that bank, a *secondary pooling event* will occur in accordance with CASS 7A.3.6R. The *firm* would be expected to reflect the *shortfall* that arises at the *failed bank* for the pool or pools affected in its records of the entitlement of *clients* and of *money* held with third parties.

...

- 7A.3.6 R If a *secondary pooling event* occurs as a result of the *failure* of a bank where one or more *general client bank accounts* are held in respect of one or more pools, then, in respect of each pool:

- (1) in relation to every *general client bank account* of the *firm* maintained in respect of that pool, the provisions of CASS 7A.3.8R, CASS 7A.3.13R and CASS 7A.3.14R will apply;

- (2) in relation to every *designated client bank account* held by the *firm* with the *failed bank* in respect of that *pool*, the provisions of CASS 7A.3.10R, CASS 7A.3.13R and CASS 7A.3.14R will apply;
- (3) in relation to each *designated client fund account* held by the *firm* with the *failed bank* in respect of that *pool*, the provisions of CASS 7A.3.11R, CASS 7A.3.13R and CASS 7A.3.14R will apply;
- (4) any *money* held at a bank, other than the bank that has *failed*, in *designated client bank accounts* in respect of that *pool*, is not pooled with any other *client money*; and
- (5) any *money* held in a *designated client fund account* in respect of that *pool*, no part of which is held by the bank that has *failed*, is not pooled with any other *client money* held in respect of that *pool* (or another *pool*).

7A.3.7 R If a *secondary pooling event* occurs as a result of the *failure* of a bank where one or more *designated client bank accounts* or *designated client fund accounts* are held in respect of a *pool*, then:

- (1) in relation to every *designated client bank account* held by the *firm* with the *failed bank* in respect of that *pool*, the provisions of CASS 7A.3.10R, CASS 7A.3.13R and CASS 7A.3.14R will apply; and
- (2) in relation to each *designated client fund account* held by the *firm* with the *failed bank* in respect of that *pool*, the provisions of CASS 7A.3.11R, CASS 7A.3.13R and CASS 7A.3.14R will apply.

7A.3.8 R *Money* held in each *general client bank account* and *client transaction account* of the *firm* must be treated as pooled and:

- (1) any *shortfall* in *client money* held, or which should have been held, in *general client bank accounts* in respect of that *pool* and *client transaction accounts*, that has arisen as a result of the *failure* of the bank, must be borne by all the *clients* of that *pool* whose *client money* is held in either a *general client bank account* or *client transaction account* of the *firm*, rateably in accordance with their entitlements;
- (2) a new *client money* entitlement must be calculated for each *client* of that *pool* by the *firm*, to reflect the requirements in (1), and the *firm's* records must be amended to reflect the reduced *client money* entitlement;
- (3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed bank* until the *client* is repaid; and
- (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), for the purposes of reconciliations pursuant to CASS 7.6.2R (Records and accounts) in respect of that *pool*, and where relevant SYSC 4.1.1R (General organisational requirements)

and SYSC 6.1.1R (Compliance).

...

7A.3.10 R For each *client* with a *designated client bank account* maintained by the firm in respect of a pool and held at the *failed* bank:

- (1) any *shortfall* in *client money* held, or which should have been held, in *designated client bank accounts* for specific clients of that pool that has arisen as a result of the *failure*, must be borne by all the *clients* of that pool whose *client money* is held in a *designated client bank account* of the *firm* at the *failed* bank, rateably in accordance with their entitlements;
- (2) a new *client money* entitlement must be calculated for each of the relevant *clients* of that pool by the *firm*, and the *firm's* records must be amended to reflect the reduced *client money* entitlement;
- (3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed* bank until the *client* is repaid; and
- (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), for the purposes of reconciliations pursuant to CASS 7.6.2R (Records and accounts) in respect of that pool, and where relevant SYSC 4.1.1R (General organisational requirements) and SYSC 6.1.1R (Compliance).

7A.3.11 R *Money held for specific clients of a pool* in each *designated client fund account* with the *failed* bank must be treated as pooled with any other *designated client fund accounts* of the *firm* which contain part of the same designated fund and:

- (1) any *shortfall* in *client money* held, or which should have been held, in *designated client fund accounts* in respect of that pool that has arisen as a result of the *failure*, must be borne by each of the *clients* of that pool whose *client money* is held in that designated fund, rateably in accordance with their entitlements;
- (2) a new *client money* entitlement must be calculated for each *client* of that pool by the *firm*, in accordance with (1), and the *firm's* records must be amended to reflect the reduced *client money* entitlement;
- (3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed* bank until the *client* is repaid; and
- (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), for the purposes of reconciliations pursuant to CASS 7.6.2R (Records and accounts) in respect of that pool, and where relevant SYSC 4.1.1R (General organisational requirements) and SYSC 6.1.1R (Compliance).



...

## Client money received after the failure of a bank

- 7A.3.13 R *Client money* received by the *firm* after the failure of a bank, that would otherwise have been paid into a *client bank account* at that bank in respect of a pool:

...

- 7A.3.14 R If a *firm* receives a *mixed remittance* after the *secondary pooling event* for the beneficiaries of a pool which consists of *client money* that would have been paid into a *general client bank account*, a *designated client bank account* or a *designated client fund account* maintained at the bank that has *failed*, it must:

- (1) pay the full sum into a *client bank account* other than one operated at the bank that has *failed* for the beneficiaries of that pool; and

...

...

## Failure of an intermediate broker, settlement agent or OTC counterparty: Pooling

- 7A.3.16 R If a *secondary pooling event* occurs as a result of the *failure* of an *intermediate broker*, *settlement agent* or *OTC counterparty*, then in relation to every *general client bank account* and *client transaction account* of the *firm* maintained in respect of a pool, the provisions of CASS 7A.3.17R and CASS 7A.3.18R will apply.

- 7A.3.17 R *Money* held in each *general client bank account* and *client transaction account* of the *firm* for the clients of a pool must be treated as pooled and:

- (1) any *shortfall* in *client money* held, or which should have been held, in *general client bank accounts* and *client transaction accounts* in respect of that pool, that has arisen as a result of the *failure*, must be borne by all the *clients of that pool* whose *client money* is held in either a *general client bank account* or a *client transaction account* of the *firm*, rateably in accordance with their entitlements;
- (2) a new *client money* entitlement must be calculated for each *client* who is a beneficiary of that pool by the *firm*, to reflect the requirements of (1), and the *firm's* records must be amended to reflect the reduced *client money* entitlement;

...

## Client money received after the failure of an intermediate broker, settlement agent or OTC counterparty

7A.3.18 R *Client money* received by the *firm* after the *failure* of an *intermediate broker, settlement agent* or *OTC* counterparty, that would otherwise have been paid into a *client transaction account* at that *intermediate broker, settlement agent* or *OTC* counterparty in respect of the relevant pool:

...

## Appendix 3

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# Designation of Handbook Provisions

FSA Handbook provisions will be ‘designated’ to create a FCA Handbook and a PRA Handbook on the date that the regulators exercise their legal powers to do so. Please visit our website <sup>1</sup> for further details about this process.

We plan to designate the Handbook Provisions which we are proposing to create and/or amend within this Consultation Paper as follows:

<b>Handbook Provision</b>	<b>Designation</b>
All the proposed new or amended provisions are in CASS.	We plan to designate the proposed new or amended provisions as FCA provisions.

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<sup>1</sup> One-minute guide <http://media.fsahandbook.info/latestNews/One-minute%20guide.pdf>

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