

Consultation Paper

CP17/2**

CASS 7A & the Special Administration Regime Review



January 2017

Contents

Abbreviations used in this paper 3

1	Overview	5
2	Proposed amendments affecting the return of client assets	10
3	Indirect client clearing (EMIR and MiFIR)	24
4	Proposals in CP13/5 and DP16/2 that we are not taking forward	27

Annexes

1	List of questions	35
2	List of Peter Bloxham Recommendations addressed by FCA	37
3	Cost benefit analysis	41
4	List of non-confidential respondents to DP16/2	45
5	Compatibility statement	47

Appendix

1	Draft Handbook text	50
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We are asking for comments on this Consultation Paper by:

- 23 February 2017 - in relation to the EMIR and MiFIR RTS proposals chapter 3.
- 24 April 2017 - in relation to all other proposals chapter 2.

You can send them to us using the form on our website at:
www.fca.org.uk/cp17-02-response-form.

Or in writing to:

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Client Assets and Resolution Department, Specialist Supervision Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Email: cp17-02@fca.org.uk

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Despite this, we may be asked to disclose a confidential response 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 Rights Tribunal.

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Abbreviations used in this paper

AIF	Alternative investment funds
Bloxham Final Report	Final review of the Investment Bank Special Administration Regulations 2011: by Peter Bloxham, January 2014
Bloxham Interim Report	Review of the Investment Bank Special Administration Regulations 2011: by Peter Bloxham, April 2013
Bloxham Review	Review of the Investment Bank Special Administration Regulations 2011 by Peter Bloxham, the output of which was the Bloxham Interim Report 2013 and the Bloxham Final Report 2014
CASS	Client Asset sourcebook
CASS RP	CASS resolution pack
CBA	Cost benefit analysis
CCP	Central counterparty
CMP	Client money pool
COBS	Conduct of Business sourcebook
COMP	Compensation sourcebook
CP	Consultation paper
DIB	Designated investment business
DP	Discussion paper
EMIR	Regulation (EU) No 648/2012 on over-the-counter derivatives, central counterparties and trade repositories, commonly referred to as the 'European Market Infrastructure Regulation'

FCA	Financial Conduct Authority
FSA	Financial Services Authority
FSCS	Financial Services Compensation Scheme
FSMA	The Financial Services and Markets Act 2000
HMRC	Her Majesty's Revenue & Customs
The Treasury	Her Majesty's Treasury
IP	Insolvency practitioner
LBIE	Lehman Brothers International (Europe)
MF Global	MF Global UK Limited
MiFID II	European Parliament and Council Directive on markets in financial instruments (No. 2014/65/EU), commonly referred to as the 'Markets in Financial Instruments Directive II'
MiFIR	Regulation (EU) No 600/2014 on markets in financial instruments and amending Regulation (EU) No 648/2012, commonly referred to as the 'Markets in Financial Instruments Regulation'
OSA	Omnibus segregated account
PPE	Primary pooling event
PRA	Prudential Regulation Authority
QMMF	Qualifying money market funds
RTS	Regulatory Technical Standards
SAR	The Investment Bank Special Administration Regulations 2011 No. 245, the Investment Bank Special Administration (England and Wales) Rules 2011 No. 1301 and the Investment Bank Special Administration (Scotland) Rules 2011 No. 2262, commonly referred to as the 'Special Administration Regime'
SAR Regulations	The Investment Bank Special Administration Regulations 2011 No. 245
UCITS	Undertakings for collective investments in transferable securities
UK	United Kingdom

1. Overview

Introduction

- 1.1** Following the failure of Lehman Brothers International (Europe) (LBIE) in 2008, Her Majesty's Treasury (the Treasury) created an insolvency regime for investment firms called the 'Special Administration Regime' (SAR). The SAR works with the Client Assets sourcebook (CASS), and in particular the client money distribution rules (CASS 7A), to provide a mechanism under which client assets¹ can be returned to clients in the event of an investment firm failure.
- 1.2** This consultation paper (CP) consults on changes in CASS in relation to an investment firm failure and their interaction with the SAR. Collectively, these proposals aim to speed up the distribution of client assets, improve consumer outcomes and reduce the market impact of an investment firm failure.

Who does this consultation affect?

- 1.3** This paper is relevant to all regulated firms that hold custody assets and/or client money in relation to investment business and in particular:
- their clients
 - their banks and custodians
 - market infrastructure firms, including central counterparties, exchanges and other intermediaries with whom a firm may place client assets, and
 - insolvency practitioners (IPs) and their advisers

Is this of interest to consumers?

- 1.4** The topics discussed in this CP will affect investment firms and their clients in the event of an investment firm failure, as well as other types of pooling events.
- 1.5** We welcome feedback from consumers and consumer groups on the proposals contained in this CP.

¹ References in this paper to client assets refer to both client money and custody assets unless otherwise stated

Context

- 1.6** The Banking Act 2009 required the Treasury to review the SAR within two years of its coming into force. The Treasury commissioned Peter Bloxham to undertake this review (Bloxham Review).
- 1.7** In parallel with this work, the FCA was carrying out a fundamental review of CASS focused on improving the regime to lead to better results for clients. This review supports the FCA's objectives relating to consumer protection and market integrity, by aiming to:
- improve the speed of return of client assets following the insolvency of an investment firm
 - achieve a greater return of client assets to clients following the insolvency of an investment firm, and
 - reduce the market impact of an insolvency of an investment firm that holds client assets
- 1.8** The above aims collectively comprise the 'CASS Review Objectives'.
- 1.9** The FCA review was initiated in CP12/22² and continued in CP13/5³. The majority of amendments to CASS resulting from this review were set out in PS14/9⁴. However, any proposals relating to the distribution of client assets were decoupled from the wider CASS review to ensure that the Bloxham Review recommendations could be considered and that the CASS rules could be aligned with any amendments to the SAR following the Bloxham Review.
- 1.10** The final report of the Bloxham Review was published in January 2014⁵ (Bloxham Final Report) and resulted in 72 recommendations aimed at speeding up the return of client assets, reducing legal uncertainty and improving consumer and market outcomes in the event of a firm failure. The FCA were assigned 30 of the 72 recommendations, with the rest addressed to the Treasury, other authorities and market participants.
- 1.11** In March 2016, we published DP16/2⁶ providing feedback on the speed proposal⁷ and discussing possible changes to CASS, in particular CASS 7A, as a result of the Bloxham Review.
- 1.12** On the same day as the publication of DP16/2, the Treasury published a consultation paper on proposed changes to the SAR Regulations⁸. These two papers should be read together to obtain a clear view of how the CASS and SAR regimes work together following an investment firm's failure.
- 1.13** We stated in DP16/2 that we would consider the legislative changes to be made to the SAR, together with all feedback received to DP16/2, before consulting on detailed changes to the CASS rules on the distribution of client assets.

2 CP12/22 'Client assets regime: EMIR, multiple pools and the wider review' <http://www.fsa.gov.uk/static/pubs/cp/cp12-22.pdf>

3 CP13/5 'Review of the client assets regime for investment business' <https://www.fca.org.uk/publication/consultation/cp13-05.pdf>

4 PS14/9 'Review of the client assets regime for investment business: Feedback to CP13/5 and final rules' <https://www.fca.org.uk/publication/policy/ps14-09.pdf>

5 Final review of the Investment Bank Special Administration Regulations 2011 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/271040/PU1560_SAR.pdf

6 DP16/2 'CASS 7A & the Special Administration Regime Review' <https://www.fca.org.uk/publication/discussion/dp16-02.pdf>

7 The Speed Proposal was set out in CP13/5 and suggested an initial, rapid distribution of an insolvent firm's client money pool based on the records of the firm, favouring speed of distribution over accuracy. The proposal stimulated debate in the industry and highlighted the limits of what the FCA can achieve to enable a speedy distribution within its powers

8 The Investment Bank Special Administration Regulations 2011 No. 245

Summary of our proposals

- 1.14** The Treasury has now published amendments to the SAR Regulations and, with that in mind, this CP:
- seeks feedback on proposed changes to the CASS rules affecting the return of client assets, against the backdrop of the amendments to the SAR Regulations;
 - explains why certain other proposals in CP13/5 and DP16/2 are not being taken forward; and
 - seeks feedback on minor consequential changes to the client money rules (CASS 7) and CASS 7A to address the forthcoming indirect clearing requirements under the European Market Infrastructure Regulation (EMIR) and Markets in Financial Instruments Regulation (MiFIR) Regulatory Technical Standards (RTS).
- 1.15** In particular, this CP seeks feedback on the following CASS proposals which have been shaped in line with the Treasury's amendments to the SAR Regulations to deliver the CASS Review Objectives:
- amendments to allow certain transfers of the client money pool (CMP) not permitted in the current rules;
 - requirements that, where relevant, work with the bar date mechanisms in the SAR Regulations to ensure an appropriate level of client protection prior to a final distribution of client assets;
 - applying hindsight to the valuation of cleared margined transactions for the purpose of determining a client's entitlement to the CMP;
 - expressly setting out in the rules which CASS requirements cease to apply or are modified following firm failures and other primary pooling events (PPEs); and
 - other amendments that ensure that CASS is aligned with the SAR Regulations, while recognising that some firm failures will not be subject to the SAR.
- 1.16** To aid the reader we recommend that this CP is read alongside the SAR Regulations. The table below sets out the principle provisions in CASS and the SAR Regulations for a number of the topics discussed in this CP. Please note that this is not an exhaustive list of all the relevant provisions in CASS and the SAR Regulations.

Topic in this CP	CASS rules	SAR Regulations (as amended)
Transfers of client assets post-failure	CASS 6.7.8R (transfers of safe custody assets) CASS 7A.2.4R(4) (transfers of client assets)	SAR Regulations 10B - 10G

Contacting clients before the closure of the client estate	CASS 6.7.2R - 6.7.7R (disposal of safe custody assets) CASS 7A.2.6AR – CASS 7A.2.6RE (closing a CMP)	SAR Regulations 11, 12A-12E
Post-administration reconciliation requirements	CASS 7.15.32BG(2) and CASS 7A.2.3DG (cross references to the SAR requirement)	SAR Regulation 10H
Administration costs	CASS 7.17.2R, CASS 7A.2.6R and CASS 7A.2.7BR (post-PPE costs)	SAR Regulations 12F and 19A

- 1.17** It is worth noting that while the CASS Review Objectives focus on the treatment of client assets following a firm's insolvency, the CASS 7A rules can apply in circumstances other than a firm's insolvency. For example, in exercise of its supervisory powers, the FCA may impose a requirement on all the client money held by a firm in a situation in which it feels this is necessary to ensure that client money is protected. Under the current CASS 7A rules, this would cause a pooling and distribution of the firm's client money⁹. The CASS 7A rules are also applicable to firms entering insolvency proceedings other than the SAR.
- 1.18** In addition to our proposals to deliver the CASS Review Objectives, we are consulting on minor consequential changes to CASS 7 and CASS 7A to address the forthcoming indirect clearing requirements in the EMIR and MiFIR RTS. The RTS are directly applicable and do not require transposition in the Handbook. However, Handbook changes are needed to ensure there are no conflicts with the RTS.

Third country UK branch insolvencies

- 1.19** If clients hold custody assets or client money with firms which are incorporated outside the UK, those client assets may be held subject to the law of that firm's country of incorporation. If such a firm were to fail, the firm may be wound up under the law of that country and the SAR may not be relevant. In these cases, the relevant insolvency regime may lead to a potentially less favourable outcome for UK clients. We commented on this issue in DP16/2¹⁰ and take this opportunity again to remind firms that they need to make an appropriate disclosure of this risk to their clients.

The draft Handbook instrument

- 1.20** In Appendix 1 we include the draft Handbook instrument showing our proposed changes to the Handbook text. The instrument is currently divided as follows:
- Part 1 of Annex A and Part 1 of Annex B to the draft Handbook instrument concern the changes required under the EMIR RTS
 - Part 2 of Annex A and Part 2 of Annex B to the draft Handbook instrument concern the changes to the CASS rules affecting the return of the client assets
 - Part 3 of Annex A and Part 3 of Annex B to the draft Handbook instrument concern the changes required under the MiFIR RTS, and

⁹ CASS 7A.2.2R(3)

¹⁰ DP16/2 paragraph 4.82

- Annex C to the draft Handbook instrument concerns changes to the SUP 3 rules for auditors regarding the CASS audit requirements following a firm's failure

Equality and diversity considerations

- 1.21** We have assessed the likely equality and diversity impacts of these proposals and do not think they give rise to any concerns. We would welcome your comments on any issues identified.

Next steps

- 1.22** We want to know what you think of our proposals. Please send us your comments by the following dates:
- 23 February 2017 in relation to the EMIR and MiFIR RTS proposals (chapter 3)
 - 24 April 2017 in relation to all other proposals (chapter 2)
- 1.23** To submit a response, please use the online response form on our website or write to us at the address in the contact box at the beginning of this CP.
- 1.24** Following consideration of feedback to this CP, we aim to publish a policy statement making final rules.

2. Proposed amendments affecting the return of client assets

- 2.1** In this chapter we outline our proposed changes to the CASS rules affecting the return of client assets following a firm's failure or other pooling events. Some of these will be familiar as similar proposals were discussed in CP13/5 and DP16/2. A number of these have been amended in light of respondents' feedback to those publications and the amended SAR Regulations, and we are consulting on these again to enable respondents to consider them in the context of the amended SAR.
- 2.2** The draft rules for these proposed changes are set out in Part 2 of Annex A, Part 2 of Annex B, and Annex C in Appendix 1.

Application of the SAR and CASS

- 2.3** The SAR is applicable to firms which are 'investment banks'¹¹. In reviewing the SAR Regulations, the Treasury has expanded the definition of 'investment bank'¹² to include managers, trustees and depositaries of alternative investment funds (AIFs)¹³ and undertakings for collective investments in transferable securities (UCITS)¹⁴. Not all firms that hold client assets fall within this definition of 'investment bank'. Excluded firms include, for example, insurance brokers and peer-to-peer lending platform operators.
- 2.4** As noted in Chapter 1 of this CP, the SAR works with CASS to provide a mechanism under which client assets are returned to clients in the event of an investment firm failure. However, if on its failure a firm does not enter the SAR, the firm would likely enter another insolvency procedure and the CASS rules would continue to apply to any client assets held by that firm.
- 2.5** Under CASS 7A, the failure of a firm constitutes a PPE. Broadly speaking, this means that all client money held by the firm in client bank accounts and client transaction accounts is notionally pooled, forming a CMP. The CMP is then distributed to clients on a pro-rated basis. There are currently no equivalent pooling or distribution rules for custody assets.
- 2.6** Our proposals in this chapter will affect all investment firms holding custody assets and/or client money subject to CASS 6 and/or 7 respectively. The proposed amendments to CASS apply to firms entering either the SAR or other insolvency procedures, except in a few instances where the rules indicate otherwise.

11 See Section 232 of the Banking Act 2009

12 See Regulations 2 and 3 of The Investment Bank (Amendment of Definition) and Special Administration (Amendment) Regulations 2017

13 Article 51ZC RAO (managing an AIF) and article 51ZD RAO (acting as a trustee or depositary of an AIF)

14 Article 51ZA RAO (managing a UCITS) and article 51ZB RAO (acting as a trustee or depositary of a UCITS)

Transfers

2.7 In response to the Bloxham Final Report¹⁵, DP16/2¹⁶ noted our support for the ability to transfer client assets after the failure of a firm. DP16/2 discussed that it may be better both for clients and markets generally if the business of a failed firm, together with the relevant client assets, is transferred to a different firm to ensure continuity of service. Clients may then continue to receive services uninterrupted, avoid opportunity costs from having their assets ‘stuck’ in the failed firm’s estate and avoid loss of value arising from premature closure of positions or loss of tax wrappers. A transfer of client assets may also reduce the costs of administration. Amending CASS to permit transfers of client assets following a firm’s failure was largely supported in feedback to DP16/2.

2.8 Objective 1 of the SAR Regulations is to ensure the return of client assets as soon as is reasonably practicable. The amended SAR Regulations make it clear that the ‘return’ of client assets includes either distribution to clients or a transfer to another firm¹⁷. The amended SAR Regulations further facilitate transfers of business, for example, by adding a mechanism for novating client contracts and, where all of the assets of the firm are being transferred, client consent (and other) requirements would not stand in the way of the IP achieving an effective transfer. The amended SAR Regulations also facilitate a part transfer of business of a failed firm.

Transfers of client money under CASS 7A

2.9 Currently the CASS 7A rules require all client money to be pooled and distributed so that each client who is a beneficiary of the pool receives a sum which is rateable to its entitlement.

2.10 To facilitate post-PPE transfers within CASS, in DP16/2 we proposed to allow the transfer of the general pool and/or any sub-pool¹⁸, if certain conditions were met. These conditions included:

- the relevant CMP must be transferred whole (no part transfers may be made)
- the transferee firm must make a number of notifications to clients post-transfer regarding how to access their assets, and
- the clients must be entitled to the return of their client money from the transferee within a specified period without exit fee or charges

2.11 DP16/2 posited that while a transfer of a business line or client book together with a transfer of part of the CMP may often be more attractive to transferee firms and a benefit to transferring clients, it risks detriment to those clients remaining at the failed firm, particularly where a shortfall in client money arises. A significant number of respondents to DP16/2 agreed with this.

Our response

2.12 In light of the amendments to the SAR Regulations, feedback to DP16/2 and our consideration of firm failures to date, we have amended our original proposal slightly. We propose to allow a firm to transfer a client’s entitlement to the CMP providing that certain conditions are met.

2.13 The firm can choose, as an alternative to distributing a client entitlement, to transfer a client’s entitlement to the CMP if the transfer does not result in other clients receiving less than they would otherwise receive in a distribution or transfer. This provides the firm or its IP with the

¹⁵ Bloxham Recommendation 1, see Annex 2

¹⁶ DP16/2 paragraphs 4.2 – 4.5

¹⁷ Regulation 10B of the amended SAR Regulations

¹⁸ Sub-pools can be transferred in accordance with Article 48 of EMIR

flexibility to undertake business transfers, including transferring the CMP, as long as the pro-rated nature of the pooling of the client money is not disturbed. We expect that this would permit transfers of the CMP or parts of the CMP in a wider range of circumstances than the proposed approach in DP16/2. For example, if a purchaser of the business wished to purchase a part of the failed firm's business which included all the business of the firm involving client money, transferring the whole CMP and all the firm's clients, this is likely to preserve the pro-rating. Alternatively, for a firm with very few clients and no chance of 'unknown' clients coming forward to make a claim, pro-rating of the CMP may be preserved even if only a proportion of the CMP were transferred to a transferee and the rest of the CMP distributed to the remaining clients.

- 2.14** In addition to ensuring that the pro-rating of the CMP is not disturbed, subject to the provisions in the SAR where applicable, the firm (as the transferor) is required to obtain specific client consent to the transfer or have in place a written client agreement which provides that the firm may transfer the client's client money to another person. If the firm enters into the SAR, the CASS 7A rules would disapply the requirement to obtain client consent to the transfer of client money to the extent that the requirement is overridden by the amended SAR Regulations.
- 2.15** The transferor will be required to obtain a contractual undertaking from the transferee stating that the money transferred will be held as client money in accordance with the client money rules or the transferor is satisfied, after exercising all due skill, care and diligence in its assessment, that the transferee will apply adequate measures to protect the money transferred.
- 2.16** The transferee will also be required to comply with certain client notification requirements (set out in more detail below under 'Post-transfer notifications to clients').
- 2.17** Given we are introducing transfer rules for firms following a PPE, we have changed the name of the CASS 7A chapter from 'client money distribution' rules to 'client money distribution or transfer' rules.

Q1: Do you agree with this proposal relating to the post-PPE transfer of client money? If not, please provide reasons.

Transfers and distribution of custody assets

- 2.18** DP16/2¹⁹ noted that firms or their IPs are not prevented by the CASS rules from transferring custody assets as part of the sale of a failed firm's business. DP16/2 proposed to introduce a new chapter in the custody rules (CASS 6) setting out communication requirements when firms carry out such transfers post-failure. We also asked for feedback on whether there was a need to codify further the post-failure transfer and distribution of custody assets in CASS²⁰.
- 2.19** The majority of respondents supported the introduction of rules setting out communication requirements when firms carry out transfers post-failure. In terms of codifying further the post-failure transfer and distribution of custody assets, the majority of respondents questioned how this would work in practice and whether it would lead to unintended costs and legal uncertainty in light of existing court judgments. Some respondents disagreed with introducing distribution rules for custody assets on the basis that it would be too complex and existing record keeping rules are sufficient. A few respondents supported a distribution regime similar to CASS 7A or codifying (as guidance) existing case law on the basis that it would provide greater clarity to IPs.

Our response

¹⁹ DP16/2 paragraphs 4.6 - 4.7

²⁰ DP16/2 paragraphs 4.80 - 4.81

2.20 Having considered the feedback, we propose to create a new section in CASS 6 to include post-failure rules on custody assets. We propose that the rules in this chapter will be limited to: (i) rules relating to certain communication requirements that must be observed by a firm or its IP in the context of a post-failure transfer of custody assets, and (ii) rules relating to post-failure unclaimed custody assets (see 'Treatment of unclaimed client assets and de minimis balances' below). We do not propose to introduce any other post-failure rules on custody assets.

Post-transfer notifications to clients

2.21 Following a post-failure transfer of client business, we propose to require the transferor to obtain a contractual undertaking from the transferee firm that it will make certain notifications to the transferred clients within seven days of the transfer commencing. These include notifying the client of:

- the applicable regulatory regime under which the client assets will be held
- the relevant compensation scheme limits that apply, and
- the fact that the transferor has the option of requesting that its client assets are returned to it or, where applicable, that the client can demand that its client assets are returned to the transferor pursuant to the SAR Regulations (i.e. a 'reverse transfer')

2.22 As noted above, we support post-failure transfers of client assets. However, in doing so we wish to ensure that clients are given sufficient information and are quickly given access to their transferred assets.

Q2: Do you agree with our proposal to create a new section containing post-failure custody rules for transfers and the treatment of unclaimed custody assets? If not, please provide reasons.

Q3: Do you agree with our proposal regarding post-transfer communications with clients? If not, please provide reasons.

Contacting clients prior to the closure of the client estate

2.23 At some point following firm failure the IP will need to close the client estate. If a firm has entered special administration, the SAR's bar date mechanisms may be applied. These provisions will not be available to firms in other types of insolvency or administration. In either case, the court are able to set a final cut-off date, on application by an IP, after which any further client claims can be disregarded in their entirety, so that the client estates can be closed (a 'hard bar date').

2.24 In response to the Bloxham Final Report²¹, in DP16/2²² we sought feedback on a process to be followed by firms wishing to set a hard bar date for client money claims. This was proposed to safeguard clients as, once a hard bar date has passed, clients who have not proved for their claims lose their proprietary right to claim against the client estate. The proposed process required the firm or its IP to take reasonable steps to trace and contact clients before the hard

²¹ Bloxham Recommendation 4, see Annex 2

²² See DP16/2 paragraphs 4.8 – 4.12

bar date could be passed. We also proposed client notifications in respect of unclaimed client assets.

- 2.25** The majority of respondents supported the proposals but requested additional detailed guidance on the “reasonable steps” required to trace and contact a client. Many respondents voiced the need for proportionality between the value of the client money entitlement and the costs of tracing clients, to avoid excessive administrative costs and delays. Additional comments highlighted the challenges this would pose for uncontactable clients, particularly if a failed firm’s books and records are incomplete and/or inaccurate. One respondent suggested that the IP should be able to rely on suitably evidenced tracing that the firm had performed under the client money rules to reduce time and administration costs.

Our response

- 2.26** In light of the feedback, we have amended our original proposal slightly. We propose to require a failed firm to take reasonable steps to notify all clients that the IP considers may have a valid claim for client money or custody assets, prior to the closure of the client estate or a hard bar date under the amended SAR Regulations taking effect. The client would need to be informed of the firm’s intention to no longer treat the balance as client money; and of the consequences of the firm’s proposed course of action in relation to the client’s ability to assert an ownership right to that money, and be invited to submit a claim for the money. This would be supported by an evidential provision outlining the minimum client contact required, with fewer steps for professional clients. We consider this safeguard to be necessary to ensure that reasonable efforts are taken to ensure that clients are aware of the implications of not submitting a claim, prior to losing their proprietary rights to their client assets.

Q4: Do you agree with this proposal to safeguard clients’ proprietary rights? If not, please provide reasons.

Treatment of unclaimed client assets and de minimis balances

- 2.27** There is currently no provision in CASS for the post-PPE treatment of either allocated but unclaimed (or declined) client monies, unallocated client monies or small client money balances (i.e. de minimis balances). This has resulted in formal CASS rule modification requests in each SAR administration reaching this stage of distribution. We recognise that an IP needs to close the client estate and cannot retain unclaimed client monies indefinitely, but are equally mindful that clients must be given sufficient opportunity to claim their assets.
- 2.28** CP13/5²³ and DP16/2²⁴ proposed to allow a firm or its IP to use any unclaimed client money entitlements to make good a shortfall in the CMP, provided certain reasonable steps had been taken to trace the clients concerned. We also considered whether equivalent provisions for unclaimed custody assets would be beneficial. In addition, we proposed de minimis levels be applied to unclaimed client money amounts (£10 in CP13/5, £25 for retail clients and £100 for professional clients in DP16/2), allowing the firm or its IP to take fewer steps to trace and contact such clients.
- 2.29** The majority of respondents supported these proposals, although few respondents supported an equivalent provision on the treatment of unclaimed custody assets. Many respondents also

²³ CP13/5 paragraphs 2.50 – 2.53

²⁴ DP16/2 paragraphs 4.68 – 4.79

suggested a significant increase in the de minimis levels (e.g. £50 for retail clients and £1,000 for professional clients).

Our response

- 2.30** Having considered the feedback, we propose allowing a firm or its IP to use allocated but unclaimed (or declined) client money entitlements and unallocated client money towards a shortfall in the CMP after payment of costs in accordance with the statutory trust waterfall provision (CASS 7.17.2R). This includes any client money amounts that the firm is holding to comply with the rules on prudent segregation²⁵. In the event of a shortfall having been met in full or not arising, any surplus in unclaimed monies would become due to the firm in line with CASS 7.17.2R(5). We do not propose to extend this proposal to custody assets on the basis that there was limited support and concerns were raised around the proposal conflicting with legal proprietary rights of clients to specific assets.
- 2.31** We also propose allowing a firm or its IP to take fewer steps to trace and contact clients with de minimis balances of client money before those balances can be treated as unclaimed client money. We consider the level suggested by respondents to DP16/2 to be too high. We therefore propose that the de minimis levels remain as proposed in DP16/2: £25 for retail clients and £100 for professional clients. We do not propose to apply de minimis treatment to claimed entitlements or to custody asset claims.

Q5: Do you agree with our proposed treatment of allocated but unclaimed (or declined) and unallocated client monies? If not, please provide reasons.

Q6: Do you agree with our proposals regarding the treatment of clients with de minimis client money balances? If not, please provide reasons why.

The Hindsight Principle

- 2.32** The current regime requires that, to determine clients' entitlements to the CMP, their open positions at the point of a PPE should be valued using the notional closing or settlement prices prevailing at the PPE. Where there is a delay between the PPE and the date the transactions are closed during the administration process, mismatches between the value attributed to the transaction (which is fed into the client money entitlement calculations) and the actual close out value can occur, leading to a shortfall or surplus in the CMP.
- 2.33** In CP13/5²⁶ and DP16/2²⁷ we considered, for the purpose of determining a client's entitlement to the CMP, requiring a firm or its IP to apply the value obtained on liquidation of margined transactions undertaken for clients through a central counterparty (CCP) that are open at PPE. That is, hindsight should be applied (the Hindsight Principle). The Bloxham Final Report also recommended²⁸ that the FCA considers whether this principle could be introduced for determining a client's entitlement to the CMP and whether it could be applied more widely to other transactions, such as non-margined transactions²⁹. In DP16/2, we sought feedback on

²⁵ CASS 7.13.41R, CASS 7.13.65R and CASS 7.13.73R

²⁶ CP13/5 paragraphs 2.44 – 2.49

²⁷ DP16/2 paragraphs 4.13 – 4.22

²⁸ Bloxham Recommendation 14, see Annex 2

²⁹ Paragraph 4.16, page 19 of Bloxham Final Report

applying the Hindsight Principle to other types of trades and whether other valuation methods should be used.

- 2.34** Most respondents to CP13/5 and DP16/2 supported the application of the Hindsight Principle to cleared open margined transactions on the basis that it may prevent some shortfalls in the CMP. Some respondents disagreed on the basis that different approaches for valuing different transactions could create complexity for a firm or its IP. Many respondents suggested the Hindsight Principle would be too complex or impractical to apply to other types of trades (particularly where there was no CCP). In contrast, a few respondents indicated the Hindsight Principle would be useful for valuing other open positions (e.g. OTC³⁰ derivative trades). Responses were split on the valuation method to be used when applying the Hindsight Principle.

Our response

- 2.35** Having considered the feedback, for the purpose of determining clients' entitlements to the CMP we propose to require all firms to apply the value achieved on close out to all cleared open margined transactions. To determine the close out value, the firm (and the counterparty) may refer to contractual provisions.
- 2.36** We do not propose to extend the application of the Hindsight Principle to other types of transactions.

Q7: Do you agree with this proposal on the application of the Hindsight Principle? If not, please provide reasons.

Post-PPE reconciliations

- 2.37** The client money rules require firms to conduct an internal client money reconciliation each business day, based on the records of the firm as at the close of business on the previous business day³¹. Firms are also required to conduct, on a regular basis, external client money reconciliations between internal records and accounts and those of any third parties which hold client money³². When a firm's internal client money reconciliation identifies a discrepancy, the firm must ensure that any shortfall is paid into a client bank account (a top-up) or any excess is withdrawn from a client bank account (a drawdown)³³.
- 2.38** Following a firm failure (a type of PPE) the firm or its IP is prohibited from topping up the client bank account with monies from the firm's account, or vice-versa, by the CASS 7A rules and general insolvency law principles. The Bloxham Final Report recommended³⁴ that where the firm uses the alternative approach to client money segregation³⁵, the IP should be given the power to top up shortfalls in the CMP with money from the firm's own accounts. This was aimed at helping the IP to rectify any discrepancy that would have been rectified by the firm, according to its own records, had it not entered the SAR. The Bloxham Final Report also suggested consideration is given as to whether the 'top up' principle should have wider application than just where firms adopt the alternative approach.

³⁰ Over-the-counter

³¹ CASS 7.15.15R – CASS 7.15.18R

³² CASS 7.15.20R

³³ CASS 7.15.29R

³⁴ Bloxham Recommendation 46, see Annex 2

³⁵ CASS 7.13.54G to CASS 7.13.69G

2.39 The Treasury has amended the SAR Regulations to require the IP, immediately after being appointed, to conduct a post-administration client money reconciliation based on the method of reconciliation previously adopted by the firm and to make a transfer to or from the firm's client bank accounts following that reconciliation³⁶. DP16/2³⁷ considered whether any amendments to CASS would be necessary to ensure consistency of the CASS rules with this new requirement under the SAR Regulations.

2.40 Some respondents suggested cross references to the amended SAR Regulations were necessary, whereas others considered such cross references to be unnecessary. Some requested clarity on how the post-administration client money reconciliation would work in practice. One respondent suggested adding a rule on subsequent amendments to the reconciliation for errors.

Our response

2.41 Having considered the amended SAR Regulations and the feedback, we propose to include guidance in CASS 7A on the post-administration client money reconciliation set out in the SAR to: (i) remind a firm or its IP of the requirement under the SAR; and (ii) clarify that the reconciliation requirement in CASS 7.15 continues to apply to a firm after a PPE. We also propose to insert new rules in CASS 7A.2.4R to make it clear that any top ups resulting from the post-administration reconciliation in the SAR must be included in the CMP and any drawdowns can be excluded from the CMP.

Q8: Do you agree with our proposed clarifications in CASS 7A relating to the post-administration reconciliation under the SAR? If not, please provide reasons.

2.42 The post-administration client money reconciliation requirement in the amended SAR Regulations, and our proposed rules relating to this requirement, only apply to firms that enter the SAR. Non-SAR firms or firms that enter into non-failure PPEs will not be subject to the post-administration client money reconciliation requirement under the SAR Regulations.

2.43 As set out in paragraphs 2.61 to 2.64, in this CP we are proposing to make it clear in CASS which CASS 6 and 7 rules will cease to apply following a firm failure or other PPE. Post-failure firms will be required to carry out daily internal and external client money reconciliations in accordance with the CASS rules. However, the proposed amendments to CASS make it clear that, following a failure, a firm is not required to comply with the top up or draw down provision in CASS that would have been applicable to the firm prior to its failure³⁸ in so far the legal procedure restricts it from doing so (although a firm entering into the SAR would be required to comply with the top up or draw down provision under the SAR).

2.44 Continuing to carry out daily client money reconciliations following a PPE allows the firm to determine the clients' entitlements to the CMP by reference to the firm's client money requirement, calculated in accordance with the client money rules. Clients' entitlements to the CMP reflect the position as at the point of the PPE, except in relation to transactions that, following a PPE, are subject to the hindsight provisions. The IP should also be mindful of updating the daily client money reconciliation to include any clients that prove to be beneficiaries to a CMP but were not originally recorded (for example, under the bar date process).

³⁶ Regulation 10H of the amended SAR Regulations

³⁷ DP16/2 paragraphs 4.41 – 4.44

³⁸ CASS 7.15.29R

Annotated sample statements

- 2.45** In response to the Bloxham Final Report³⁹, in DP16/2⁴⁰ we sought feedback on whether a detailed explanation of how client statements⁴¹ are presented was necessary, and whether this should include clearly setting out the particular methodology used by a firm or the notes to it. We also asked whether a detailed explanation of how client statements are presented should be added to the CASS resolution pack (CASS RP)⁴² to assist IPs.
- 2.46** A number of respondents commented that client statements are currently required to be clear, fair and not misleading and therefore sufficient information is provided to clients in statements. Regarding the suggestion that additional detail be provided on the actual client statements, specifically the methodology used by the firm, respondents felt that this may be too much information on 'an already busy' client statement, or that they may become too complicated if a full and detailed explanation of the statement content was required.
- 2.47** The majority of respondents did not think that adding a detailed explanation of client statements to the CASS RP would be helpful. Some respondents considered that the CASS RP was not the correct place for an explanation of the statements, with the majority of feedback favouring websites as the most suitable location. However, it was raised that mandating the use of a website may be a barrier to those customers who do not use the internet.
- 2.48** We understand that some firms already make explanations of their statements available to clients and therefore may not be impacted by this proposal.

Our response

- 2.49** We propose to require a firm to make a sample of its client statement available to its clients and that this sample statement must be annotated by the firm. We propose that the annotations must explain the meaning of the information that the firm presents in such statements. Based on the feedback, we do not propose to require firms to include this as an addition to their CASS RPs. The purpose of our proposal is to ensure clarity for both IPs and clients with regard to client statements and the information contained within. We propose to allow some flexibility for firms to decide how they make this available to their clients, for example, firms can provide the annotated sample statement in a durable medium, such as on the reverse side of client statements, or on the firm's website. We do, however, propose to require that the annotated sample statement is in a prominent place on the website or where the firm provides statements to clients via an online system using that same online system. We also propose that the annotated sample statement is available to clients free of charge.⁴³

Q9: Do you agree with this proposal on annotated client statements? If not, please provide reasons.

Q10: Do you anticipate that this proposal will have significant cost implications? If so, please explain this further.

³⁹ Bloxham Recommendation 31, see Annex 2

⁴⁰ DP16/2 paragraphs 4.38 – 4.40

⁴¹ By 'client statement', we are referring to the statement required under the conduct of business rules (COBS) (in particular COBS 16.4) as well as the information provided to ad hoc client requests under CASS 9.5.4R – CASS 9.5.6R

⁴² CASS 10

⁴³ We recently published a discussion paper exploring how we and the industry can work together to ensure consumers receive smarter and more effective communications. See Smarter Consumer Communications <https://www.fca.org.uk/publications/discussion-papers/smarter-consumer-communications-further-step-journey>

Triggers to a PPE

- 2.50** In CP13/5⁴⁴ we proposed to amend the CASS 7A rules so that neither (i) the coming into force of a requirement of all client money held by a firm⁴⁵, nor (ii) a notification by a firm that it is unable to comply with its record keeping requirements following a secondary pooling event⁴⁶, would constitute a PPE.
- 2.51** We have further reviewed the events which result in a PPE occurring. Currently, placing a requirement on all of a firm's client money causes a PPE, followed by a pro-rated distribution of the CMP. Our supervision experience has shown that, to ensure that client money is protected, it would be helpful for the FCA to be able to place a requirement on all client money without automatically causing a pooling and distribution of client money. On this basis, we propose to amend our rules to enable the FCA to place a requirement on all client money without automatically triggering a PPE event. The rules will also retain the FCA's ability to trigger a PPE when placing a requirement on all client money, where the requirement also stipulates that the firm must take steps to cease to hold client money.

Q11: Do you agree with our proposal to enable the FCA to place a requirement over client money without triggering a PPE event? If not, please provide reasons.

- 2.52** Currently, a PPE is triggered by a firm notifying, or being in breach of its duty to notify, the FCA that it is unable to comply with its record keeping requirements following a secondary pooling event. We propose to amend our rules so that *only* a notification by a firm that it is unable to comply with its record keeping requirements following a secondary pooling event constitutes a PPE. We have deleted the reference to a 'breach of duty to notify the FCA' as, the timing of the occurrence of a PPE needs to be as precise as possible, and the point at which a breach of duty to notify the FCA occurs is difficult or impossible to determine.

Q12: Do you agree with our proposal to remove the breach of duty to notify the FCA that it is unable to comply with its record keeping requirements following a secondary pooling event from triggering a PPE event? If not, please provide reasons.

Client money received by the firm after a PPE

- 2.53** In CP13/5⁴⁷ we sought feedback on proposals regarding the treatment of client money received after PPE. We proposed to amend the existing rule to make it clear that post-PPE receipts of client money can be placed in: (i) client bank accounts that are opened following PPE, or (ii) client bank accounts of the firm that existed at the time of the PPE, if the money constituting the CMP has been transferred out of those client bank accounts.
- 2.54** We also proposed a new rule allowing the firm to retain costs properly attributable to the distribution of the client money received by the firm after the PPE.

⁴⁴ CP13/5 paragraphs 2.41 – 2.43

⁴⁵ CASS 7A.2.2R(3)

⁴⁶ CASS 7A.2.2R(4)

⁴⁷ CP13/5 paragraphs 2.56 – 2.59

2.55 The treatment of client money received after a PPE was not explored further in DP16/2. The feedback received in response to CP13/5 was generally supportive and we have now considered this proposal in conjunction with the other changes we are proposing in this CP.

Our response

2.56 We are re-consulting on this proposal largely as set out in CP13/5. We propose to:

- allow post-PPE receipts of client money where the firm has operated the normal approach to be placed in (i) client bank accounts that are opened following PPE or (ii) client bank accounts of the firm that existed at the time of the PPE, provided the money constituting the CMP has been transferred out of those client bank accounts
- allow an exception to the requirement to place post-PPE receipts in a client bank account where the firm has operated the alternative approach to client money⁴⁸ or the normal approach in relation to certain regulated clearing arrangements pre-PPE⁴⁹
- allow a firm to use monies relating to transactions entered into before the PPE, which had not settled at the time of PPE, to settle that transaction
- to the extent client money relates to one or more cleared margined transactions that had not closed out as at the PPE, then provided that the firm has not failed, allow it to transfer that client money to the relevant client transaction account for the purpose of collateralising those transactions, and
- allow a firm to retain costs properly attributable to the distribution of post-PPE client money from these monies, but allocate these costs per individual client rather than on a mutualised basis

Q13: Do you agree with our proposal to allow client monies received post-PPE to be placed in an existing client bank account? If not, please provide reasons.

Q14: Do you agree with our proposal to allow firms to retain costs properly attributable to the distribution of post-PPE client money? Should these deductions be allocated per individual rather than on a mutualised basis? If not, please provide reasons.

Q15: Do you agree with our proposed approach to clarifying the treatment of client monies received post-PPE? If not, please provide reasons.

Redistribution of client money following a secondary pooling event

2.57 Broadly speaking, if a bank or a third party holding client money on behalf of a firm fails, this constitutes a secondary pooling event for the firm. If the firm does not choose to make good any shortfall that results from this event, the secondary pooling rules⁵⁰ require a firm to:

⁴⁸ CASS 7.13.62R

⁴⁹ CASS 7.13.72R

⁵⁰ CASS 7A.3

- ensure that any shortfall resulting from the third party failure is shared rateably among the firm's clients in accordance with their entitlements, and
- calculate new entitlements for clients reflecting any shortfall and update the firm's records to reflect the new entitlements

2.58 In CP13/5⁵¹, we proposed to:

- extend the secondary pooling event rules (CASS 7A.3) to apply to an exchange or CCP failure
- carve out client money in certain client transaction accounts from the firm's other client money in a secondary pooling event, and
- remove the requirement on a firm to notify the FCA as soon as it becomes aware of the failure of a bank or other third party with which it has placed client money, of whether it intends to make good any resulting shortfall and the amounts involved

2.59 The responses were generally supportive of our proposals. Two respondents disagreed with the proposal to remove the notification requirement and some individual comments were also received regarding sub-pools, costs, legal drafting and the treatment of cash and non-cash collateral.

Our response

2.60 We are re-consulting on this proposal largely as set out in CP13/5. We propose to (i) extend the secondary pooling event rules to apply to an exchange or CCP failure, and (ii) carve out client money in certain client transaction accounts at an authorised CCP from pooling with other client monies held by the firm in a secondary pooling event. In particular, we propose to exclude individual client accounts at authorised CCPs because in the event that the firm itself fails all clients do not share in the benefits of these accounts (e.g. in relation to porting⁵² and direct return to clients of their monies). We therefore consider that only the clients of these accounts should share in any shortfall arising from a secondary pooling event on the failure of an authorised CCP. For the same reasons, we also propose to exclude gross omnibus segregated accounts (OSAs) where no excess client money is held by the firm as margin and the amount attributable to each client is apparent from the information provided to the firm by the CCP⁵³ and sub-pool OSAs⁵⁴.

2.61 We have decided to retain the existing requirement on a firm to notify the FCA as soon as it becomes aware of the failure of a bank or other third party, with which it has placed client money, as to whether it intends to make good any shortfall associated with a secondary pooling event and the expected amount of that shortfall.

Q16: Do you agree with the proposals to include CCPs in the scope of a secondary pooling event, and to exclude from secondary pooling amounts in certain client transaction accounts, including where relating to sub-pools? If not, please provide reasons.

⁵¹ CP13/5 paragraphs 2.60 – 2.67

⁵² Porting is a term used in derivatives markets referring to the transfer of a client's open positions and collateral to a third party in the event of a firm's failure

⁵³ CASS 7A.2.4R(3)(c)

⁵⁴ CASS 7A.2.4R(3)(d)

CASS and SUP rules applying post-failure and PPE

- 2.62** At present, all the CASS rules (and related chapters in SUP) continue to apply to a firm in failure or following a PPE. However, there are some CASS and SUP requirements which do not 'fit' well with a firm in failure or other PPE situations. This has led to the need for formal FCA waiver modification applications.
- 2.63** We propose to disapply certain CASS rules from a firm following failure or a PPE. We consider this provides clarity and continued protection of client assets in failure or in PPE. Combined with the increased certainty, this is expected to reduce the time to distribute client assets and administration costs.
- 2.64** The going-concern CASS rules we intend to disapply include:
- following a firm's failure, rules relating to the annual firm classification exercise
 - following a firm's failure or PPE, provisions in CASS 6 and CASS 7 relating to the treatment of unclaimed client assets⁵⁵
 - following a PPE, provisions in CASS 7 relating to transfers of business⁵⁶
 - following a firm's failure, certain provisions in CASS 6 and 7 relating to the treatment of shortfalls (including associated notification requirements) on payment or withdrawals of client money
 - following a PPE, provisions in CASS 7 relating to money due to a client from a firm, and
 - following a PPE, provisions in CASS 7 relating to procedures and recordkeeping of prudent segregation of client money, except the requirement to retain the prudent segregation record for a period of five years after the firm ceases to prudently segregate
- 2.65** We also propose to disapply the requirements under SUP 3.10 on an auditor to produce an annual CASS audit of compliance for the period following a firm's failure. If the firm fails during its CASS audit year, we propose to require an audit report covering only matters up to the day of the firm's failure. In addition, we propose to provide a transitional period for failed firms who are mid-audit at the time of the new rules coming into force, enabling their auditors to complete the audit.

Q17: Do you agree with our proposed application of the CASS and SUP going concern rules following failure or PPE? If not, please provide reasons.

⁵⁵ We are proposing post-PPE rules for unclaimed client assets

⁵⁶ We are proposing post-PPE rules for transfers of client assets

2.66 The new rules set out in Part 2 of Annex B of Appendix 1 will not be applicable to firms that have already failed, entered the SAR and/or experienced another type of PPE before the entry in to force of those rules. Such firms will continue to read the CASS rules as if the instrument in Part 2 of Annex B in Appendix 1 had not been made. We consider this approach to be the necessary approach as we do not wish to disturb any pooling, client entitlement calculations, claims processing and planning that will have taken place in advance of the entry in to force of these rules.

Q18: Do you agree with this proposed approach? If not, please provide reasons.

3. Indirect client clearing (EMIR and MiFIR)

- 3.1** In this chapter we consult on minor changes to the client money rules and client money distribution rules to address the indirect clearing requirements under the draft EMIR and MiFIR RTS⁵⁷. The requirements apply directly to clearing members and their clients who are acting on behalf of their clients.
- 3.2** Please note that the consultation period for the proposals in this section is for a period of one month, ending on 23 February 2017. This is to coincide with the EMIR RTS coming into force two months following publication in the Official Journal of the European Union. Subject to the feedback we receive, we will aim to publish our final rules shortly after the consultation.⁵⁸
- 3.3** At the time of publishing this CP, the RTS have not been adopted by the European Commission and are currently in draft form (as published by ESMA in its final report on indirect clearing arrangements under EMIR and MiFIR). We will review, and make any necessary adjustments to, our proposed changes once the RTS have been adopted by the European Commission and published in Official Journal of the European Union.
- Background**
- 3.4** An indirect clearing arrangement is an arrangement under which a clearing member is prepared to facilitate clearing the positions of its clients' clients, i.e. its indirect clients.

⁵⁷ Available at: <https://www.esma.europa.eu/sites/default/files/library/2016-725.pdf>

⁵⁸ The timetable is driven by the EMIR and MiFIR RTS implementation deadlines. We intend for our final rule changes to apply immediately for the EMIR-related changes and apply on 3 January 2018 for the MiFIR-related changes

- 3.5** Figure 1 illustrates a direct clearing arrangement in which each party acts as principal (figure 1), and Figure 2 illustrates an indirect clearing arrangement in which each party acts as principal (figure 2).



- 3.6** The current CASS regime addresses indirect clearing requirements under the existing EMIR RTS as follows:

- CASS 7 allows for ‘porting’, i.e. for the clearing member to remit any client money relating to indirect clearing to an alternative client or clearing member (in accordance with the agreements in place) and to discharge its fiduciary duty by doing so⁶⁰, and
- CASS 7A allows: (i) a clearing member, in accordance with the existing EMIR RTS, to remit any client money relating to indirect clearing directly to the relevant indirect clients in the event of the failure of the client; (ii) the money so remitted to cease to be client money in the hands of the client (and if applicable, the clearing member); and (iii) the clients’ entitlement to the CMP (of the failed client-firm) to be reduced by any sum so remitted⁶¹

- 3.7** The amended draft EMIR and MiFIR RTS set out the following requirements which are relevant to CASS:

- When the assets and positions of one or more indirect clients are managed by the clearing member in a ‘basic omnibus indirect account’, the RTS provide that the clearing member shall ‘allow the prompt liquidation of the assets and positions of indirect clients following the default of a client’⁶² and ‘readily return to the client for the account of the indirect clients any balance owed from the liquidation of the assets and positions of the indirect clients by the clearing member’⁶³

⁵⁹ The draft EMIR and MiFIR RTS also provide for instances where an indirect clearing arrangement can include up to six entries (i.e. ‘long chains’)

⁶⁰ CASS 7.11.35R – CASS 7.11.38R

⁶¹ CASS 7A.2.4R – CASS 7A.2.5R

⁶² Article 4(6)(a) of the draft EMIR RTS and MiFIR RTS

⁶³ Article 4(6)(b) of the draft EMIR RTS and MiFIR RTS

- When the assets and positions of one or more indirect clients are managed by the clearing member in a 'gross omnibus indirect account', the RTS provide that the clearing member, following the default of a client, shall:
 - 'at least, contractually commit itself to trigger the procedures for the transfer of the assets and positions held by the defaulting client for the account of its indirect clients to another client or clearing member designated by all the indirect clients whose assets and positions are being transferred'⁶⁴ (i.e. porting)
 - 'allow the prompt liquidation of the assets and positions of indirect clients following the default of a client'⁶⁵
 - 'contractually commit itself to trigger the procedures for the payment of the liquidation proceeds to each of the indirect clients'⁶⁶ (i.e. leapfrog payments), and
 - 'when the clearing member has not been able to identify the indirect clients or to complete the payment of the liquidation proceeds to each of the indirect clients ... readily return to the client for the account of the indirect clients any balance owed from the liquidation of the assets and positions of the indirect clients by the clearing member'⁶⁷

Current policy and proposed changes

3.8 We are responding to the requirements in the draft EMIR and MiFIR RTS only in so far as they affect CASS. The draft EMIR and MiFIR RTS discuss the requirements on clearing members and clients in relation to the clearing arrangements for indirect clients. The CASS rules speak to clearing members and clients that are UK-authorized. The changes proposed will only affect such clearing arrangements to the extent that there is a client money relationship between two relevant parties.

3.9 We propose to amend our existing rules on indirect clearing arrangements to facilitate the above default mechanisms and update existing cross-references and definitions in the Glossary referring to indirect clearing arrangements. The draft rules are set out in Appendix 1. Part 1 of Annex A and Part 1 of Annex B to the draft Handbook instrument concern the draft EMIR RTS; Part 3 of Annex A and Part 3 of Annex B to the draft Handbook instrument concern the draft MiFIR RTS.

Q19: Do you agree that our proposed changes will ensure that CASS is compatible with the draft EMIR and MiFIR RTS? If not, please provide reasons.

⁶⁴ Article 4(7)(b) of the draft EMIR RTS and MiFIR RTS

⁶⁵ Article 4(7)(c) of the draft EMIR RTS and MiFIR RTS

⁶⁶ Article 4(7)(d) of the draft EMIR RTS and MiFIR RTS

⁶⁷ Article 4(7)(e) of the draft EMIR RTS and MiFIR RTS

4. Proposals in CP13/5 and DP16/2 that we are not taking forward

- 4.1** There were a number of proposals discussed in CP13/5 and DP16/2 that we are no longer considering. In this chapter we summarise the feedback received on these proposals and set out our reasons for not taking them forward.

Administration costs to be deducted from the general estate

- 4.2** Following recommendations made by the Bloxham Final Report⁶⁸ on allocation of administration costs, the Treasury has amended the SAR Regulations to contain a mechanism for the IP to seek costs attributable to the firm's failure to comply with the client money rules from the firm estate, to the extent that such amounts are available in the firm estate.
- 4.3** In DP16/2⁶⁹ we stated that we were not proposing to reflect these changes in CASS, as they would be fully set out in the SAR. Instead we asked whether guidance on this in our existing statutory trust rules (CASS 7.17) was necessary.
- 4.4** The majority of feedback agreed that no changes or additions to CASS 7.17 were required. However, some respondents suggested adding guidance to cross-refer to the new requirement in the SAR Regulations to remind IPs and provide clarity for firms and IPs.

Our response

- 4.5** Having considered the feedback, we have decided not to add guidance to our rules as we do not generally cross-refer to primary or secondary legislation in the Handbook.

Client money buffer

- 4.6** In CP13/5 we proposed that a firm could choose to maintain a prudent segregation of client money in its client bank accounts for costs that may be borne by the CMP following the firm's failure. In PS14/9 the guidance in the final rules on the types of risks that a firm may wish to address by prudently segregating did not expressly refer to costs that may be borne by the CMP following the firm's failure, and we noted that we would consider this point further in the context of our review of the CASS 7A rules.

⁶⁸ Bloxham Recommendations 12 and 45, see Annex 2

⁶⁹ DP16/2 paragraphs 4.23 – 4.25

- 4.7** The Bloxham Final Report⁷⁰ supported the use of a ‘client money buffer’, i.e. what we refer to as a prudential segregation of client money under CASS, to meet insolvency expenses. DP16/2⁷¹ asked whether firms should be encouraged to segregate a prudent margin in respect of administration costs. Costs incurred in an administration may include maintaining firm systems and records, the claims process and potentially significant legal costs of court applications or litigation to resolve any disputes. Thus the amount of administration costs that we have seen in the context of firm failures has varied significantly from one firm failure to another.
- 4.8** The majority of feedback disagreed with the proposal. Some respondents noted that maintaining a prudent segregation amount for this purpose would not be necessary as firms are already subject to existing capital requirements. Respondents were also concerned that a prudent segregation amount is difficult to determine for an uncertain risk, gives preference to clients over general creditors, increases costs to firms on a going concern basis and poses a disproportionate burden on small firms.
- Our response**
- 4.9** Having considered the feedback and the changes made to the SAR Regulations on allocation of administration costs (see paragraph 4.2 above), we do not propose any amendments to encourage firms to segregate a prudent margin for administration costs. In any event, the current CASS rules do not prevent firms from holding such a prudent segregation amount should they choose to do so.

Firm records of FSCS⁷² entitlement

- 4.10** The Bloxham Final Report⁷³ recommended that firms should do more to assist IPs and the Financial Services Compensation Scheme (FSCS) to understand the status of their clients and products, to help determine FSCS eligibility. This could include flagging or otherwise linking their products to whether the firm is carrying on ‘designated investment business’ (DIB) in relation to each product.
- 4.11** In DP16/2 we sought feedback on the benefits of requiring firms to flag whether the provision of their products constitutes DIB, and for this information to be held in the firm’s CASS RP. We did not support Bloxham’s additional suggestion that firms should flag each client’s individual FSCS eligibility, as individuals are generally ‘eligible claimants’ under COMP 4.2.1.R, so flagging their individual status would bring little benefit for the costs of establishing and maintaining this record. There are also other variables involved in determining whether, at the time of the firm’s default, FSCS compensation may be payable and each claim is determined on a case-by-case basis.
- 4.12** Most respondents disagreed with this proposal on the basis that it was disproportionate and unduly burdensome. Respondents cited significant costs (both to resource, implement and maintain the records), systems complexity and development, that CASS protections only generally apply in relation to DIB, overlaps with the ‘single customer view’⁷⁴ and requirements under the Markets in Financial Instruments Directive II (MiFID II), and legal complexities. Many respondents also pointed to a lack of clear benefits to the IP and the FSCS.

⁷⁰ Bloxham Recommendation 52, see Annex 2 of this CP and paragraph 6.23 of Bloxham Final Report

⁷¹ DP16/2 paragraphs 4.46 - 4.60

⁷² Financial Services Compensation Scheme

⁷³ Bloxham Recommendation 16, see Annex 2

⁷⁴ See <http://www.fscs.org.uk/industry/single-customer-view/>

Our response

- 4.13** We do not propose to require firms to record whether the provision of each of their products constitutes DIB for the purposes of helping to determine FSCS eligibility in the manner suggested in the Bloxham Final Report. Particularly for large, complex firms as well as those offering bespoke products feedback indicated that flagging DIB products in firms' books and records in this way would require systems changes and is likely to be costly. In addition, CASS firms already need to be able to identify which parts of their business constitute DIB and which do not in order to comply with the rule book and they need to report on this business to clients in statements. We would expect most business that falls within the scope of CASS to be DIB, with some exceptions such as an ISA that only contains a cash deposit ISA. This information can be made available to the FSCS in the event of a firm's failure. Pre-existing flags in a firm's books and records highlighting DIB products may be a helpful indication to help determine eligibility to compensation. However, such flags would likely be a starting point for the FSCS and they would want to undertake their own review of a firm's products at the time of a firm default.
- 4.14** We agree that, in the context of a firm's failure, it is very important that the FSCS and failed firm cooperate and share information in order to expedite the claims and compensation processes as much as possible. As such, the amended SAR Regulations include a provision expressly requiring cooperation between a failed firm and the FSCS including the provision of 'any assistance identified by the FSCS as being necessary' to enable the FSCS to administer the compensation scheme in relation to clients' entitlements to compensation. We consider that requiring good information flow between the firms/IPs and the FSCS, including in relation to what constitutes DIB is a more proportionate, less costly approach than requiring firms to maintain DIB product flags in their books and records on an on-going basis.

Inclusion of FSCS entitlement in customer statements

- 4.15** The Bloxham Final Report⁷⁵ recommended that firms should consider explaining the circumstances in which the FSCS might provide compensation if the firm failed and the elements of a product that would not be covered in customer statements.
- 4.16** In DP16/2⁷⁶ we agreed in principle that clients should be provided with information on when the FSCS might provide compensation if a firm fails and the products or part(s) of a product that would not be covered. We identified the client statement as one means of communicating this but highlighted the number of conditions that must be met before any FSCS compensation can be paid. We also noted that any communication to clients would need to be carefully considered and qualified, as it could not provide confirmation of FSCS eligibility. DP16/2 sought feedback on whether firms should provide more clarity to clients around whether a firm's activities are covered by the FSCS, and asked whether the client statement was the best place to provide this and what such a record should comprise.
- 4.17** The majority of respondents disagreed with including FSCS compensation entitlement details in client statements. Concerns were raised in relation to possible misinterpretation by clients (as FSCS eligibility is determined by the FSCS based on the fact scenario at the time on a case-by-case basis), significant complexity and systems difficulties (caveated statements were not considered useful and incorrect statements worse); difficulties in determining protection in relation to certain products (e.g. offshore funds), implementation and maintenance costs and

⁷⁵ Bloxham Recommendation 17, see Annex 2

⁷⁶ DP16/2 paragraphs 4.30 – 4.32

legal complexities. There was mixed support for inclusion of this information on either the firm's website or in the terms of business.

Our response

- 4.18** We do not propose to require firms to provide more clarity to clients around whether a firm's activities may or may not be covered by the FSCS. Given that a number of factors are relevant to whether or not a client may ultimately receive FSCS compensation, firms are unlikely to be able to provide further clarity on FSCS compensation or certainty as to whether they might receive it. Firms are required under COBS 6.1 to provide compensation details to clients. We consider that this will be sufficient information in client documentation to flag to clients that they may be able to seek compensation from the FSCS in certain circumstances, without requiring clients to read through firm-by-firm explanations which may amount to the same message.

Inclusion of FSCS entitlement data in the CASS RP

- 4.19** The Bloxham Final Report⁷⁷ suggested that a firm's CASS RP should contain sufficient data to help the IP and FSCS identify clients' FSCS eligibility and possible FSCS compensation more speedily.
- 4.20** In DP16/2⁷⁸ we noted that we do not believe that it will be possible to provide all the necessary information in the firm's records, and therefore by extension in the CASS RP, to determine a client's eligibility to claim against the FSCS or for the FSCS to determine whether it can provide compensation. However, we agreed that it could be helpful for the IP if firms provided information about the structure of products and whether they are carrying on DIB in relation to a particular product. We therefore sought feedback on the benefits of requiring this data to be held in the CASS RP.
- 4.21** We received mixed responses. Some respondents suggested that general or practical information about products which may be eligible for FSCS compensation should be included in the CASS RP. Others commented that such an analysis would be unduly burdensome to create and maintain particularly with complex firms who regularly create bespoke products for clients, and it was questioned whether this would be proportionate to the objective and purpose of the CASS RP. Respondents also felt that the requirement of such information may introduce a level of complexity to the distribution process.

Our response

- 4.22** We do not propose to make any amendments to the CASS RP given the concerns that including information about the structure of products and whether a firm is carrying on DIB in relation to a particular product, would not in this regard be proportionate to the objective and purpose of the CASS RP. In addition, as highlighted under 'Firm records of FSCS entitlement' above, in the event of the firm's default, the FSCS may be unable to rely on such information without conducting its own review of the products.

⁷⁷ Bloxham Recommendation 18, see Annex 2

⁷⁸ DP16/2 paragraphs 4.33 – 4.34

CASS RP additions

- 4.23** In response to the Bloxham Final Report⁷⁹, in DP16/2⁸⁰ we considered incorporating additional record keeping requirements into the CASS RP⁸¹. In particular, we sought feedback on whether there should be any further additions made to the CASS RP to assist administrators and the FSCS to achieve speedy return or transfer of client assets, and prompt payment of FSCS compensation where due. Our proposal listed a number of areas the additional documents could be in relation to.
- 4.24** Some respondents suggested that it may be useful to require firms to hold a list of products offered and whether they are covered by FSCS compensation within the CASS RP. However, the majority of respondents disagreed with the proposed additions on the grounds that the information in these documents would be of little help to an IP in the initial days of insolvency. It was also noted that the additions would not add sufficient value when compared with the significant systems changes and related implementation efforts required. There was also concern that with these additions the CASS RP could take on more of the characteristics of a CASS policy and procedures manual.
- 4.25** Many respondents commented that sufficient documentation was currently already required in the CASS RP and covered by existing CASS rules. It was suggested that a summary of much of the information needed (such as whether the firm is acting as trustee, relying on exemptions, prudently segregating money), can be included on a product-by-product basis in a 'CASS footprint document', which would show how CASS arises in the firm. Feedback also emphasised the importance of access to the 'right' information in the initial days of insolvency; giving specific examples of up-to-date standard reconciliation data, bank acknowledgement letters and contact details, and custody agreements, as being of far more help to an IP than sheer quantity.

Our response

- 4.26** Having considered the feedback, we have decided not to proceed with our proposal to incorporate additional record keeping requirements into the CASS RP. We consider that the CASS RP currently requires appropriate documentation (including procedures) and the right information needed by an IP within the first 48 hours of a firm's insolvency. Provided firms ensure these are available to the IP through the firm's standard record-keeping processes, we believe this should be sufficient.

Codification of case law and LBIE judgments within CASS

- 4.27** CP13/5⁸² considered whether the client money distribution rules should codify some of the lessons learnt from firm insolvencies. This was suggested as an alternative to the speed proposal⁸³. DP16/2⁸⁴ also considered the Bloxham Final Report recommendations on whether any points from the LBIE judgments or any other court decisions would benefit from codification in CASS 7A and asked for views on these questions.

⁷⁹ Bloxham Recommendation 30, see Annex 2

⁸⁰ DP16/2 paragraphs 4.35 – 4.37

⁸¹ Introduced by PS14/9 in 2014

⁸² CP13/5 paragraphs 2.30 – 2.31

⁸³ See paragraph 1.11 in Chapter 1 above

⁸⁴ Bloxham Recommendation 48 and 49, see Annex 2

4.28 The majority of respondents disagreed with codifying any points from case law and LBIE judgments. The reasons given were that they were not aware of any further points requiring codification, codification could lead to legal uncertainty and conflict with existing legislation, and the CASS rules already adequately capture the lessons learned from firm failures. In contrast, two respondents suggested the CASS rules should provide further clarity on the currency conversion of client money entitlements and points arising from the MF Global shortfall judgment.⁸⁵

Our response

4.29 Having considered the feedback, we do not intend to codify any further points from the LBIE judgments or other court decisions. In particular, we are not proposing to introduce any further currency related provisions in CASS (see paragraphs under 'Currency conversion' below for further details) or to codify the MF Global shortfall judgment. We agree with the position set out by the Treasury in its March 2016 consultation paper that court decisions have already provided a considerable degree of clarity to the types of client claims, and we further agree that determination of the different types of claims that clients may be able to bring in different circumstances continues to be a matter for the courts.

Standardisation of data supplied

4.30 In DP16/2⁸⁶ we explored the Bloxham recommendation to consider the standardisation of data, particularly in relation to on-going transactions that an administrator may use to determine a client's entitlement.

4.31 We considered that it would not be feasible to mandate a standard of data across all firms given the diversity across the market of different working systems and platforms. We also noted that there are a number of existing work streams on data standards and formats for reporting requirements under EMIR, MiFIR and MiFID II.

4.32 The majority of feedback agreed that data standardisation was not feasible and additionally commented on the potential complexity and cost that could be involved. A number of respondents also commented that the current CASS rules requiring firms to hold a CASS RP, designed to comprise all the key information and books and records required by an administrator on insolvency, were sufficient.

Our response

4.33 Having considered the feedback, we do not intend to require the further standardisation of firms' data. We consider that the CASS RP and current work streams on data standards and formats for reporting requirements under EMIR, SFTR⁸⁷ and MiFID II/MiFIR are sufficient. The UK is also supportive of global initiatives to standardised data standards and formats including the work of CPMI-IOSCO and the LEI Regulatory Oversight Group.

⁸⁵ Re MF Global UK Limited [2013] EWHC 2556 (Ch)

⁸⁶ DP16/2 paragraphs 4.61 – 4.64

⁸⁷ Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012, commonly referred to as the 'Securities Financing Transactions Regulation'

Payment of interest

- 4.34** In CP13/5⁸⁸, we proposed a rule requiring any interest earned on client money after a PPE to be used to reduce any shortfall in that CMP. The responses were broadly supportive, with a few respondents requesting further clarification, noting that this would unfairly disadvantage clients with large cash balances or that it contradicted the post-PPE receipts rule.
- 4.35** In DP16/2⁸⁹ we requested feedback on the proposal in CP13/5, and an alternative option of paying interest earned on the CMP to clients on a *pari passu* basis. We proposed that such interest would be paid into the CMP but would be accounted for separately, and a *de minimis* of £5 (for retail clients) and £10 (for professional clients) applied, with these *de minima* used to offset any shortfall in the CMP.
- 4.36** Responses to DP16/2 were fairly evenly split between support for interest to be added to the CMP and paid *pro-rata*, and those suggesting a continuation of the firm's existing contractual arrangements with clients. A number of comments were received in relation to both options, raising concerns including the possibility of legal challenge from clients with large cash balances if contractual terms are overridden post-PPE.

Our response

- 4.37** We do not propose to introduce a post-PPE interest provision in CASS 7A. We have reached this decision having weighed up the lack of consensus in the responses received, the potential conflict with contractual arrangements and costs that could arise in the event of legal challenge from clients if contractual terms were overridden or not clear post-PPE. We also understand that the treatment of post-PPE interest has not been identified as causing difficulties in insolvencies to date.

Currency conversion

- 4.38** In CP13/5⁹⁰ we proposed a rule that required the CMP to be converted promptly to the most prevalent currency in the CMP, following the recovery of the client money by the IP. Client entitlements were also proposed to be valued in this currency as at the date of the PPE.
- 4.39** Most responses were in agreement, but a significant number disagreed, expressed reservations or raised queries as to the timing of conversion or the rates to be employed. Concerns raised related to the risks of converting the money to a volatile or exotic currency, disadvantages to clients who have a contractual agreement to be paid in a specific currency and the potential exchange rate risks of converting all monies into a single currency. Some respondents suggested that for large pools it would be more feasible to hold the monies in a number of key currencies, as a slight variation in the rate could significantly impact the overall entitlement. Respondents also commented on converting client money entitlements to sterling (as per the general estate) and maintaining client money in the most appropriate currency or currencies. Others noted that it may be better for the IP to determine the most appropriate approach to currency conversion, as the circumstances of each case are likely to be different.

88 CP13/5 paragraph 2.54

89 DP16/2 paragraphs 4.65 – 4.67

90 CP13/5 paragraph 2.55

Our response

- 4.40** We have taken into account the feedback received and noted the concerns raised. We recognise that each firm will have a unique currency risk profile, according to its business model and the currency related arrangements in place within its contractual agreements. With this in mind, we do not propose to make any amendments to CASS 7A on currency conversion.

Placement of client money in client transaction accounts at CCPs

- 4.41** We received some feedback that, in order to help minimise the ability of third parties to successfully assert proprietary claims over assets and positions in accounts at CCPs and as a result potentially undermine the CCP's default management processes and the legislation supporting them, it would be helpful for the client money rules to expressly set out that firms can only transfer client money to accounts which are made available by the recipient CCP for usage as client transaction accounts.

Our response

- 4.42** We have considered this feedback. The CASS 7 rules as currently drafted, subject to limited exceptions, only permit firms to place client money in client bank accounts and qualifying money market funds (QMMFs), (pursuant to CASS 7.13.3R) and client transaction accounts (pursuant to CASS 7.14). As such, the rules do not permit firms to place client money in other types of accounts, such as accounts at CCPs which are not client transaction accounts.

Annex 1

List of questions

- Q1:** Do you agree with this proposal relating to the post-PPE transfer of client money? If not, please provide reasons.
- Q2:** Do you agree with our proposal to create a new section containing post-failure custody rules for transfers and the treatment of unclaimed custody assets? If not, please provide reasons.
- Q3:** Do you agree with our proposal regarding post-transfer communications with clients? If not, please provide reasons.
- Q4:** Do you agree with this proposal to safeguard clients' proprietary rights? If not, please provide reasons.
- Q5:** Do you agree with our proposed treatment of allocated but unclaimed (or declined) and unallocated client monies? If not, please provide reasons.
- Q6:** Do you agree with our proposals regarding the treatment of clients with de minimis client money balances? If not, please provide reasons why.
- Q7:** Do you agree with this proposal on the application of the Hindsight Principle? If not, please provide reasons.
- Q8:** Do you agree with our proposed clarifications in CASS 7A relating to the post-administration reconciliation under the SAR? If not, please provide reasons.
- Q9:** Do you agree with this proposal on annotated client statements? If not, please provide reasons.
- Q10:** Do you anticipate that this proposal will have significant cost implications? If so, please explain this further.
- Q11:** Do you agree with our proposal to enable the FCA to place a requirement over client money without triggering a PPE event? If not, please provide reasons.

- Q12:** Do you agree with our proposal to remove the breach of duty to notify the FCA that it is unable to comply with its record keeping requirements following a secondary pooling event from triggering a PPE event? If not, please provide reasons.
- Q13:** Do you agree with our proposal to allow client monies received post-PPE to be placed in an existing client bank account? If not, please provide reasons.
- Q14:** Do you agree with our proposal to allow firms to retain costs properly attributable to the distribution of post-PPE client money? Should these deductions be allocated per individual rather than on a mutualised basis? If not, please provide reasons.
- Q15:** Do you agree with our proposed approach to clarifying the treatment of client monies received post-PPE? If not, please provide reasons.
- Q16:** Do you agree with the proposals to include CCPs in the scope of a secondary pooling event, and to exclude from secondary pooling amounts in certain client transaction accounts, including where relating to sub-pools? If not, please provide reasons.
- Q17:** Do you agree with our proposed application of the CASS and SUP going concern rules following failure or PPE? If not, please provide reasons.
- Q18:** Do you agree with this proposed approach? If not, please provide reasons.
- Q19:** Do you agree that our proposed changes will ensure that CASS is compatible with the draft EMIR and MiFIR RTS? If not, please provide reasons.
- Q20:** Do you have any comments on our cost benefit analysis? Please provide explanations and quantitative evidence to support your response where appropriate.
- Q21:** Do you have any comments on the compatibility statement?

Annex 2

List of Peter Bloxham Recommendations addressed by FCA

Recommendation	Addressed in DP16/2 and/or CP17/2
A. Facilitating transfers	
Transfer mechanism 1. Introduce a SAR mechanism to facilitate rapid transfer of customer relationships and positions, where feasible. (SAR Objective 1)	DP16/2 CP17/2
Use of Nominee Companies 3. FCA should consider encouraging firms, in appropriate cases, to use a wholly owned subsidiary as the nominee company to hold legal title to client investments (other than cash).	DP16/2
B. Bar Date reforms	
Extend Bar Date to Client Monies 4. Bar Date mechanism should be extended to include Client Monies.	DP16/2 CP17/2
C. Making CASS and SAR work together better	
Relationship between CASS and SAR rights 10. Ensure relationship between client's rights under CASS in respect of Client Assets and its rights to make claims as a creditor are clearly set out and understood and do not operate unfairly to other creditors.	DP16/2
Extension of Hindsight Principle 14. FCA to consider whether Hindsight Principle could be introduced for CASS Client Money Pool Entitlement purposes.	DP16/2 CP17/2
D. FSCS recommendations	
Shortfalls 15. FCA should consider extending FSCS compensation for portfolio transfers to cover shortfalls in Custody Assets as well as Client Money shortfalls (provided they fall within the scope of FSCS protection).	DP16/2
Firm records 16. Firms in going concern mode should do more to ensure their records would assist Administrators and FSCS to understand the status of their clients for FSCS purposes and how their products are structured and consequently whether FSCS may be able to provide compensation.	DP16/2 CP17/2

<p>Statements on FSCS Entitlements</p> <p>17. Firms should consider explaining in customer statements the circumstances in which FSCS might provide compensation if firm failed and elements of a product that would not be covered.</p>	<p>DP16/2 CP17/2</p>
<p>CASS Resolution Packs</p> <p>18. CASS resolution packs to contain sufficient data to enable Administrator and FSCS to more speedily identify eligible clients and whether FSCS can provide compensation in relation to any parts of the business of the failed firm.</p>	<p>DP16/2 CP17/2</p>
<p>F. Other SAR recommendations</p>	
<p>CASS Resolution Packs</p> <p>30. FCA to seek views on proportionate additions to CASS Resolution Packs, to provide maximum assistance to Administrator and FSCS to achieve speedy return or transfer of Client Assets, and prompt payment of FSCS compensation where available.</p>	<p>DP16/2 CP17/2</p>
<p>Reporting formats</p> <p>31. Every firm's CASS Resolution Pack should contain a detailed explanation of how client statements are presented. The particular methodology used by a firm should be clearly set out as part of the client statement.</p>	<p>DP16/2 CP17/2</p>
<p>Restrictions on Status Changes ("Switching")</p> <p>32. Clarity regarding status of professional clients who, having contracted out of CASS, seek to switch back from unsecured creditor to client status, to maximise their protection. Switching only to be allowed to take place after the firm's records (and if necessary transfers between firm and client accounts) has been updated to reflect the client's change to protected client status.</p>	<p>DP16/2</p>
<p>G. Role of the Courts and dispute resolution</p>	
<p>FCA power to make determinations</p> <p>44. As an alternative to Court, an FCA power to make binding rulings on points unclear or not covered by CASS, in individual cases.</p>	<p>DP16/2</p>
<p>H. Some more general recommendations</p>	
<p>Administrator power to top up Client Money shortfalls from firm funds where Client Monies not paid into client accounts prior to the firm's failure.</p> <p>46. Where firms use the 'Alternative Approach' to temporarily pay client monies into a general firm account, there should be a mechanism allowing the Administrator to transfer out of credit balances on firm account sums which they consider to reflect the proceeds of payments made by clients, or by third parties for the account of the firm's clients, into a firm account and not transferred into a client account prior to the failure. If this recommendation is adopted, the authorities should consider both whether the Administrator can do this of their own accord, or should require court consent and whether this "top up" principle should have wider application than just where firms adopt the "Alternative Approach".</p>	<p>DP16/2 CP17/2</p>

<p>FCA powers</p> <p>47. FCA and Treasury should identify legislative constraints under which FCA works in this area to consider whether to empower FCA to operate a more effective regime to protect Client Assets in going concern mode and also on the failure of an investment firm.</p>	<p>DP16/2</p>
<p>Codification</p> <p>48. Any codification of CASS Rules should provide an alternative mechanism to the outcomes of Court decisions that are considered unworkable, e.g. by providing a regulatory alternative or substitute to Tracing.</p> <p>49. Codify the existing CASS regime as now elucidated by LBIE Court judgements.</p>	<p>DP16/2 CP17/2</p>
<p>FCA CP13/5 and Speed Proposal</p> <p>50. FCA involves experienced Insolvency Practitioners, in-house Client Asset specialists at investment firms and expert financial services and insolvency lawyers in formulating any rules relating to the FCA's Speed Proposal if introduced.</p> <p>51. If the FCA implements 'Speed Proposal', consider mechanism for FCA to "bless" Administrator's conclusion that Speed Proposal can be pursued, as it is reasonable to determine client entitlements from firm records.</p>	<p>DP16/2</p>
<p>Buffer</p> <p>52. Support use of buffer for insolvency expenses.</p>	<p>DP16/2 CP17/2</p>
<p>Segregation/multiple pools</p> <p>53. Create regulatory requirement for clear "virtual" segregation in a firm's records between securities purely held on a custody basis and others, such as those which may be charged back to the firm.</p>	<p>DP16/2</p>
<p>FCA/PRA roles</p> <p>58. Guidance Note on FCA/PRA Roles in SAR cases.</p>	<p>DP16/2</p>

I. Behavioural recommendations

65. Good record-keeping essential: Some firms need to improve quality of records. Practices of reconciliation of firm and client or counterparty records need to be enhanced.

66. Clients should be encouraged to review statements received from firms.

67. Consider standardisation of the data supplied or notes provided particularly on-going transactions.

68. Firms to make sure clients (especially retail clients) should be able readily to understand contents of client statements, particularly in relation to the status of on-going trades. Regulators should ensure this.

69. Client asset and money rules need to be fully understood by both regulators and regulated.

70. Firm's intra-group relations need to be clear and transparent: firms should remove any ambiguities in their intra-group contractual and entitlement arrangements. Regulators should focus on this and consider whether CASS resolution packs for groups should contain copies of the principal long term intra-group agreements.

71. Improvements to communications should be considered: FCA, FSCS and HMRC should explore whether dialogue and co-operation between them on SAR cases could be improved; making sure the existing gateways for exchange of information are adequate. These authorities should also consider whether there are any lessons from the cases to date. The complexities of the circumstances in which FSCS may be able to provide compensation would be one example.

72. Changes to the SAR regime should be tested. At a future point, the authorities should consider operating "test cases" of a hypothetical SAR taking into account improvements made as a result of this review or otherwise, any changes the FSA makes to the CASS rules following its own review of those, and, importantly, taking account of EMIR.

DP16/2

Annex 3

Cost benefit analysis

1. The Financial Services and Markets Act 2000 (FSMA) requires us to publish a cost benefit analysis (CBA) when proposing draft rules. Specifically, section 138(2)(a) requires us to publish a CBA of proposed rules, defined as ‘an analysis of the costs, together with an analysis of the benefits’ that will arise if the proposed rules are made. It also requires us to include estimates of those costs and benefits, unless these cannot reasonably be estimated or it is not reasonably practicable to produce an estimate.
2. In this chapter we:
 - summarise the proposals and assess the costs and benefits, and
 - explain why we expect the incremental costs of the proposals to be of minimal significance

Our proposed rule changes

3. This CBA compares the overall position if the proposed regulatory changes are applied and the overall position if they are not (i.e. the baseline). A detailed CBA has not been prepared as the costs arising from the proposals are deemed to be of minimal significance. This is explained further at paragraphs 4 to 6 and 16 to 26 below.
4. Our proposed Handbook changes fall into 3 categories:
 - changes to implement the Bloxham Final Report’s recommendations to the FCA;
 - changes that our experience of firm failures has shown need to be made; and
 - changes required under the amended EMIR RTS and MiFIR RTS
5. The majority of our proposals apply to firms following a PPE and do not impact firms on a going-concern basis. In most cases, the relevant PPE will be the firm’s insolvency. Where this is the case, the SAR or other insolvency regime requirements specifically set out how the costs of the insolvency are to be allocated; broadly, these are between clients and creditors.
6. We anticipate that the majority of our proposals will not result in an increase in costs, or that where they do, the costs will be of minimal significance. This is because our changes are largely clarificatory, reduce regulatory obstacles and provide flexibility for the IP. Overall, we consider our proposals will reduce the time and costs associated with distribution of client money.

Benefits of the proposals

Changes to implement the Bloxham Review’s recommendations to the FCA

7. The proposal to **allow transfers of client assets** following a PPE will remove the need for a firm or IP to obtain court approval to use this process; allow clients to continue receiving services

without their assets being caught up in insolvency proceedings; and reduce administration costs.

8. The proposal to require a firm or IP to **apply the close-out value (i.e. hindsight) to cleared open margined transactions** will provide certainty over how to calculate client entitlements to the CMP for such trades and consequently reduce time and costs of distribution of client money. The proposal also reduces discrepancies between the close-out value of these trades and the amount contributed to the CMP in respect of these trades; and aligns the way these types of trades are valued for the purposes of claims on the client estate and the general estate. This reduces the opportunity for clients and creditors to arbitrage the estates to the cost of all clients and creditors.
9. The proposal to clarify the **post-administration client money reconciliation** required under the amended SAR regulations⁹¹ will provide clarity for an IP when dealing with a firm in a SAR administration and consistency with the amended SAR regulations.
10. The proposal to require firms to make an **annotated sample statement** available to clients will provide clarity for clients and will explain the meaning of the information that the firm presents to clients in their statements. The proposal will also provide the same clarity for a firm or IP. This avoids any potential litigation and minimises obstacles to the return of client assets.

Changes that our experience of firm failures has shown need to be made

11. The proposal to amend one of the **triggers of the PPE** will provide the FCA with a more flexible tool in the context of placing requirements on all client money of a firm. This is to the benefit of the firm and consumers if a PPE is not appropriate.
12. The proposal to clarify the treatment of **client money received by the firm after a PPE** will provide clarity to a firm or IP on how to deal with such money. It will also reduce costs for the firm by avoiding the need to change existing payment instructions and to set up new accounts.
13. The proposal to **add exchanges and CCPs to the secondary pooling event rules** will clarify the treatment of client money held by these entities if they fail.
14. The proposal to require a firm or IP to **trace and contact clients prior to a final distribution of client assets** will provide an additional safeguard to clients before their assets are distributed, enables the CMP to be closed earlier and consequently improves the level of client assets returned.
15. The proposal to clarify which **CASS and SUP rules apply post-PPE** will provide clarity to the firm or IP and continues the protection of client assets under CASS following a PPE. In particular, the proposal to dis-apply the annual CASS audit of compliance for the audit period following a firm failure will generate cost saving of between £1,000 to £127,000 per failing firm⁹².

⁹¹ Regulation 10H of the amended SAR Regulations

⁹² This includes three elements: (i) producing the report - ranges from £700 to £125,000; (ii) staff admin costs averaged as £200; and (iii) reviewing the findings of the auditor's report – ranging between £200 and £2,000 annually. These are based on figures and assumptions made in CP11/13

Costs of the proposals

Changes to implement the Bloxham Review's recommendations to the FCA

16. The proposal to require firms to make an **annotated sample statement** available to clients will result in cost increases of minimal significance, as firms will already have this information available when compiling client statements (e.g. under existing requirements in CASS and COBS⁹³). We envisage the costs could arise from: documenting the annotation; making it available to clients; and maintaining this on an on-going basis. We consider these steps could use existing resource (e.g. one web editor uploading the annotation onto a prominent place on their website).
17. The proposal to **allow transfers of client assets** will not result in any additional cost as it will reduce regulatory obstacles (e.g. court approval) relating to transferring client assets following a PPE. The proposed change is also an option (rather than a requirement) for the firm or IP following PPE.
18. The proposal to **apply hindsight to cleared open margined transactions** will not result in any additional costs as the increased clarity on the treatment of these trades will reduce the time and costs of distribution of client money. In a firm failure situation, the opportunity for clients and creditors to arbitrage between the estates is also reduced, thus reducing the costs of the administration.
19. The proposal to clarify the **post-administration client money reconciliation** required under the amended SAR regulations will not result in any additional costs as a result of the proposed changes to CASS 7A.

Changes that our experience of firm failures has shown need to be made

20. The proposal to require a firm or IP to **trace and contact clients prior to a final distribution of client assets** may result in costs associated with tracing and contacting clients. However, we consider that firms compliant with record-keeping requirements under CASS should maintain current contact details for their clients and therefore should not need to incur significant tracing costs. In addition, firms can rely on previous tracing exercises undertaken under the client money rules⁹⁴, and the provisions are reduced for professional clients and dis-applied in relation to de minimis client balances and clients who do not wish to submit a claim, further reducing costs. In any event, these costs will be incurred post-failure and may be absorbed by the client estate.
21. The proposal on clarifying the treatment of **client money received by the firm after a PPE** will not result in additional costs, as it provides flexibility and certainty on dealing with client money post-PPE and consequently reduces administration costs.
22. The proposal to clarify which **CASS and SUP rules apply post-PPE** will not result in additional costs as it will increase certainty, which is expected to reduce time to distribute client assets and administration costs.
23. The proposals to amend the **triggers of the PPE** and add **exchanges and CCPs to the secondary pooling event rules** will not result in any additional costs to a firm, IP or other parties.

⁹³ Conduct of Business sourcebook

⁹⁴ CASS 7.11.52E

Indirect client clearing (EMIR RTS and MiFIR RTS)

- 24.** The proposed changes to the client money rules due to EMIR and MiFIR RTS will largely impact firms on distribution of client money in the event of the firm's failure. We therefore do not foresee any material compliance costs to firms with these proposals. Most of the proposed changes are updating cross-references referring to indirect clearing arrangements. This includes references in the client transaction acknowledgement letter⁹⁵. There may be some costs associated with repapering these letters for indirect clearing arrangements⁹⁶.
- 25.** There could be changes for firms that are attributed by EMIR or MiFIR. The costs associated with these changes are not part of these proposals.
- 26.** We do not consider the changes will reduce the current level of consumer protection as the changes simply facilitate additional default procedures a clearing member is required to follow for indirect clients in the event that a client defaults.

**Q20: Do you have any comments on our cost benefit analysis?
Please provide explanations and quantitative evidence to
support your response where appropriate.**

⁹⁵ CASS 7 Annex 3R

⁹⁶ Client transaction account acknowledgement letters under CASS 7 Annex 3 for other arrangements would not need to be re-papered as we understand such firms would delete the square-bracketed text referring to indirect clearing arrangements in the letter

Annex 4

List of non-confidential respondents to DP16/2

Below is a list of respondents to DP16/2⁹⁷ who provided their feedback on a non-confidential basis:

1. Association for Financial Markets in Europe (AFME)
2. Aviva
3. Baillie Gifford
4. British Bankers' Association
5. CMC Markets UK Plc
6. Deutsche Bank
7. Ernst & Young LLP
8. Eurex Clearing AG
9. Insolvency Lawyers' Association
10. Investec Wealth & Management Limited
11. IG Group
12. Invesco
13. James Hastie Consulting
14. KPMG
15. Swingmill Limited
16. London Stock Exchange Plc & LCH Clearnet Group Limited
17. Lloyds Banking Group
18. Multrees Investor Services Limited
19. The Northern Trust Company London Branch, Northern Trust Global Services Limited

⁹⁷ Throughout this document references are also made to feedback provided in response to CP13/5. For a list of the non-confidential respondents to CP13/5, see Annex 2 in PS14/9

20. Pershing Securities Limited
21. PricewaterhouseCoopers
22. Royal Bank of Scotland
23. TA Forum
24. The Tax Incentivised Savings Association (TISA)
25. Wealth Management Association

Annex 5

Compatibility statement

1. This annex explains how our proposals for consultation in this CP are compatible with the requirements under section 138I of FSMA.
2. When consulting on new rules, we are required by section 138I(2)(d) of FSMA to explain why the proposed rules are compatible with our strategic objective of ensuring relevant markets function well, advances one or more of our operational objectives, and has regard to the statutory principles in section 3B of FSMA. We are also required by section 138K(2) of FSMA to state our opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.
3. This annex also sets out our view of how the proposed rules are compatible with our duty to discharge our general functions (including rule-making) in a way that promotes effective competition in the interests of consumers (section 1B(4) of FSMA). This duty applies in so far as promoting competition is compatible with advancing either or both of our consumer protection and integrity objectives.

Our regulatory objectives

4. Our consultation proposals in this CP aim primarily to advance our operational objectives of:
 - delivering consumer protection – secure an appropriate degree of protection for consumers by improving speed of return of assets, reduced administration costs and improved consumer outcomes in the event of an investment firm entering SAR insolvency
 - enhancing market integrity - protecting and enhancing the integrity of the UK financial system by reducing impact of firm failure on the markets and legal uncertainty, and
 - building competitive markets - promoting effective competition in the interests of consumers
5. In preparing the consultation proposals in this CP, we have had regard to the principles set out in section 3B of FSMA.

Compatibility with the principles of good regulation

The need to use our resources in the most efficient and economical way

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

Proportionality of burdens or restrictions imposed on persons or on carrying on an activity

7. We believe we are putting forward a proportionate approach that sets an appropriate level of client protection while minimising, as far as possible, burdens on firms and the impact on competition, including competitive entry.
8. We consider that the cost of our consultation proposals is proportionate to the benefits, because as discussed in the CBA section (Annex 3) they will:
 - provide additional clarity, flexibility and certainty to IPs when distributing client money;
 - reduce the time delays and costs of insolvencies;
 - reduce applications to court for direction and the likelihood legal action in respect of client claims;
 - reduce the impact and level of consumer detriment suffered by clients of a failed firm; and
 - reduce the lost opportunity costs to clients arising from having their client money tied up in the insolvency

Exercise our functions as transparently as possible

9. We are using this CP to seek input into the approach we adopt and we invite feedback to help shape the final rules and guidance to be introduced.

Expected effect on mutual societies

10. We do not expect that the consultation proposals in this CP will have an impact on mutual societies as we are not aware of any mutual societies that hold client assets and would, therefore, be subject to these proposed rules.

Compatibility with the duty to promote effective competition in the interests of consumers

11. We have a duty to discharge our general functions (which include rule making) in a way that promotes effective competition in the interests of consumers (section 1B(4) of FSMA). This duty applies in so far as promoting competition is compatible with advancing our consumer protection and/or integrity objectives.
12. As explained in the CBA in Annex 3, we do not expect these changes to have significant market impacts. In particular, in relation to competition, we do not expect that the proposed changes will materially affect the number of firms providing investment or custody services, or their incentives to compete with each other for customers.

Legislative and Regulatory Reform Act 2006 (LRR)

13. We are required under the LRR to have regard to the principles in the LRR and to the Regulators' Compliance Code when determining general policies and principles and giving general guidance (but not when exercising other legislative functions).
14. We have also considered the Regulators' Compliance Code for the parts of the proposals that consist of general policies, principles or guidance.
15. We consider that the proposals are proportionate to the potential market failures identified.

Equality and diversity

16. We are required under the Equality Act 2010 to 'have due regard' to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. As part of this, we have conducted an equality impact assessment to ensure that the equality and diversity implications of any new policy proposals are considered.
17. Our findings indicate that these proposals have no anticipated positive or negative impacts on particular groups as a result of any protected characteristic.

Q21: Do you have any comments on the compatibility statement?

Appendix 1

Draft Handbook text

CLIENT ASSETS (CLIENT MONEY AND CUSTODY ASSETS DISTRIBUTION AND TRANSFERS) INSTRUMENT 2017

Powers exercised

- A. The Financial Conduct 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 137A (The FCA’s general rules);
 - (2) section 137B (FCA general rules: clients’ money, right to rescind etc);
 - (3) section 137T (General supplementary powers);
 - (4) section 138C (Evidential provisions); and
 - (5) section 139A (Power of the FCA to give guidance).
- B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. Annexes A and B to this instrument come into force as specified within those Annexes, and Annex C to this instrument comes into force on [date].

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.
- F. The Supervision manual (SUP) is amended in accordance with Annex C to this instrument.

Citation

- G. This instrument may be cited as the Client Assets (Client Money and Custody Assets Distribution and Transfers) Instrument 2017.

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.

Part 1: Comes into force on [date]

Amend the following definitions as shown.

<i>EMIR L2 Regulation</i>	<p>Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP, as amended by <u>Commission Delegated Regulation (EU) No [.../..] of [date] amending Commission Delegated Regulation (EU) No 149/2013 with regard to regulatory technical standards on indirect clearing arrangements.</u></p> <p>[<i>Editor's note:</i> At the time of consultation, this EU Regulation has not been published in the Official Journal of the European Union. A draft can be found at section 3.3.1 of the document available here: https://www.esma.europa.eu/sites/default/files/library/2016-725.pdf. This instrument for consultation takes into account the draft as if it had passed into EU law.]</p>
<i>individual client account</i>	<p>as the context requires, either:</p> <p>(a) an account <u>account</u> maintained by a <i>firm</i> at 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> has agreed with the <i>firm</i> to provide <i>individual client segregation</i>; or</p> <p>(b) an account <u>account</u> maintained by a <i>firm</i> for an <i>indirect client</i> at a <i>clearing member</i> of an <i>authorised central counterparty</i> in respect of which the <i>clearing member</i> has agreed with the <i>firm</i> to provide segregation arrangements that satisfy the requirements of article 4(2)(b) of <u>as described in recital 6 to the EMIR L2 Regulation.</u></p>
<i>omnibus client account</i>	<p>as the context requires, either:</p> <p>(a) an account <u>account</u> maintained by a <i>firm</i> at 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> has agreed with the <i>firm</i> to provide <i>omnibus client segregation</i>; or</p> <p>(b) an account <u>account</u> maintained by a <i>firm</i> for more than one <i>indirect</i></p>

client at a clearing member ~~in respect of which that clearing member has agreed with the firm to provide segregation arrangements that satisfy the requirements of~~ as described in article 4(2)(a) or 4(2)(b) of the EMIR L2 Regulation.

Part 2: Comes into force on [date]

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

IBSAR Regulations the Investment Bank Special Administration Regulations 2011 (SI 2001/245).

[*Editor's note:* At the time of consultation, SI 2001/245 is proposed to be amended. A draft of the amending statutory instrument has been published and is available here:

<http://www.legislation.gov.uk/id/ukdsi/2017/9780111152980>. This instrument for consultation takes into account the changes proposed by that draft amending statutory instrument as if they were made.]

secondary pooling shortfall (in CASS 7A.3) the amount by which the *client money* held by a *firm* is insufficient to satisfy the claims of the *firm's clients* in respect of that *money*, or not immediately available to satisfy such claims, in either case following the *failure* of a *person* to which a *firm* had transferred *client money* under CASS 7.13.3R(1) to CASS 7.13.3R(3) (Depositing client money) or CASS 7.14.2R (Client money held by a third party).

Amend the following definitions as shown.

client money distribution or transfer rules CASS 7A.

failure the appointment of a liquidator, receiver, ~~or~~ administrator, special administrator or trustee in bankruptcy, or any equivalent procedure in any relevant jurisdiction.

secondary pooling event ...

(3) (in CASS 7 and CASS 7A) an event that occurs in the circumstances described in CASS 7A.3.1R (Failure of a bank, intermediate broker, settlement agent, ~~or~~ OTC counterparty, exchange or clearing house: secondary pooling events).

...

Part 3: Comes into force on [date after Part 1]

Insert the following new definition in the appropriate alphabetical position. The text is not underlined.

MiFIR indirect clearing RTS Commission Delegated Regulation (EU) No [.../..] of [date] supplementing *MiFIR* with regard to regulatory technical standards on indirect clearing arrangements.

[*Editor's note:* At the time of consultation, this EU Regulation has not been published in the Official Journal of the European Union. A draft can be found at section 3.3.2 of the document available here: <https://www.esma.europa.eu/sites/default/files/library/2016-725.pdf>. This instrument for consultation takes into account the draft as if it had passed into EU law.]

Amend the following definitions as shown.

individual client account as the context requires, either:

...

(b) an account maintained by a *firm* for an *indirect client* at a *clearing member* of an *authorised central counterparty* in respect of which the *clearing member* has agreed with the *firm* to provide segregation arrangements as described in:

(i) recital 6 to the *EMIR L2 Regulation*; or

(ii) recital 6 to the *MiFIR indirect clearing RTS*.

omnibus client account as the context requires, either:

...

(b) an account maintained by a *firm* for more than one *indirect client* at a *clearing member* as described in:

(i) article 4(2)(a) or 4(2)(b) of the *EMIR L2 Regulation*; or

(ii) article 4(2)(a) or 4(2)(b) of the *MiFIR indirect clearing RTS*.

Annex B

Amendments to the Client Assets sourcebook (CASS)

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

Part 1: Comes into force on *[date]*

7 Client money rules

...

7.11 Treatment of client money

...

- 7.11.37 R *Client money* received or held by the *firm* and transferred to a *clearing member* who facilitates indirect clearing through a *regulated clearing arrangement* ceases to be *client money* for that *firm* and, if applicable, the *clearing member*, if the *clearing member*:
- (1) remits payment to another *firm* or to another *clearing member* in accordance with default management procedures adopted by the *clearing member* which comply with the requirements of article ~~4(4)~~ 4 of the *EMIR L2 Regulation*; or
 - (2) remits payment to the *indirect clients* of the *firm* in accordance with default management procedures adopted by the *clearing member* which comply with the requirements of ~~articles 4(4) and 4(5)~~ article 4 of the *EMIR L2 Regulation*.

...

7 Annex 3R Client transaction account acknowledgment letter template

...

- (d) all money standing to the credit of the Client Transaction Account is payable to us in our capacity as trustee under the laws applicable to us[, except where, in accordance with your default management procedures in respect of a default by us, you transfer money credited to the Client Transaction Account to anyone other than us in accordance with ~~articles 4(4) or 4(5)~~ article 4 of Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012];

[*Editor's note:* At the time of consultation, the EU Regulation amending Commission Delegated Regulation (EU) No 149/2013 has not been published in the Official Journal of the European Union. A draft can be found at section 3.3.1 of this document: <https://www.esma.europa.eu/sites/default/files/library/2016-725.pdf>.]

...

Part 2: Comes into force on [date]**1A CASS firm classification and operational oversight****1A.1 Application**

...

1A.1.2 R The rules and guidance in CASS 1A.2 do not apply to a firm following its failure.

...

6 Custody rules

...

6.2 Holding of client assets

...

Allocated but unclaimed safe custody assets

6.2.7A R CASS 6.2.8G to CASS 6.2.16G do not apply to a firm following its failure.

6.2.7B G CASS 6.7.2R (Disposal of safe custody assets) applies to a firm following its failure in respect of allocated but unclaimed safe custody assets.

...

6.6 Records, accounts and reconciliations

...

Treatment of shortfalls

6.6.54 R (1) ...

(2) Subject to paragraphs (3) and (4), until the discrepancy is resolved a firm must do one of the following:

...

...

(4) A firm that has failed is not required to take steps under paragraph (2) in relation to the firm's own applicable assets or money in so far as the legal procedure for the firm's failure prevents the firm from

taking any such steps.

...

6.6.56A G CASS 6.6.54R(4) recognises that a *failed firm* is required to investigate and resolve discrepancies, but the extent to which it is able to address *shortfalls* pending the resolution of discrepancies may be limited by insolvency law, for example.

...

6.7 Treatment of custody assets after a failure

Application

6.7.1 R This section applies to a *firm* following its *failure*.

Disposal of safe custody assets

- 6.7.2 R (1) Before a *firm* takes any steps to dispose of a *safe custody asset* it must:
- (a) (subject to paragraph (2)) attempt to return it to the relevant *client* or transfer it to another *person* for safekeeping on behalf of the *client* in accordance with CASS 6.7.8R; and
 - (b) (subject to paragraph (3)) take reasonable steps to notify the *client* of the *firm's* proposed course of action for disposing the *safe custody asset*.
- (2) A *firm* is not required to attempt to return or transfer a safe custody asset under paragraph (1)(a) where the *client* to whom the *safe custody asset* belongs has confirmed to the *firm* that it disclaims all its interests in the *safe custody asset*.
- (3) A *firm* is not required to notify a *client* under paragraph (1)(b) where:
- (a) the *firm* is able to return the *safe custody asset* to the relevant *client* or transfer it to another *person* on behalf of the *client* in accordance with CASS 6.7.8R; or
 - (b) the *client* to whom the *safe custody asset* belongs has confirmed to the *firm* that it disclaims all its interests in the *safe custody asset*.
- 6.7.3 G (1) The disposal of a *safe custody asset* referred to under CASS 6.7.2R(1) includes where the *firm* is using the procedure under regulation 12B of the *IBSAR Regulations* to set a ‘hard bar date’ by giving a ‘hard bar date notice’, or another similar procedure in accordance with the legal procedure for the *firm's failure*.
- (2) In any case, a *firm* should consider the whether its obligations under

law or any agreement permit it to dispose of a *safe custody asset* in the way in which it proposes to do so.

- 6.7.4 E (1) Reasonable steps in CASS 6.7.2R(1)(b) include the following course of conduct:
- (a) determining, as far as reasonably possible, the correct contact details for the relevant *client*;
 - (b) for a *client* for whom the *firm* has evidence that it was a *professional client* for the purposes of the *custody rules* at the time of the *failure*:
 - (i) writing to the *client* at the last known address either by post or by electronic mail:
 - (A) to inform it of the *firm's* intention to dispose of the *safe custody asset*;
 - (B) to inform it of the consequences of the *firm's* proposed course of action in relation to the *client's* ability to assert a claim in respect of that *safe custody asset*; and
 - (C) inviting the *client* to submit a claim for that *safe custody asset*;
 - (ii) where the *client* has not responded within 28 *days* of the communication under (i), attempting to communicate the information in (i) to the *client* on at least one further occasion by any means other than that used in (i) including by post, electronic mail, telephone or media advertisement; and
 - (c) for any other *client*:
 - (i) the same steps as under (b); and
 - (ii) where the *client* has not responded within 28 *days* of the second communication under (b)(ii), attempting to communicate the information set out in (b)(i) to the *client* on at least one further occasion by any means other than one in respect of which the *firm* has obtained positive confirmation that the *client* is not receiving such communications.
- (2) Compliance with paragraph (1) may be relied on as tending to establish compliance with CASS 6.7.2R(1)(b).
- (3) Contravention of paragraph (1) may be relied on as tending to establish contravention of CASS 6.7.2R(1)(b).

- 6.7.5 G For the purpose of CASS 6.7.4E(1)(a), a *firm* may use any available means to determine the correct contact details for the relevant *client*, including:
- (1) telephoning the *client*;
 - (2) searching internal and/or public records;
 - (3) media advertising;
 - (4) mortality screening; and
 - (5) using credit reference agencies or tracing agents.
- 6.7.6 R If the *firm* undertook a tracing exercise for the purposes of CASS 6.2.10R(4) before its *failure* but had not made the charity payment under that *rule* by the time of its *failure* then the findings of that exercise may be relied on for the purposes of CASS 6.7.4E(1)(a).
- 6.7.7 R (1) A *firm* must make a record of any *safe custody asset* disposed of in accordance with CASS 6.7.2R at the time of the disposal.
- (2) The record under paragraph (1) must state:
- (a) the *safe custody asset* that was disposed of;
 - (b) the value of the consideration received for the *safe custody asset* disposed of;
 - (c) the name of the *client* to whom the *safe custody asset* was allocated, according to the *firm*'s records at the time of making the record under this *rule*; and
 - (d) either:
 - (i) the efforts applied by the *firm* to determine the *client*'s correct contact details under CASS 6.7.4E(1)(a); or
 - (ii) if being relied on under CASS 6.7.6R, the efforts applied by the *firm* to determine the *client*'s correct contact details for the purposes of CASS 6.2.10R(4).
- (3) A *firm* must keep the record under paragraph (1) indefinitely.

Transfers of safe custody assets

- 6.7.8 R (1) This *rule* applies where, instead of returning a *safe custody asset* to a *client*, a *firm* (Firm A) is able to transfer the *safe custody asset* to another *person* (Firm B) for safekeeping on behalf of the *client*.
- (2) Firm A may only effect such a transfer if, in advance of the transfer, it has obtained a contractual undertaking from Firm B that:

- (a) where regulation 10C(3) of the *IBSAR Regulations* does not apply, Firm B will return the *safe custody asset* to the *client* at the *client's* request; and
- (b) Firm B will notify the *client*, within 7 days of the transfer of that *client's safe custody asset* having commenced:
 - (i) of the applicable regulatory regime under which the *safe custody asset* will be held by Firm B;
 - (ii) of the relevant compensation scheme limits that apply in respect of Firm B's handling of the *safe custody asset*; and
 - (iii) where regulation 10C(3) of the *IBSAR Regulations* does not apply, that the *client* has the option of having its *safe custody asset* returned to it by Firm B.

6.7.9 G Where regulation 10C(3) of the *IBSAR Regulations* does apply, Firm A should, in advance of the transfer under CASS 7.6.8R, obtain a contractual undertaking from Firm B that:

- (1) Firm B will comply with the *client's* request for a 'reverse transfer' as defined in regulation 10C of the *IBSAR Regulations*; and
- (2) Firm B will notify the *client*, within 7 days of the transfer of that *client's safe custody asset* having commenced that the *client* can demand a 'reverse transfer' as defined in regulation 10C of the *IBSAR Regulations* where regulation 10C(3) applies.

...

7 Client money rules

...

7.10 Application and purpose

...

7.10.19 R ...

- (2) if the firm fails, the ~~*client money distribution rules*~~ *client money distribution or transfer rules* will not apply to these sums and so the *client* will not be entitled to share in any distribution under the ~~*client money distribution rules*~~ *client money distribution or transfer rules*.

...

7.10.22 R ...

- (3) that, if the *firm fails*, the ~~*client money distribution rules*~~ *client money distribution or transfer rules* will apply to *money* held in relation to the business in question.

...

7.11 Treatment of client money

...

Discharge of fiduciary duty

7.11.33A R (1) CASS 7.11.34R(2)(c), CASS 7.11.34R(2)(d) and CASS 7.11.34R(10) do not apply to a *firm* following a *primary pooling event*.

(2) CASS 7.11.34R(2)(e) only applies to a *firm* following a *primary pooling event*.

7.11.34 R *Money ceases to be client money* (having regard to CASS 7.11.40R where applicable) if:

...

(2) ...

(e) transferred in accordance with CASS 7A.2.4R(4); or

...

...

Transfer of business

...

7.11.41A R CASS 7.11.41G to CASS 7.11.47R do not apply to a *firm* following a *primary pooling event*.

7.11.41B G CASS 7A.2.4R(4) applies to a *firm* in respect of transfers of business following a *primary pooling event*.

...

Allocated but unclaimed client money

7.11.47A R CASS 7.11.48G to CASS 7.11.58G do not apply to a *firm* following a *primary pooling event*.

7.11.47B G CASS 7A.2.6AR (Closing a client money pool) applies to a *firm* following a *primary pooling event* in respect of allocated but unclaimed *client money*.

...

7.13 Segregation of client money

...

Money due to a client from a firm

7.13.38A R CASS 7.13.39R and CASS 7.13.40G do not apply to a firm following a primary pooling event.

7.13.38B G CASS 7A.2.10AR and CASS 7A.2.10BG (Money due to a client from a firm after a primary pooling event) apply to a firm following a primary pooling event in respect of money due to a client from a firm.

7.13.39 R Pursuant to the *client money segregation requirements*, a firm that is operating the normal approach and becomes liable to pay ~~money~~ money to a *client* ~~should~~ must promptly, and in any event no later than one *business day* after the *money* is due and payable, pay the *money*:

...

...

Prudent segregation

7.13.40A R (1) Subject to paragraph (2), CASS 7.13.41R to CASS 7.13.49R do not apply to a firm following a primary pooling event.

(2) If, at the time of a primary pooling event, a firm has retained money in a client bank account for the purposes of CASS 7.13.41R, that money remains client money for the purposes of the client money rules and the client money distribution or transfer rules.

7.13.41 R If it is prudent to do so to prevent a *shortfall* in *client money* on the occurrence of a *primary pooling event*, a firm may pay *money* of its own into a *client bank account* and subsequently retain that *money* in the *client bank account* (*prudent segregation*). *Money* that the firm retains in a *client bank account* under this ~~rule~~ rule is *client money* for the purposes of the *client money rules* and the ~~client money distribution rules~~ client money distribution or transfer rules.

...

7.13.45 R The firm's written policy must not conflict with the *client money rules* or the ~~client money distribution rules~~ client money distribution or transfer rules. If there is a conflict, the *client money rules* and the ~~client money distribution rules~~ client money distribution or transfer rules will prevail.

...

Prudent segregation record

- 7.13.49A R (1) Subject to paragraph (2), CASS 7.13.50R to CASS 7.13.52G do not apply to a firm following a primary pooling event.
- (2) Where a firm holds a prudent segregation record under CASS 7.13.53R following a primary pooling event, the prudent segregation record must continue to satisfy the requirements set out in CASS 7.13.51R.

...

The alternative approach to client money segregation

- 7.13.53A R (1) Subject to paragraphs (2) and (3), CASS 7.13.59R, CASS 7.13.62R(3), 7.13.62R(4) and CASS 7.13.63R to CASS 7.13.67R do not apply to a firm following its failure.
- (2) If, at the time of a primary pooling event, a firm has retained money in a client bank account for the purposes of alternative approach mandatory prudent segregation under CASS 7.13.65R, that money remains client money for the purposes of the client money rules and the client money distribution or transfer rules.
- (3) Where a firm holds an alternative approach mandatory prudent segregation record under CASS 7.13.68R following a primary pooling event, the alternative approach mandatory prudent segregation record must continue to satisfy the requirements set out in CASS 7.13.67R.

...

- 7.13.65 R (1) A firm that uses the alternative approach must, in addition to CASS 7.13.62R, pay an amount (determined in accordance with this rule) of its own money into its client bank account and subsequently retain that money in its client bank account (alternative approach mandatory prudent segregation). The amount segregated by a firm in its client bank account under this rule is client money for the purposes of the client money rules and the ~~client money distribution rules~~ client money distribution or transfer rules.

...

...

Use of the normal approach in relation to certain regulated clearing arrangements

...

- 7.13.72A R (1) Subject to paragraphs (2) and (3), CASS 7.13.73R to CASS 7.13.75R do not apply to a firm following a primary pooling event.
- (2) If, at the time of a primary pooling event, a firm has retained money

in a client bank account for the purposes of clearing arrangement mandatory prudent segregation under CASS 7.13.73R, that money remains client money for the purposes of the client money rules and the client money distribution or transfer rules.

(3) Where a firm holds a clearing arrangement mandatory prudent segregation record under CASS 7.13.76R following a primary pooling event, the alternative approach mandatory prudent segregation record must continue to satisfy the requirements set out in CASS 7.13.75R.

7.13.73 R (1) Where the circumstances described in CASS 7.13.72R(1)(a) apply to a firm it must pay an amount (determined in accordance with this rule) of its own money into its client bank account and retain that money in its client bank account (clearing arrangement mandatory prudent segregation). The amount segregated by a firm in its client bank account under this rule will be client money for the purposes of the client money rules and the ~~client money distribution rules~~ client money distribution or transfer rules.

...

...

7.15 Records, accounts and reconciliations

...

Reconciliation discrepancies

7.15.29 R When a discrepancy arises between a firm's client money resource and its client money requirement identified by a firm's internal client money reconciliations, the firm must determine the reason for the discrepancy and, subject to CASS 7.15.29AR, ensure that:

...

7.15.29A R A firm that has failed is not required to make a payment or withdrawal under CASS 7.15.29R(1) or CASS 7.15.29R(2) respectively in so far as the legal procedure for the firm's failure restricts the firm from doing so.

...

7.15.32 R While a firm is unable to immediately resolve a discrepancy identified by an external client money reconciliation, and one record or set of records examined by the firm during its external client money reconciliation indicates that there is a need to have a greater amount of client money or, if appropriate, approved collateral than is the case, the firm must assume, until the matter is finally resolved, that that record or set of records is accurate and, subject to CASS 7.15.32AR, pay its own money into a relevant account.

7.15.32A R A firm that has failed is not required to pay its own money into a relevant account under CASS 7.15.32R in so far as the legal procedure for the firm's failure restricts the firm from doing so.

7.15.32B G (1) CASS 7.15.29AR and CASS 7.15.32AR recognise that a failed firm is required to investigate discrepancies, but the extent to which it is able to resolve discrepancies may be limited by insolvency law, for example.

(2) CASS 7.15.29AR and CASS 7.15.32AR would not prevent a failed firm from making any transfers required under regulation 10H(3) or (4) of the IBSAR Regulations.

...

7.17 Statutory trust

...

7.17.2 R ...

(1) for the purposes of, and on the terms of, the *client money rules* and the *client money distribution rules* client money distribution or transfer rules;

...

7A Client money distribution or transfer

7A.1 Application and purpose

Application

7A.1.1 R Subject to CASS 7A.1.1AR, this chapter (the ~~*client money distribution rules*~~ *client money distribution or transfer rules*) applies to a firm that holds *client money* which is subject to the *client money rules* when a pooling event occurs.

7A.1.1A R The ~~*client money distribution rules*~~ *client money distribution or transfer rules* do not apply to any *client money* held by a *trustee firm* under CASS 7.10.34R to CASS 7.10.40G.

7A.1.1B G As a result of CASS 7A.1.1AR, the ~~*client money distribution rules*~~ *client money distribution or transfer rules* relating to *primary pooling events* and *secondary pooling events* will not affect any *client money* held by a firm in its capacity as *trustee firm*. Instead, the treatment of that *client money* will be determined by the terms of the relevant instrument of trust or by applicable law. However, the ~~*client money distribution rules*~~ *client money distribution or transfer rules* do apply to a firm for any *client money* that it holds other than in that capacity which is subject to the *client money rules*.

Purpose

7A.1.2 G The ~~client money distribution rules~~ client money distribution or transfer rules seek to facilitate set out the timely return required treatment of *client money* to a *client* in the event of the ~~failure~~ of a *firm* or third party at which the *firm* holds ~~client money~~ on the occurrence of a pooling event so that where:

- (1) a *firm* fails, the rules in CASS 7A.2 (Primary pooling events) facilitate the return or transfer of *client money*; and
- (2) a *person* at which the *firm* holds *client money* fails, the rules in CASS 7A.3 (Secondary pooling events) allocate any loss of *client money* among certain of the *firm's* *clients*.

7A.2 Primary pooling events

Failure of the authorised firm: primary pooling event

- 7A.2.1 G
- (1) ~~A *firm* can hold *client money* in a *general client bank account*, a *designated client bank account* or a *designated client fund account*.~~
 - (2) ~~A *firm* holds all *client money* in *general client bank accounts* for its *clients* as part of a common pool of *money* so those particular *clients* do not have a claim against a specific sum in a specific account; they only have a claim to the *client money* in general.~~
 - (3) ~~A *firm* holds *client money* in *designated client bank accounts* or *designated client fund accounts* for those *clients* that requested their *client money* be part of a specific pool of *money*, so those particular *clients* do have a claim against a specific sum in a specific account; they do not have a claim to the *client money* in general unless a *primary pooling event* occurs. A *primary pooling event* triggers a notional pooling of all the *client money*, in every type of *client money* account, and the obligation to distribute it.~~
 - (4) ~~If the *firm* becomes insolvent, and there is (for whatever reason) a *shortfall in money* held for a *client* compared with that *client's* entitlements, the available funds will be distributed in accordance with the *client money distribution rules*. [deleted]~~

7A.2.2 R A *primary pooling event* occurs:

- (1) on the *failure* of the *firm*;
- (2) on the vesting of assets in a trustee in accordance with an '*assets requirement*' imposed under section 55P(1)(b) or (c) (as the case may be) of the *Act*;
- (3) on the coming into force of a *requirement* for all *client money* held by

the firm or requirements which, either separately or in combination:

- (a) is or are for all client money held by the firm; and
 - (b) require the firm to take steps to cease holding all client money;
or
 - (4) when the firm notifies, ~~or is in breach of its duty to notify,~~ the FCA, in accordance with CASS 7.15.33R (Notification requirements), that it is unable correctly to identify and allocate in its records all valid claims arising as a result of a *secondary pooling event*.
- 7A.2.3 R CASS 7A.2.2R(4) does not apply so long as:
- (1) the firm is taking steps, in consultation with the FCA, to establish those records; and
 - (2) there are reasonable grounds to conclude that the records will be capable of rectification within a reasonable period.
- 7A.2.3A R If a *primary pooling event* occurs in circumstances where the firm had, before the *primary pooling event*, reduced its *marginated transaction* requirement by utilising *approved collateral* under CASS 7.16.33R, it must immediately liquidate this *approved collateral* and place the proceeds in a *client bank account* that relates to the relevant notional pool under CASS 7A.2.4R(1).
- 7A.2.3B R ~~CASS 7A.2.7R~~ 7A.2.7-AR (Client money received after the failure of the firm) does not apply to the proceeds under CASS 7A.2.3AR.
- 7A.2.3C G The proceeds of the assets realised under CASS 7A.2.3AR:
- (1) will form part of the relevant notional pool ~~pool~~ *pool* of *client money* (see CASS 7A.2.4R(1A)(a)(i) (Pooling and distribution or transfer); and
 - (2) must be distributed or transferred on behalf of clients in accordance with this chapter.

Client money reconciliations after a primary pooling event

- 7A.2.3D G (1) If a special administrator has been appointed to the firm under the IBSAR Regulations then they will be required to carry out a reconciliation under regulation 10H of the IBSAR Regulations.
- (2) Notwithstanding regulation 10H of the IBSAR Regulations, CASS 7.15 has application to a firm after a primary pooling event, meaning, for example, that ongoing compliant record-keeping is required.

Pooling and distribution or transfer

- 7A.2.4 R If a *primary pooling event* occurs, then:
- (1) (a) in respect of a *sub-pool*, the following is treated as a single

notional *pool of client money* for the beneficiaries of that *pool*:

- (i) any *client money* held in a *client bank account* of the *firm* relating to that *sub-pool*; and
 - (ii) any *client money* held in a *client transaction account* of the *firm* relating to that *sub-pool*, except for *client money* held in a *client transaction account* at an *authorised central counterparty* or a *clearing member* which is, in either case, held as part of a *regulated clearing arrangement*;
- (b) in respect of the *general pool*, the following is treated as a single notional *pool of client money* for the beneficiaries of the *general pool*:
- (i) any *client money* held in any *client bank account* of the *firm*;
 - (ii) any *client money* held in a *client transaction account* of the *firm*, except for *client money* held in a *client transaction account* at an *authorised central counterparty*, or a *clearing member* which is, in either case, held as part of a *regulated clearing arrangement*; and
 - (iii) any *client money* identifiable in any other account held by the *firm* into which *client money* has been received;

except, in each case, for *client money* relating to a *sub-pool* which falls under (1)(a)(i) or (ii); and

- (1A) (a) a notional *pool* under paragraph (1) shall also include any *client money* that is:
- (i) transferred by the *firm* under regulation 10H(3) of the *IBSAR Regulations* to a *client bank account* that is included in that *pool* under paragraph (1);
 - (ii) paid under CASS 7A.2.3AR into a *client bank account* that is included in that *pool* under paragraph (1);
 - (iii) paid under CASS 7A.2.4R(3)(b) or CASS 7A.2.4R(3)(d) into a *client transaction account* that is included in that *pool* under paragraph (1);
 - (iv) (subject to (b)) otherwise received after the *primary pooling event* into a *client transaction account* that is included in that *pool* under paragraph (1) where the receipt is in relation to a *marginied transaction* that the *firm* had entered into through the use of that *client transaction account* and which had not *closed out*

before primary pooling event; and

- (v) paid under CASS 7.15.29R(1) after the primary pooling event into a client bank account that is included in that pool under (1); and
- (b) the firm must not transfer any client money in a notional pool under (1)(a) or (b) to a client transaction account except where necessary to comply with (2)(b);
- (c) a notional pool under paragraph (1) shall cease to include any client money that is:
 - (i) transferred by the firm under regulation 10H(4) of the IBSAR Regulations from a client bank account that is included in that pool under (1);
 - (ii) paid out after the primary pooling event from a client transaction account that is included in that pool under (1) where the payment is in relation to a margined transaction that the firm had entered into through the use of that client transaction account and which had not closed out before primary pooling event; and
 - (iii) paid out after the primary pooling event under CASS 7.15.29R(2) from a client bank account that is included in that pool under (1); and
- (2) the firm must, as soon as reasonably practicable:
 - (a) (subject to paragraph (4)) distribute client money comprising a notional pool in accordance with CASS 7.17.2R, 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; or
 - (b) (where applicable) transfer client money comprising a sub-pool to effect or facilitate porting of positions held for the clients who are beneficiaries of that sub-pool; and
- (3) if, in connection with a regulated clearing arrangement, client money is remitted directly to the firm either from an authorised central counterparty or from a clearing member as part of that person's default management procedures, then, as soon as reasonably practicable:
 - (a) any such remittance in respect of a client transaction account that is an individual client account does not form a part of any notional pool under CASS 7A.2.4R(1) and must be distributed to the relevant client subject to CASS 7.17.2R(4);

- (b) subject to (3)(c) and (d), any such remittance in respect of a *client transaction account* that is an *omnibus client account* must form part of the notional *pool* under CASS 7A.2.4R(1)(b) and be subject to distribution in accordance with CASS 7A.2.4R(2)(a);
- (c) any such remittance in respect of a *client transaction account* that is an *omnibus client account* must be distributed to the relevant *clients* for whom that *omnibus client account* is held if:
 - (i) no *client money* in excess of the amount recorded in that *omnibus client account* is held by the *firm* as margin in relation to the positions recorded in that *omnibus client account*; and
 - (ii) the amount of such remittance attributable to each *client* of the *omnibus client account* is readily apparent from information provided to the *firm* by the *authorised central counterparty* or, in the case of *indirect clients*, the *clearing member*;

in which case the amount of such remittance does not form a part of any notional *pool* under CASS 7A.2.4R(1) and must be distributed to each such *client* in accordance with the information provided by the *authorised central counterparty* or *clearing member* subject to CASS 7.17.2.R(4); and

- (d) any such remittance in respect of a *client transaction account* that is a *net margined omnibus client account* in respect of which the *firm* maintains a *sub-pool* must form part of such *sub-pool* under CASS 7A.2.4R(1)(a) to be distributed in accordance with CASS 7A.2.4R(2)(a); and
- (4) as an alternative to distributing a *client's client money* in a notional *pool* to the relevant *client* under CASS 7A.2.4R(2)(a), a *firm* (Firm A) may on its own initiative transfer some or all of that *client's client money* in the relevant notional *pool* to any other *person* (Firm B) for safekeeping on behalf of the *client* provided that:
- (a) as a consequence of any such transfer, Firm A does not distribute to any other *client* whose *client money* is in that notional *pool*, or transfer on behalf of any such other *client* to another *person*, an amount of *money* that would be less than that which such other *client* was entitled to have distributed or transferred under this *rule*;
 - (b) unless Firm A is able to rely on regulation 10B(3)(b) of the *IBSAR regulations* for the transfer to Firm B to have effect without the consent of the *client*, either:

- (i) Firm A has the specific consent of the *client* to the transfer to Firm B; or
 - (ii) there is a written agreement between Firm A and the *client* which provides that Firm A may transfer the *client's client money* to another *person* and Firm A can lawfully rely on that provision to achieve the transfer under this *rule*;
- (c) Firm A has, in advance of the transfer under this *rule*, either:
- (i) obtained a contractual undertaking from Firm B that the *money* transferred will be held by Firm B as *client money* in accordance with the *client money rules*; or
 - (ii) where the *client money rules* do not apply to Firm B, or where they do apply but Firm B is able to hold the *money* transferred other than as *client money*, satisfied itself, having exercised all due skill care and diligence in its assessment, that Firm B will apply adequate measures to protect the *money* transferred;
- (d) where regulation 10C(3) of the *IBSAR Regulations* does not apply, Firm A has, in advance of the transfer under this *rule*, obtained a contractual undertaking from Firm B that Firm B will return the money to the *client* at the *client's* request; and
- (e) Firm A has, in advance of the transfer under this *rule*, obtained a contractual undertaking from Firm B that Firm B will notify to the *client* within 7 days of the transfer of that *client's* balance having commenced:
- (i) the applicable regulatory regime under which the *money* will be held by Firm B;
 - (ii) the relevant compensation scheme limits that apply in respect of Firm B's handling of the transferred *money*; and
 - (iii) where regulation 10C(3) of the *IBSAR Regulations* does not apply, that the *client* has the option of having its *money* returned to it by Firm B.

7A.2.4A G Where regulation 10C(3) of the *IBSAR Regulations* does apply, Firm A should, in advance of the transfer under CASS 7A.2.4R(4), obtain a contractual undertaking from Firm B that:

-1

- (1) Firm B will comply with the *client's* request for a 'reverse transfer' as defined in regulation 10C of the *IBSAR Regulations*; and
- (2) Firm B will notify the *client*, within 7 days of the transfer of that

client's safe custody asset having commenced that the client can demand a 'reverse transfer' as defined in regulation 10C of the IBSAR Regulations where regulation 10C(3) applies.

- 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; and
 - (b) after the completion of the default management process:
 - (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 any balance to the *firm* for the account of its *clients* if the *clients* are not known to the *authorised central counterparty*.
- (1A) Under the *EMIR L2 Regulation*, where a *firm* acting in connection with a *regulated clearing arrangement* for a *client* (who is also an *indirect client*) defaults, the *clearing member* with whom the *firm* has placed *client money* of the *indirect client*, may, in accordance with the *EMIR L2 Regulation*:
- (a) transfer the positions and assets either to another *clearing member* of the relevant *authorised central counterparty* or to another *firm* willing to act for the *indirect client*; or
 - (b) liquidate the assets and positions of the *indirect clients* and remit all monies due to the *indirect clients*.
- (1B) For the avoidance of doubt, 'relevant *clients*' in the case of CASS 7A.2.4R(3)(a) and CASS 7A.2.4R(3)(c) includes a *client* who is also an *indirect client*.
- (2) Where any balance remitted from an *authorised central counterparty*, or, in the case of *indirect clients*, a *clearing member*, 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*.
- (3) Remittances received by the *firm* falling within CASS 7A.2.4R(3)(a) and CASS 7A.2.4R(3)(c) 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 each *client* on whose behalf the remittance was received.
- (4) For the avoidance of doubt, in respect of a *regulated clearing arrangement*, any *client money* remitted by the *authorised central counterparty* or, in the case of *indirect clients*, the *clearing member*,

to the *firm* pursuant to CASS 7A.2.4R(3) should not be treated as *client money* received after the failure of the *firm* under CASS ~~7A.2.7R~~ 7A.2.7-AR.

- (5) The *firm's* obligation to its *client* in respect of *client money* held in a *sub-pool* is discharged to the extent that the *firm* transfers that *client money* to facilitate *porting* in accordance with CASS 7.11.34R(8).

- 7A.2.4B G (1) The restrictions on transfers of client money at CASS 7A.2.4R(4) are of the type referred to at regulation 10B(4) of the *IBSAR Regulations*.
- (2) Where Firm A has complied with the restrictions at CASS 7A.2.4R(4) for any transfers to Firm B, any money transferred to Firm B ceases to be *client money* held by Firm A (see CASS 7.11.34R(2)(e) (Discharge of fiduciary duty)).
- (3) But any money returned by Firm B to Firm A in the event of a reverse transfer will be subject to the *client money rules* and *client money distribution or transfer rules* as applied to Firm A, and should be treated by Firm A in accordance with CASS 7A.2.7-AR (Client money received after the failure of the firm).

Client money entitlements

- 7A.2.5 R (-2) (a) Subject to (-2)(b), each *client's* entitlement to *client money* in a notional *pool* is calculated with reference to the *client money requirement* as shown by an *internal client money reconciliation* carried out in accordance with CASS 7.15 (Records, accounts and reconciliations) as at the *primary pooling event*.
- (b) If, as at the *primary pooling event*, the *firm* had entered in to one or more cleared *marginied transactions* through the use of a *client transaction account* at a *clearing house* that had not *closed out* as at the *primary pooling event*, the *client money requirement* under (-2)(a) must be calculated as follows:
- (i) CASS 7.16.28R does not apply in respect of those *marginied transactions*; and
- (ii) subject to CASS 7.16.30R, a *client's equity balance* is instead the amount which the *firm* is liable to pay to the *client* (or the *client* to the *firm*) under the *client money rules* for *marginied transactions* following the *close out* of those *marginied transactions*. This balance should include any cash margin the *firm* has received from the *client* in connection with those transactions.
- (-1) Each *client's client equity balance* following any adjustments under paragraph (-2) must be reduced by:

- (a) any amount paid by:
 - (i) an ~~authorised central counterparty~~ authorised central counterparty to a ~~clearing member~~ clearing member other than the *firm* in connection with a *porting* arrangement in accordance with CASS 7.11.34R(6) in respect of that *client*; and
 - (ii) a *clearing member* to another *clearing member* or *firm* (other than the *firm*) in connection with a transfer in accordance CASS 7.11.34R(8);
- (b) any amount paid by:
 - (i) an *authorised central counterparty* directly to that *client*, in accordance with CASS 7.11.34R(7); and
 - (ii) a *clearing member* directly to an *indirect client* in accordance with CASS 7.11.34R(9); and
- (c) any amount that must be distributed to that *client* by the *firm* in accordance with CASS 7A.2.4R(3)(a) or (c).

- (1) When, in respect of a *client* who is a beneficiary of a ~~pool~~ pool and following any adjustments under paragraph (-2) and reductions under paragraph (-1), there is a positive *individual client balance* and a negative *client equity balance* in relation to that *pool*, the credit for that *pool* 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~~ pool and following any adjustments under paragraph (-2) and reductions under paragraph (-1), there is a negative *individual client balance* and a positive *client equity balance* in relation to that *pool*, the credit for that *pool* must be offset against the debit for that *pool* reducing the *client equity balance* for that *client*.

- 7A.2.5A G (1) (a) The effect of CASS 7A.2.5R(-2)(b) is that the *client equity balance* for the relevant cleared *margin*ed transaction is with reference to the eventual *close out* or ‘hindsight’ value of the transaction, instead of being a notional balance as at the *primary pooling event* under CASS 7.16.28R.
- (b) CASS 7A.2.5R(-2)(b) applies in respect of cleared *margin*ed transactions that a *firm* had entered into for any *client*, including for *indirect clients* where the *firm* is itself a *client* of a *clearing member*.
- (2) In cases where CASS 7A.2.5R(-2)(b) does not apply, the *client equity balance* for a *margin*ed transaction will be the notional balance as at the *primary pooling event* under CASS 7.16.28R.

...

Closing a client money pool

- 7A.2.6A R (1) Before a *firm* ceases to treat a balance of *client money* in a notional *pool* as *client money* by transferring it to itself under CASS 7.17.2R(5) it must:
- (a) (subject to paragraph (2)) attempt to distribute the balance to the relevant *client* or transfer it to another *person* for safekeeping on behalf of the *client* in accordance with CASS 7A.2.4R;
 - (b) (subject to paragraph (3)) take reasonable steps to notify any *client* in respect of whom the *firm* has evidence that the *money* may belong, of the *firm*'s proposed course of action;
 - (c) where the *firm* has *failed*, apply any of the following types of balances of *client money* in the notional *pool* towards any costs incurred in accordance with CASS 7.17.2R, including any costs incurred under paragraph (1)(d):
 - (i) *client money* allocated to a *client* for which, following the steps taken by the *firm* to satisfy paragraph (1)(b), the *client* to whom the *client money* belongs has not provided the *firm* with instructions that would enable the *firm* to make a distribution or transfer under paragraph (1)(a); or
 - (ii) *client money* belonging to a *client* who, in response to a notification made under paragraph (1)(b), has confirmed to the *firm* that it disclaims the benefit of the statutory trust under CASS 7.17.2R in relation to the *client money*; or
 - (iii) *client money* that, following the steps taken by the *firm* to satisfy paragraph (1)(b), is unallocated to any *client* in the *firm*'s records and accounts; and
 - (d) immediately before transferring the balances of *client money* under paragraph (1)(c) to the *firm* itself, apply them towards making good any outstanding *shortfall* in the notional *pool*, and subsequently distribute or transfer them in accordance with CASS 7A.2.4R to or on behalf of *clients* for whom the *firm* is able to make such distributions or transfers.
- (2) A *firm* is not required to attempt to return or transfer the balance of *client money* under paragraph (1)(a) where the *client* to whom the balance belongs has confirmed to the *firm* that it disclaims the benefit of the statutory trust under CASS 7.17.2R in relation to the balance

client money.

- (3) A firm is not required to notify a client under paragraph (1)(b) where:
- (a) the firm is able to distribute the client money to the relevant client or transfer it to another person on behalf of the client in accordance with CASS 7A.2.4R;
 - (b) the client to whom the balance of client money belongs has confirmed to the firm that it disclaims the benefit of the statutory trust under CASS 7.17.2R in relation to the balance client money;
 - (c) in respect of a client for whom the firm has evidence that they were a retail client for the purposes of the client money rules at the time of the primary pooling event, the entitlement of that client in the notional pool is £25 or less when calculated under CASS 7A.2.5R; or
 - (d) in respect of a client for whom the firm has evidence that they were a professional client for the purposes of the client money rules at the time of the primary pooling event, the entitlement of that client is £100 or less when calculated under CASS 7A.2.5R.

- 7A.2.6B G (1) A firm may propose to cease to treat a balance of money as client money under CASS 7A.2.6AR(1) where the firm is using the procedure under regulation 12C of the IBSAR Regulations to set a ‘hard bar date’ by giving a ‘hard bar date notice’, or another similar procedure in accordance with the legal procedure for the firm’s failure.
- (2) In any case, a firm should consider the whether its obligations under law (including trust law) or any agreement permit it cease to treat a balance of money as client money in the way in which it proposes to do so.
- (3) Balances of client money under CASS 7A.2.6AR(1)(b)(iii) include those that the firm is holding to comply with:
- (a) CASS 7.13.41R (Prudential segregation);
 - (b) CASS 7.13.65R(1) (The alternative approach to client money segregation); and
 - (c) CASS 7.13.73R(1) (Use of the normal approach in relation to certain regulated clearing arrangements).
- 7A.2.6C E (1) Reasonable steps in CASS 7A.2.6AR(1)(b) include the following course of conduct:

- (a) determining, as far as reasonably possible, the correct contact details for the relevant *client*;
- (b) for a *client* for whom the *firm* has evidence that it was a *professional client* for the purposes of the *client money rules* at the time of the *primary pooling event*:
 - (i) writing to the *client* at the last known address either by post or by electronic mail:
 - (A) to inform it of the *firm's* intention to no longer treat the balance as *client money*;
 - (B) to inform it of the consequences of the *firm's* proposed course of action in relation to the *client's* ability to assert an ownership right to that *money*; and
 - (C) inviting the *client* to submit a claim for the *money*; and
 - (ii) where the *client* has not responded within 28 days of the communication under (i), attempting to communicate the information in (i) to the *client* on at least one further occasion by any means other than that used in (i) including by post, electronic mail, telephone or media advertisement; and
- (c) for any other *client*:
 - (i) the same steps as under (b); and
 - (ii) where the *client* has not responded within 28 days of the second communication under (b)(ii), attempting to communicate the information set out in (b)(i) to the *client* on at least one further occasion by any means other than one in respect of which the *firm* has obtained positive confirmation that the *client* is not receiving such communications.

(2) Compliance with paragraph (1) may be relied on as tending to establish compliance with CASS 7A.2.6AR(1)(b).

(3) Contravention of paragraph (1) may be relied on as tending to establish contravention of CASS 7A.2.6AR(1)(b).

7A.2.6C G For the purpose of CASS 7A.2.6CE(1)(a), a *firm* may use any available means to determine the correct contact details for the relevant *client*, including:

- (1) telephoning the *client*;

- (2) searching internal and/or public records;
- (3) media advertising;
- (4) mortality screening; and
- (5) using credit reference agencies or tracing agents.

7A.2.6D R If the *firm* undertook a tracing exercise for the purposes of CASS 7.11.50R(3) prior to the *primary pooling event* but had not made the charity payment under that rule by the time of the *primary pooling event* then the findings of that exercise may be relied on for the purposes of CASS 7A.2.6CE(1)(a).

7A.2.6E R (1) A *firm* must make a record of any balance under CASS 7A.2.6AR(1)(c)(i) or (ii) which is to be applied towards any costs or towards any *shortfall* in the relevant notional *pool* in accordance with CASS 7A.2.6AR(1)(c) or (d) respectively, immediately before taking such steps.

(2) The record under paragraph (1) must state:

- (a) the amount of the balance of *client money*;
- (b) the name of any *client* to whom that balance was allocated according to the *firm*'s records at the time of making the record under this rule; and
- (c) either:
 - (i) efforts applied by the *firm* to determine the *client*'s correct contact details under CASS 7A.2.6CE(1)(a); or
 - (ii) if being relied on under CASS 7A.2.6DR, the efforts applied by the *firm* to determine the *client*'s correct contact details for the purposes of CASS 7.11.50R(3).

(3) A *firm* must keep the record under (1) indefinitely.

Client money received after ~~the failure of the firm~~ a primary pooling event

7A.2.7 R ~~*Client money* received by the *firm* after a *primary pooling event* in respect of a *pool* 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:~~

- (1) ~~it is *client money* relating to a transaction that has not settled at the time of the *primary pooling event*; or~~

(2) ~~it is *client money* relating to a *client*, for whom the *client money* entitlement, calculated in accordance with CASS 7A.2.5R, shows that *money* is due from the *client* to the *firm* at the time of the *primary pooling event*. [deleted]~~

- 7A.2.7-A R (1) This rule applies in respect of *client money* received by a *firm* after a *primary pooling event* that does not form part of a notional *pool*.
- (2) Where the *firm* is using the normal approach under CASS 7.13.6R, *client money* to which this rule applies must be received into a *client bank account* that does not contain any *client money* that forms part of a notional *pool* under CASS 7.A.2.4R(1).
- (3) (a) This paragraph applies where the *firm* receives *client money* into an account other than a *client bank account* in accordance with CASS 7.13.62R or CASS 7.13.72R.
- (b) To the extent the *firm* makes any transfers from its own account to a *client bank account* under CASS 7.13.62R(3) or CASS 7.13.72R(2)(b), such transfers must be made into a *client bank account* that does not contain any *client money* that forms part of a notional *pool* under CASS 7.A.2.4R(1).
- (4) A *firm* must, subject to paragraphs (5) and (6), return promptly to each relevant *client* all *client money* to which this rule applies.
- (5) To the extent that *client money* relates to a transaction for a *client* that was concluded before the *primary pooling event* but had not yet settled at the time of the *primary pooling event*, the *firm* may use that *client money* to settle that transaction.
- (6) (a) This paragraph applies where *client money* which is not received by the *firm* into a *client transaction account* relates to one or more cleared *marginied transactions* entered into by the *firm* through the use of a *client transaction account* at a *clearing house*.
- (b) Where such transactions have not *closed out* as at the *primary pooling event*, then provided that the *firm* has not *failed*, it may transfer that *client money* to a *client transaction account* with the relevant *clearing house* in accordance with CASS 7.14 (Client money held by a third party) for the purpose of collateralising those *marginied transactions*.
- 7A.2.7A G ~~If a *firm* opens~~ A *firm* may open a *client bank account* after a *primary pooling event*, for the purposes of complying with CASS 7A.2.7-AR(2) and CASS 7A.2.10AR(2) and if it does so it must comply with CASS 7.18.15R regarding *acknowledgement letters*.
- 7A.2.7B R A *firm* must deduct any costs properly attributable to the return of a *client's client money* under CASS 7A.2.7-AR(4) from the amount to be returned to

that particular *client*.

- 7A.2.8 G ~~*Client money* received after the *primary pooling event* relating to an unsettled transaction should be used to settle that transaction. Examples of such transactions include:~~
- ~~(1) an equity transaction with a trade date before the date of the *primary pooling event* and a settlement date after the date of the *primary pooling event*; or~~
 - ~~(2) a *contingent liability investment* that is 'open' at the time of the *primary pooling event* and is due to settle after the *primary pooling event*. [deleted]~~
- 7A.2.9 R If a *firm* receives a *mixed remittance* after a *primary pooling event* other than where using the alternative approach under CASS 7.13.62R or under a regulated clearing arrangement to which CASS 7.13.72R applies, it must:
- (1) pay the full sum into ~~the separate a *client bank account* opened in accordance with that~~ meets the requirements of CASS 7A.2.7R 7A.2.7-AR(2); and
 - (2) pay the *money* that is not *client money* out of that *client bank account* into a *firm's* own bank account within one *business day* of the *day* on which the *firm* would normally expect the *remittance* to be cleared.
- 7A.2.10 G Whenever possible the *firm* should seek to split a *mixed remittance* before the relevant accounts are credited.

Money due to a client from a firm after a primary pooling event

- 7A.2.10A R A *firm* that is operating the normal approach to segregation under CASS 7.13 (Segregation of client money) which becomes liable to pay money to a client after a primary pooling event must promptly, and in any event no later than one business day after the money is due and payable, pay the money:
- (1) to, or to the order of, the *client*; or
 - (2) into a *client bank account* that does not contain any *client money* that forms part of a notional *pool* under CASS 7.A.2.4R(1).
- 7A.2.10B G Where the *firm* has payment instructions from the *client* the *firm* should pay the money to the order of the *client*, rather than into a *client bank account*.

Secondary pooling events

- 7A.2.11 R If both a *primary pooling event* and a *secondary pooling event* occur, the provisions of this section relating to a *primary pooling event* apply.

7A.3 Secondary pooling events

Failure of a bank, intermediate broker, settlement agent, ~~or OTC~~ OTC counterparty, exchange or clearing house: secondary pooling events

- 7A.3.1 R A *secondary pooling event* occurs on the *failure* of a ~~third party~~ person to which *client money* held by the *firm* has been transferred under CASS 7.13.3R(1) to CASS 7.13.3R(3) (Depositing client money) or CASS 7.14.2R (~~Transfer of client money to a third party~~ Client money held by a third party).
- 7A.3.2 R CASS 7A.3.6R to ~~CASS 7A.3.18R~~ CASS 7A.3.12AR do not apply if, on the *failure* of the ~~third party~~ relevant person, ~~the firm repays to its clients or pays into a client bank account~~, at an unaffected bank, an amount equal to the amount of *client money* which would have been held if a *shortfall* had not occurred at that third party:
- (1) there is no secondary pooling shortfall; or
 - (2) where there is a secondary pooling shortfall, the firm pays an amount equal to the amount of client money which would have been held at that person if a secondary pooling shortfall had not occurred either:
 - (a) to its clients in the appropriate amounts such that they are compensated by the amount of the secondary pooling shortfall that they would otherwise be required to bear under this section; or
 - (b) into a client bank account at an unaffected bank with the effect that any shortfall that would otherwise arise for the purposes of CASS 7.15 is avoided.
- 7A.3.3 G ~~When client money is transferred to a third party, a firm continues to owe fiduciary duties to the client. Whether a firm is liable for a shortfall in client money caused by a third party failure will depend on whether it has complied with its duty of care as agent or trustee. [deleted]~~

Failure of a bank

- 7A.3.4 G When a ~~bank~~ person, to which *client money* held by the *firm* has been transferred under CASS 7.13.3R(1) to CASS 7.13.3R(3) (Depositing client money) or CASS 7.14.2R (Client money held by a third party) *fails*, and the *firm* decides not to make good the ~~shortfall~~ any secondary pooling shortfall in the amount of *client money* held at that ~~bank~~ person (see CASS 7A.3.2R(2)), a *secondary pooling event* will occur ~~in accordance with CASS 7A.3.6R~~. The *firm* would be expected to reflect the ~~shortfall~~ secondary pooling shortfall that arises ~~at the failed bank~~ in the *general pool* (where the *firm* maintains only a *general pool*) and, where relevant, in a particular *sub-pool* (where the *firm* maintains both a *general pool* and one or more *sub-pools*) in its records of the entitlement of *clients* and of *money* held with third parties under CASS 7.15 (Records, accounts and reconciliations).

- 7A.3.5 G The ~~*client money distribution rules*~~ *client money distribution or transfer rules* seek to ensure that *clients* who have previously specified that they are not willing to accept the risk of the bank that has *failed*, and who therefore requested that their *client money* be placed in a *designated client bank account* at a different bank, should not suffer the loss of the bank that has *failed*.

Failure of a bank: pooling

- 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 and/or where one or more *designated client bank accounts* or *designated client fund accounts* are held, for the *general pool* or particular *sub-pool*, then:

- (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 for the relevant *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 for the relevant *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* for the relevant *pool*, is not pooled with any other *client money* held for that *pool* or any other *pool*; 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 for that *pool* or any other *pool*.

- 7A.3.6A G Depending on the *person* at which the *secondary pooling event* occurs, the types of *client bank accounts* and *client transaction accounts* that are affected by the *secondary pooling shortfall* and the nature of a *firm's* business with a particular *client*, it is possible that the *client's* overall entitlement to *client money* held by the *firm* may be affected by a combination of CASS 7A.3.8R, CASS 7A.3.8AR, CASS 7A.3.10R and CASS 7A.3.11R.

- 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. [deleted]~~

Failure of an exchange, clearing house, intermediate broker, settlement agent or OTC counterparty: pooling

- 7A.3.7A R If a *secondary pooling event* occurs as a result of the *failure* of an exchange, *clearing house*, *intermediate broker*, *settlement agent* or *OTC counterparty*, then, in relation to every *general client bank account* and *client transaction account* of the *firm*, CASS 7A.3.8R and CASS 7A.3.13R will apply.

Failure of a bank, intermediate broker, settlement agent, OTC counterparty, exchange or clearing house: treatment of general client bank accounts and client transaction accounts

- 7A.3.8 R Subject to CASS 7A.3.8AR, if a *secondary pooling event* occurs as a result of the *failure* of a bank, *intermediate broker*, *settlement agent*, *OTC counterparty*, exchange or *clearing house*, ~~Money~~ *money* held in each *general client bank account* and *client transaction account* of the *firm* for the *general pool* or a *sub-pool* must be treated as pooled and:

- (1) any ~~shortfall~~ *secondary pooling shortfall* in *client money* held, or which should have been held, in *general client bank accounts* and *client transaction accounts* for the relevant *pool*, that has arisen as a result of the *failure* of the bank, exchange, clearing house, intermediate broker, settlement agent or OTC counterparty, must be borne by all the *clients* of that *pool* whose *client money* is held in such *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 the relevant *pool* by the *firm*, to reflect the requirements in paragraph (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~~ *secondary pooling shortfall* until the *client* is repaid; and
- (4) the *firm* must use the new *client money* entitlements, calculated in accordance with paragraph (2), for the purposes of reconciliations pursuant to CASS 7.15.3R (Records and accounts) for that *pool*, ~~and where relevant SYSC 4.1.1R (General organisational requirements) and SYSC 6.1.1R (Compliance).~~

- 7A.3.8A R If a *secondary pooling event* occurs as a result of the *failure* of an *authorised central counterparty*:

- (1) any *money* held in a *client transaction account* that is an *individual client account* at the *failed authorised central counterparty* is not

pooled by the firm with any of its other client money;

- (2) any money held in a client transaction account that is an omnibus client account at the failed authorised central counterparty is not pooled by the firm with any of its other client money provided that:
 - (a) no client money in excess of the amount recorded in that omnibus client account is held by the firm as margin in relation to the positions recorded in that omnibus client account; and
 - (b) the client or clients of the firm to whom the amount recorded in that omnibus client account relates is readily apparent from information provided to the firm by the authorised central counterparty or, in the case of indirect clients, the clearing member;
- (3) any money held in a client transaction account that is a net margined omnibus client account at the failed authorised central counterparty in respect of which the firm maintains a sub-pool is not pooled by the firm with any of its other client money;
- (4) any secondary pooling shortfall in client money held, or which should have been held, in an individual client account to which paragraph (1) applies must be borne by the client whose client money was held in that individual client account;
- (5) any secondary pooling shortfall in client money held, or which should have been held, in an omnibus client account to which paragraph (2) applies must be borne by all the clients whose client money is held in that account, rateably in accordance with their entitlements;
- (6) any secondary pooling shortfall in client money held, or which should have been held, in a net margined omnibus client account to which paragraph (3) applies must be borne by all the clients whose client money is held in the relevant sub-pool, rateably in accordance with their entitlements;
- (7) a new client money entitlement must be calculated for each relevant client of the relevant pool, to reflect the requirements in paragraphs (1),(2) and(3) and the firm's records must be amended to reflect the reduced client money entitlement;
- (8) the firm must make and retain a record of each client's share of the secondary pooling shortfall until the client is repaid; and
- (9) the firm must use the new client money entitlements calculated under paragraph (7) for the purposes of reconciliations pursuant to CASS 7.15.3R (Records and accounts) for the relevant pool.

7A.3.9 G The term "which should have been held" is a reference to the relevant failed

~~bank's~~ *person's* failure to hold the *client money* at the time of the ~~pooling event~~ *its failure*.

Failure of a bank: treatment of designated client bank accounts and designated client fund accounts

- 7A.3.10 R For each *client* with a *designated client bank account* maintained by the *firm* for the *general pool* or a particular *sub-pool* and held at the *failed bank*:
- (1) any ~~shortfall~~ *secondary pooling shortfall* in *client money* held, or which should have been held, in *designated client bank accounts* that has arisen as a result of the *failure*, must be borne by all the *clients* of the relevant *pool* whose *client money* is held in a *designated client bank account* of the *firm* at the *failed bank*, rateably in accordance with their *client money* entitlements;
 - (2) a new *client money* entitlement must be calculated for each of the relevant *clients* of the relevant *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~~ *secondary pooling 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 paragraph (2), for the purposes of reconciliations pursuant to CASS 7.15.3R (Records and accounts) in respect of the relevant *pool*, ~~and where relevant SYSC 4.1.1R (General organisational requirements) and SYSC 6.1.1R (Compliance)~~.
- 7A.3.11 R *Money* held by the *firm* in each *designated client fund account* for the *general pool* or a particular *sub-pool* with the *failed bank* must be treated as pooled with any other *designated client fund accounts* for the *general pool* or a particular *sub-pool* as the case may be which contain part of the same designated fund and:
- (1) any ~~shortfall~~ *secondary pooling shortfall* in *client money* held, or which should have been held, in *designated client fund accounts* that has arisen as a result of the *failure*, must be borne by each of the *clients* of the relevant *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 the relevant *pool* by the *firm*, in accordance with paragraph (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~~ *secondary pooling 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 paragraph (2), for the purposes of reconciliations pursuant to CASS 7.15.3R (Records and accounts) for the relevant *pool*, ~~and where relevant SYSC 4.1.1R (General organisational requirements) and SYSC 6.1.1R (Compliance).~~

7A.3.12 R A *client* whose *money* was held, or which should have been held, in a *designated client bank account* with a bank that has *failed* is not entitled to claim in respect of that *money* against any other *client bank account* or *client transaction account* of the *firm*.

7A.3.12A R A *client* whose *money* was held, or which should have been held, in a *designated client fund account* with a bank that has *failed* is not entitled to claim in respect of that *money* against any other *client bank account* of the *firm* that is not part of the same *designated fund* or against any *client transaction account* of the *firm*.

Client money received after the failure of a bank, exchange, clearing house, intermediate broker, settlement agent or OTC counterparty

7A.3.13 R *Client money* received by the *firm* after the failure of a bank, exchange, clearing house, intermediate broker, settlement agent or OTC counterparty, that would otherwise have been paid into a *client bank account* or *client transaction account* at that bank, exchange, clearing house, intermediate broker, settlement agent or OTC counterparty, as the case may be, for either the *general pool* or a particular *sub-pool*:

- (1) must not be transferred to the *failed bank person* unless specifically instructed by the *client* in order to settle an obligation of that *client* to the *failed bank person*; and
- (2) must be, subject to paragraph (1), placed in a ~~separate~~ *client bank account* or *client transaction account* relating to the *general pool* or the particular *sub-pool* as the case may be ~~that has been opened after the secondary pooling event and either:~~ other than one operated at the *failed person*.
- (a) ~~on the written instruction of the *client*, transferred to a bank other than the one that has *failed*; or~~
- (b) ~~returned to the *client* as soon as possible.~~

7A.3.14 R If a *firm* receives a *mixed remittance* after the *secondary pooling event* 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*; and
- (2) pay the *money* that is not *client money* out of that *client bank account*

within one *business day* of the day on which the *firm* would normally expect the remittance to be cleared.

- 7A.3.15 G Whenever possible the *firm* should seek to split a *mixed remittance* before the relevant accounts are credited.

~~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* relating to the *general pool* or a particular *sub pool* as the case may be, the provisions of CASS 7A.3.17R and CASS 7A.3.18R will apply. [deleted]~~

- 7A.3.17 R ~~Money held in each *general client bank account* and *client transaction account* of the *firm* relating to the *general pool* or a particular *sub pool* as the case may be, 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*, that has arisen as a result of the *failure*, must be borne by all the *clients* whose *client money* is held in either a *general client bank account* or a *client transaction account* of the *firm* relating to the *general pool* or the particular *sub pool* as the case may be, rateably in accordance with their entitlements;~~
- ~~(2) a new *client money* entitlement must be calculated for each *client* by the *firm*, to reflect the requirements of (1), and the *firm's* records must be amended to reflect the reduced *client money* entitlement relating to the *general pool* or the particular *sub pool* as the case may be;~~
- ~~(3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed intermediate broker, settlement agent or OTC counterparty* 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 7.15.3R (Records and accounts), and where relevant SYSC 4.1.1R (General organisational requirements) and SYSC 6.1.1R (Compliance). [deleted]~~

~~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* relating to the *general pool* or a particular *sub pool* as the case may be:~~

- ~~(1) must not be transferred to the *failed* third party unless specifically~~

instructed by the *client* in order to settle an obligation of that *client* to the *failed intermediate broker, settlement agent or OTC* counterparty; and

- (2) ~~must be, subject to (1), placed in a separate *client bank account* relating to the *general pool* or the particular *sub pool* as the case may be, that has been opened after the *secondary pooling event* and either:~~
- (a) ~~on the written instruction of the *client*, transferred to a third party other than the one that has *failed*; or~~
 - (b) ~~returned to the *client* as soon as possible. [deleted]~~

Notification to the FCA: failure of a bank, exchange, clearing house, intermediate broker, settlement agent or OTC counterparty

7A.3.19 R ~~On the *failure* of a third party with which *money* is held, a A firm must notify the FCA as soon as reasonably practical after it becomes aware of the *failure of any bank, exchange, clearing house, intermediate broker, settlement agent, OTC* counterparty or other entity with which it has placed, or whom it has allowed to hold, *client money*:~~

- (1) ~~as soon as it becomes aware of the *failure* of any bank, *intermediate broker, settlement agent, OTC* counterparty or other entity with which it has placed, or to which it has passed, *client money*; and [deleted]~~
- (2) ~~as soon as reasonably practical, whether it intends to make good any *shortfall* that has arisen or may arise and of the amounts involved. [deleted]~~
- (3) whether it intends to make good any *secondary pooling shortfall* that has arisen or may arise; and
- (4) the amount of that *secondary pooling shortfall*, or the expected amount if the actual amount is not known.

...

9 Information to clients

9.1 Application

9.1.1 R This chapter applies as follows:

- (1) ...
- (2) subject to paragraphs (3) and (4), CASS 9.4 and CASS 9.5 to CASS 9.6 apply to a *firm* to which either or both CASS 6 (Custody rules) and CASS 7 (Client money rules) applies;
- (3) CASS 9.4 and CASS 9.5 to CASS 9.6 do not apply to a *firm* which

only *arranges safeguarding and administration of assets*; and

(4) ...

Insert the following new section after CASS 9.5 (Reporting to clients on request). The text in this section is all new and not underlined.

[*Editor's note:* The text in this new section takes into account the changes proposed by CP16/29 Markets in Financial Instruments Directive II Implementation – Consultation Paper III (September 2016), as if they were made.]

9.6 Annotated sample statements

- 9.6.1 R (1) A *firm* must make available to its *clients* an annotated sample statement in the form of the statement which it uses to satisfy its obligations to report on *client money* and *safe custody assets* under:
- (a) COBS 16.4 (Statements of client designated investments or client money); or
 - (b) COBS 16A.5 (Statements of client financial instruments or client funds); or
 - (c) article 63 of the *MiFID Org Regulation*.
- (2) The annotations in the sample statement must explain the meaning of the information that the *firm* presents in such statements.
- (3) The annotated sample statement must either:
- (a) be provided to *clients* in a *durable medium*:
 - (i) at the time at which it provides its first statement under the requirements listed under paragraph (1), and thereafter once every year;
 - (ii) at the time it changes the form of its statement under the requirements listed under paragraph (1); and
 - (iii) within five *business days* following the receipt of a request from the *client* for the annotated sample statement;
 - (b) be made available to *clients* through a link on the *firm's* website (if it does not constitute a *durable medium*) provided that the *website conditions* are satisfied and the link is in a prominent place on that website's homepage; or
 - (c) in cases where the *firm* provides statements to *clients* via an

online system in accordance with *COBS* 16.4.1R(1)(b), *COBS* 16A.5.1EU or article 63(2) of the *MiFID Org Regulation*, be made available to *clients* through that same online system.

- (4) A *firm* must not charge its *clients* a *fee* for providing the annotated sample statement.

Amend the following as shown.

TP 1 Transitional Provisions

TP 1.1

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
<u>1AZ</u>	<u>The changes to CASS in Part 2 of Annex B of the Client Assets (Client Money and Custody Assets Distribution and Transfers) Instrument 2017</u>	<u>R</u>	<p><u>In relation to a <i>firm</i>:</u></p> <p><u>(i) that has <i>failed</i>; or</u></p> <p><u>(ii) in respect of which a <i>primary pooling event</i> occurred,</u></p> <p><u>in either case before the changes in column (2) took effect, the changes effected by the provisions in the Annex listed in column (2) do not apply to the <i>firm</i>, and therefore the provisions in CASS amended by that Annex will continue to apply as they were in force as</u></p>	<u>Indefinitely</u>	<u>[<i>date this instrument comes into force</i>]</u>

			at [<i>day before this instrument comes into force</i>].		
...					

Sch 1 Record keeping requirements

...

1.3G

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
...				
<u>CASS 6.7.6R</u>	<u>Any safe custody asset disposed of in accordance with CASS 6.7.2R</u>	<p>(i) <u>The safe custody asset that was disposed of;</u></p> <p>(ii) <u>the value of the consideration received for the safe custody asset disposed of;</u></p> <p>(iii) <u>the name of the client to whom the safe custody asset was allocated, according to the firm's records at the time of making the record; and</u></p> <p>(iv) <u>efforts applied by the firm to determining the client's correct contact details under CASS</u></p>	<u>At the time of the disposal</u>	<u>Indefinite</u>

		<u>6.7.4E(1)(a)</u> or, if being <u>relied on, for</u> <u>the purposes of</u> <u>CASS</u> <u>6.2.10R(4).</u>		
...				
<u>CASS</u> <u>7A.2.6DR</u>	<u>Any balance</u> <u>under CASS</u> <u>7A.2.6AR(1)(b)(i)</u> or (ii) which has <u>been applied</u> <u>towards any costs</u> <u>incurred in</u> <u>accordance with</u> <u>CASS 7.17.2R</u> or <u>towards any</u> <u>shortfall in the</u> <u>relevant notional</u> <u>pool in</u> <u>accordance with</u> <u>CASS</u> <u>7A.2.6AR(1)(b)</u> or (c) respectively	(i) The amount of the balance of <i>client</i> <i>money</i> ; (ii) the name of any <i>client</i> to whom that balance was allocated according to the <i>firm's</i> records at the time of making the record; and (iii) efforts applied by the <i>firm</i> to determining the <i>client's</i> correct contact details under <u>CASS</u> <u>7A.2.6CE(1)(a)</u>) or, if being <u>relied on, for</u> <u>the purposes of</u> <u>CASS</u> <u>7.11.50R(3).</u>	<u>Immediately</u> <u>before</u> <u>taking steps</u> <u>to apply the</u> <u>balance</u> <u>towards</u> <u>costs or a</u> <u>shortfall in</u> <u>accordance</u> <u>with CASS</u> <u>7A.2.6AR(1)</u> <u>(b) or (c)</u> <u>respectively</u>	<u>Indefinite</u>
...				

Part 3: Comes into force on [date after Part 1]

7 Client money rules

...

7.11 Treatment of client money

...

- 7.11.37 R *Client money* received or held by the *firm* and transferred to a *clearing member* who facilitates indirect clearing through a *regulated clearing arrangement* ceases to be *client money* for that *firm* and, if applicable, the *clearing member*, if the *clearing member*:
- (1) remits payment to another *firm* or to another *clearing member* in accordance with default management procedures adopted by the *clearing member* which comply with the requirements of article 4 of the *EMIR L2 Regulation* or article 4 of the *MiFIR indirect clearing RTS*; or
 - (2) remits payment to the *indirect clients* of the *firm* in accordance with default management procedures adopted by the *clearing member* which comply with the requirements of article 4 of the *EMIR L2 Regulation* or article 4 of the *MiFIR indirect clearing RTS*.

...

7 Annex Client transaction account acknowledgment letter template

3R

...

- (d) all money standing to the credit of the Client Transaction Account is payable to us in our capacity as trustee under the laws applicable to us[, except where, in accordance with your default management procedures in respect of a default by us, you transfer money credited to the Client Transaction Account to anyone other than us in accordance with [article 4 of Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012] [and/or] [article 4 of Commission Delegated Regulation (EU) No [.../..] of [date]];

[*Editor's note*: At the time of consultation, the EU regulation supplementing MiFIR with regard to regulatory technical standards on indirect clearing arrangements has not been published in the Official Journal of the European Union. A draft can be found at section 3.3.2 of this document:
<https://www.esma.europa.eu/sites/default/files/library/2016-725.pdf>.]

...

7A Client money distribution or transfer

...

7A.2 Primary pooling events

...

7A.2.4A G ...

- (1A) Under the *EMIR L2 Regulation* or the *MiFIR indirect clearing RTS*, where a *firm* acting in connection with a *regulated clearing arrangement* for a *client* (who is also an *indirect client*) defaults, the *clearing member* with whom the *firm* has placed *client money* of the *indirect client*, may, in accordance with the *EMIR L2 Regulation* or the *MiFIR indirect clearing RTS*:

...

...

Annex C

Amendments to the Supervision sourcebook (SUP)

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

3 Auditors

...

3.10 Duties of auditors: notification and report on client assets

...

3.10.3A G An auditor's obligations under this section are modified in relation to a *failed firm* under SUP 3.10.6AR.

...

Client assets report: period covered

3.10.6 R ~~The~~ Subject to SUP 3.10.6AR, the period covered by a report under SUP 3.10.4R must end not more than 53 weeks after the period covered by the previous report on such matters, or, if none, after the *firm* is *authorised* or becomes subject to SUP 3.11 and its auditor becomes subject to SUP 3.10.

Client assets report: period covered where a firm has failed

3.10.6A R (1) This rule applies to an auditor of a *firm* that has *failed*.

(2) The period covered by a report under SUP 3.10.4R must end at the close of the *day* of the *firm's* failure.

(3) An auditor is not required to produce a report under SUP 3.10.4R to cover any period that commences after the *firm's* failure.

3.10.6B G (1) If a *firm* fails during a client assets report period then SUP 3.10.6AR requires a report to be produced covering matters up to the day of the *firm's* failure.

(2) SUP 3.10.6AR is subject to SUP TP 1.7.3.

...

TP 1 Transitional provisions

TP 1.7 Client assets report

(1)	(2)	(3)	(4)	(5)	(6)
-----	-----	-----	-----	-----	-----

	Material to which the transitional provision applies		Transitional Provision provision	Transitional provision: date in force	Handbook provisions; coming into force
...					
<u>3</u>	<u>SUP 3.10.6AR(2)</u>	<u>R</u>	<u>In relation to a <i>firm</i> for which the most recent period under SUP 3.10.6R has ended before [date this instrument comes into force] and where the <i>firm</i> failed during that period, the rule to which column (2) refers does not apply in relation to that period.</u>	<u>From [date this instrument comes into force] to [four months after the date this instrument comes into force]</u>	<u>[date this instrument comes into force]</u>



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