
Review of the client assets regime for investment business Feedback to CP13/5 and final rules

June 2014



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In this Policy Statement we report on the main issues arising from Consultation Paper 13/5** (*Review of the client assets regime for investment business*) and publish the final rules.

Please send any comments or enquiries to:

Jane Moore, Andrea Ferguson and John David Thiede
Client Assets and Wholesale Conduct Department
Markets Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Telephone: 020 7066 1000

Email: ps14-9@fca.org.uk

You can download this Policy Statement from our website: www.fca.org.uk.

Abbreviations used in this paper

AFMs	authorised fund managers
AIF	alternative investment fund
CADD	client assets disclosure document
CASS	Client Assets sourcebook
CASS RP	CASS resolution pack
CCP	a central counterparty authorised or recognised under EMIR
CFTC	US Commodities Futures Trading Commission
CF10a	CASS operational oversight function
client assets	for the purposes of this PS, collectively both custody assets and client money
client money	for the purposes of this PS, any money belonging to a client which a firm holds under the client money rules in CASS 7
CMAR	client money and asset return
COBS	Conduct of Business sourcebook
COLL	Collective Investment Schemes sourcebook
CP	consultation paper
the CP	CP13/5: Review of the client assets regime for investment business
custody assets	for the purposes of this PS, any asset belonging to a client which a firm holds in accordance with the custody rules in CASS 6
DvP	delivery versus payment
EMIR	Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories, commonly referred to as the 'European Markets Infrastructure Regulation'
ESMA	European Securities Markets Authority
FCA	Financial Conduct Authority (previously known as the FSA)

FRC	Financial Reporting Council
FSA	Financial Services Authority
FSCS	Financial Services Compensation Scheme
FUND	Investment Funds sourcebook
HMRC	HM Revenue & Customs
HMT	HM Treasury
ICA	an individual client account maintained by a firm at a CCP for a client in respect of which the CCP has agreed with the firm to provide individual client segregation in accordance with EMIR
IMRO	Investment Management Regulatory Organisation
IOSCO	International Organization of Securities Commissions
IP	insolvency practitioner
ISA	individual savings accounts operated under the ISA Regulations
IT	information technology
LBIE	Lehman Brothers International (Europe)
MiFID	European Parliament and Council Directive on markets in financial instruments (No. 2004/39/EC)
MiFID implementing Directive	Commission Directive No. 2006/73/EC implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive
MLRs	the Money Laundering Regulations 2007
mn	million
MPSA	mandatory prudent segregation amount
OCA	an omnibus client account maintained by a firm at a CCP for more than one client in respect of which the CCP has agreed with the firm to provide omnibus client segregation in accordance with EMIR
Part 1	the part of the instruments in Appendix 1 that enter into force on 1 July 2014
Part 2	the part of the instruments in Appendix 1 that enter into force on 1 December 2014
Part 3	the part of the instruments in Appendix 1 that enter into force on 1 June 2015

PRA	Prudential Regulation Authority
PS	policy statement
this PS	this policy statement, PS14/9
RAO	Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 ¹
SAR	Special Administration Regime for Investment Banks
SAR Review	Independent review of the SAR led by Peter Bloxham
SFA	Securities and Futures Authority
SIPP	self-invested personal pension scheme
SUP	Supervision sourcebook
TTCA	title transfer collateral arrangement
US	United States
UTD	unbreakable term deposit

¹ As amended, original version available at: <http://www.legislation.gov.uk/uksi/2001/544/contents/made>.

1. Overview

Introduction

- 1.1** In our consultation paper CP13/5: *Review of the client assets regime for investment business*² ('**the CP**') we proposed changes to the rules in the Client Assets sourcebook ('**CASS**') to address specific risks, to clarify the requirements firms must comply with and to enhance our client assets regime to achieve better results for consumers and increase confidence in financial markets.
- 1.2** This policy statement ('**this PS**') summarises the feedback we received to the CP and our response and includes final rules.

Who does this affect?

- 1.3** This PS makes changes to the rules in CASS. These affect **all firms that are subject to CASS** because they conduct investment business and hold client money, custody assets, collateral and/or mandates in relation to that investment business (or rely on an exemption contained within CASS). This includes **loan-based crowdfunding firms** who recently became subject to the client money rules in CASS 7 through the changes published in PS14/4³.
- 1.4** This PS will also be of interest to:
- **Auditors** in relation to providing annual auditors' client assets reports and other reports related to the alternative approach to client money segregation and non-standard methods of internal client money reconciliation;
 - **Third-party providers** who provide back office functions that firms use for their client assets operations;
 - **Market infrastructure firms**, including central counterparties, exchanges and other intermediaries with whom firms may place client assets;
 - **Banks** with whom firms deposit client money;
 - **Custodians and other third parties** who may hold client assets in a client transaction account for a firm subject to CASS; and

² CP13/5 (July 2013), available at: www.fca.org.uk/your-fca/documents/consultation-papers/cp13-5.

³ PS14/4: *The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realisable securities by other media – feedback to CP13/13 and final rules* (March 2014), available at: www.fca.org.uk/your-fca/documents/consultation-papers/cp13-5.

- **Insolvency practitioners** and their advisers that would be responsible for distributing client assets if a firm that holds client assets enters into insolvency proceedings.
- 1.5** This PS will not apply to general insurance intermediaries that only hold client money in accordance with CASS 5 or debt management firms that only hold, or will only hold, client money in accordance with CASS 11.

Is this of interest to consumers?

- 1.6** Our new rules will affect any consumers who conduct investment business with firms as the rules are designed to ensure that investment firms better protect client money and custody assets (together '**client assets**') while responsible for them. In particular, consumers will receive enhanced information from firms about how firms hold their money and assets and the impact those arrangements could have on the protections available to them under our client assets rules.

Context

- 1.7** The client assets regime supports our objectives by requiring firms to adequately protect client assets when they are responsible for them.
- 1.8** Protecting client assets is fundamental to consumers' rights and the trust they place in firms that are often acting as their agents, fiduciaries and/or counterparties; it is at the heart of ensuring a well-functioning and robust marketplace.
- 1.9** We increased our focus on client assets protection following the failure of Lehman Brothers International (Europe) ('**LBIE**'). We did this by creating the Client Assets Unit (bringing together specialist risk, supervision and policy functions) and making various improvements to the client assets regime, such as enhancements to auditor reporting, reintroduction of the Client Money and Asset Return ('**CMAR**') and the creation of the CASS operational oversight function ('**CF10a**').
- 1.10** Following recent firm failures, the client assets rules have come under scrutiny and the UK has been subject to some criticism about the length of time it takes for client assets to be returned after a firm's failure. As set out in the CP, following the conclusion of the LBIE Supreme Court client money case in 2012, we conducted a comprehensive review of the client assets rules for investment firms and consulted on changes to the custody rules, client money rules and client money distribution rules in the CP. These proposed changes aimed to address issues coming out of lessons learnt from recent insolvencies, feedback from firms, observations by our Client Assets Unit and lengthy discussions with various industry professionals, including trade associations and auditors.
- 1.11** We are now making rules that will improve the protection of client money and custody assets held by investment firms.
- 1.12** We are not at this time proceeding with the main proposals we consulted on around our client money distribution rules. This is because of various reasons (discussed below⁴): in summary, we received significant feedback from respondents on various potential problems if the

⁴ At para. 3.7.

'Speed Proposal' set out in the CP were introduced; and second, any change we make to our client money distribution rules will need to work with the recommendations, if implemented, published in the final report of the independent review the government commissioned of the Investment Bank Special Administration Regulations 2011 ('SAR').⁵

- 1.13** As discussed below⁶, we are going to keep our client money distribution rules under review and we intend to further consult on the topic later this year. We believe changes to the underlying legislative framework for the client assets regime and the SAR will secure further improvements in the speed of return of client assets.

Review of the Special Administration Regime

- 1.14** After the CP's consultation period ended, HM Treasury ('HMT') published the final report of an independent review it commissioned of the SAR⁷. This report contained a large number of recommendations, which we will work with HMT to explore. We consider that some of the recommendations could, if implemented, achieve better results for clients by accelerating the process for distributing client assets and reducing costs. These include introducing a bar date for the processing client money claims⁸, facilitating transfers of client relationships and positions⁹, allocating costs of distributing client assets to¹⁰, and covering shortfalls with¹¹, the general estate and exploring methods to speed-up reaching determinations of legal issues on the interpretation of SAR and CASS in an insolvency.¹²
- 1.15** We believe a number of the recommendations made by the independent reviewer are likely to be facilitated in part by the changes to the client asset regime made in this PS. This includes, in particular, the behavioural recommendations¹³ made around good recordkeeping¹⁴, enhanced reporting to clients¹⁵, improved understanding around our client assets regime (the protections it affords and its limitations)¹⁶ and increased clarity around certain intra-group relationships¹⁷. Also included in this PS are changes that might support the general recommendations made around facilitating transfers.¹⁸

5 See generally *Investment Bank Special Administration Regulations 2011 (SI 2011/245)*, available at: www.legislation.gov.uk/ukSI/2011/245/pdfs/ukSI_20110245_en.pdf.

6 At para. 3.9.

7 See P. Bloxham, Final review of the Investment Bank Special Administration Regulations 2011 (January 2014)(hereinafter 'SAR independent review'), available at: www.gov.uk/government/uploads/system/uploads/attachment_data/file/271040/PU1560_SAR.pdf.

8 *Ibid.* Chapter 8, Section B, Bar Date reforms, pp. 39 to 40.

9 *Ibid.* Chapter 8, Section A, Facilitating transfers, pp. 37 to 39.

10 *Ibid.* Paras. 5.14 to 5.20.

11 *Ibid.* Paras. 5.21 to 5.30, 7.11 and 7.19.

12 *Ibid.* Paras. 8.15, 8.31, 8.41, 8.44 to 8.46, 8.52 to 8.53 and 8.89.

13 See *Ibid.* Annex B Behavioural Recommendations 65 to 72.

14 For example, the requirements we are introducing on firms documenting title transfer collateral arrangements (discussed at para. 6.10) and amounts prudently segregated (discussed at paras. 7.153 to 7.157).

15 For example, the reporting requirements discussed in Chapter 9 of this PS.

16 For example, the requirement to report all information concerning safeguarding client assets to all clients, discussed below in para. 9.24.

17 For example, written custody agreement, discussed below at paras. 5.23 to 5.26. See also footnote 7 above, SAR independent review at p.73.

18 For example, the restrictions we are introducing around the registration of firm and custody assets, discussed below at para. 5.4. See also footnote 9 above, SAR independent review at Chapter 8, Section A, Facilitating transfers, pp. 37 to 39.

European policy making

- 1.16** We are liaising with HMT about notifying the European Commission (under Article 4 of the Markets in Financial Instruments Directive implementing Directive¹⁹ (**‘MiFID implementing directive’**)) because the change to the rules which will require firms to provide the same information on safeguarding of client assets, as already required for certain client types, to all clients regardless of type (discussed below²⁰) is additional to the relevant provisions within that Directive. The Commission is also aware that we intend to notify them, on a precautionary basis, about three changes being introduced in this PS which might be interpreted as additional to the provisions within that Directive. We will publish these notifications in due course.
- 1.17** The Level 1 text of the revised MiFID (**‘MiFID II’**) has been agreed. In terms of changes in relation to safeguarding of client assets, these are limited to barring the use of title transfer collateral arrangements (**‘TTCA’**) with retail clients in Article 16(10). The Level 1 text also allows for provisions to be made under this Article in the revised Level 2 text.
- 1.18** We worked alongside other EU regulators with the European Securities Markets Authority (**‘ESMA’**) to deliver a consultation paper published in May.²¹ The outcome of the consultation will be technical advice to the European Commission on Level 2 provisions following the agreement of MiFID II and MiFIR. The consultation period closes on 1 August. This consultation paper will interest investment firms and the trade associations representing them.

Summary of feedback and our response

- 1.19** We received 118 written responses to the CP. On the whole we found these very constructive. Detailed descriptions of the feedback are included with each topic in this PS and it has shaped the final rules we are making which are published in Appendix 1. We would like to thank all respondents for their feedback.

Next steps

- 1.20** All investment firms to which the CASS sourcebook applies should review the instrument set out in Appendix 1 in detail and establish how the changes we are making will affect their business. If these changes affect your firm, you will need to comply with the new rules by the dates set out in **Chapter 2 in Table 1**.
- 1.21** The key dates are:
- **1 July 2014** – certain rules and guidance come into force providing clarifications to existing requirements, introducing optional arrangements with which firms may choose to comply and limiting the placement of client money in new unbreakable term deposits. These include clarifications of application provisions and the introduction of the option to operate multiple client money pools;

19 Commission Directive 2006/736/EC of 10 August 2006 implementing Directive 2004/39/EC, available at: <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32006L0073>.

20 At paras. 9.20 to 9.26.

21 Consultation Paper ESMA/2014/549 (22 May, 2014) available at: www.esma.europa.eu/system/files/2014-549_-_consultation_paper_mifid_ii_-_mifir.pdf.

- **1 December 2014** – certain rules and guidance come into force relating to the provision of information to or obtaining the agreement of new clients and the documenting of agreements and arrangements with any new counterparties with whom firms deposit or otherwise place custody assets or client money, these include requirements to notify the client of certain matters if operating the banking exemption and mandating the use of template acknowledgment letters with new client bank accounts and client transaction accounts; and
- **1 June 2015** – all of the remaining rules and guidance come into force and firms will need to ensure they fully comply with all of the new rules set out in Appendix 1 to this PS.

2. Summary of all changes being made

- 2.1** This chapter summarises the key changes we are introducing and when they will come into effect in our Handbook.
- 2.2** These changes affect the whole of CASS (except the client money rules for insurance mediation activity (CASS 5) and the debt management client money chapter (CASS 11)), with the changes predominantly occurring in the custody rules (CASS 6) and the client money rules (CASS 7). As well as the many amendments occurring to CASS 6 and CASS 7 to improve the protection of client assets, we are also introducing provisions allowing clearing member firms to offer multiple client money pools to their clients in certain circumstances.

Key Topics

- 2.3** There are a large number of changes in this PS covering the entire operation of the client money and custody rules. Whilst we have summarised the key proposals in **Table 1**, this does not necessarily cover all the changes proposed in the CP and we encourage firms to consider the detail in this PS and in particular in the instrument in Appendix 1.
- 2.4** Table 1 sets out a summary of the changes being introduced in this PS and the rule references implementing these changes as at 1 July 2014 ('**Part 1**' of the final rules), 1 December 2014 ('**Part 2**' of the final rules) and 1 June 2015 ('**Part 3**' of the final rules) (as relevant).

Table 1

Key topics	High level summary of changes being introduced	Relevant paragraphs in this PS	CASS Rule References at 1 July 2014	CASS Rule References at 1 December 2014	CASS Rule References at 1 June 2015
CASS 1 – application provisions					
Application of the Client Assets sourcebook (CASS 1)	General guidance clarifying the application of CASS to affiliates and trustee firms.	10.4 to 10.6		1.2 to 1.4	
CASS 3 – collateral rules					
Application of collateral rules	General guidance reminding firms of their obligations under the client's best interest rule when agreeing to a collateral arrangement.	10.7		3.1.7AG	

Key topics	High level summary of changes being introduced	Relevant paragraphs in this PS	CASS Rule References at 1 July 2014	CASS Rule References at 1 December 2014	CASS Rule References at 1 June 2015
CASS 6 – custody rules					
Application of the custody rules	General guidance clarifying which rules apply to depositaries of AIFs and when a firm is arranging safeguarding and administration of assets.	5.2	6.1.1R, 6.1.16FR, 6.1.16JR and 6.1.16KR		
Registration of firm assets and custody assets	A firm's ability to register title to its own assets in the same name as any custody assets registered in the name of a nominee will be restricted to circumstances in which this is necessary to facilitate a client transaction (e.g. in handling dealing errors, allocating bulk deals and/or processing transaction in fractional shares) or as a result of the law or market practice of an overseas jurisdiction.	5.4 to 5.19	N/A		6.2.3R to 6.2.6G
Depositing custody assets when using third parties	We are introducing a number of clarifications, reordering the rules to improve readability and amending the matters a firm should consider when selecting, appointing and periodically reviewing any third party custodian with whom it deposits assets.	5.20 to 5.22	N/A		6.3.1R to 6.3.4A-1R
Written custody agreements	Firms will be required to have in place a written agreement whenever they place custody assets, or arrange for custody assets to be placed, with a third party custodian.	5.23 to 5.26	N/A	6.3.4AR to 6.3.4BG	
Right to use arrangements	Reminder to firms that they must consider their client's best interest when agreeing to a right to use arrangement with a retail client.	5.27	6.4.1AG to 6.4.2G		
Custody recordkeeping, record checks and reconciliations	We are: (a) updating our rules to accommodate firms that use integrated systems to maintain their records for custody assets; (b) introducing a minimum frequency at which firms are required to undertake reconciliations or perform other checks to ensure the accuracy of their records for custody assets; (c) clarifying the obligation on firms to fund shortfalls in custody assets only for which they are responsible (using a firm's own assets or, where appropriate, other funds); and (d) introducing more detailed notification and recordkeeping requirements (including requiring firms to maintain internal procedures and policies for their custody reconciliations).	5.28 to 5.97	N/A		Various rules in 6.6 (6.5 will have been deleted in its entirety from 1 June 2015 and replaced by 6.6)

Key topics	High level summary of changes being introduced	Relevant paragraphs in this PS	CASS Rule References at 1 July 2014	CASS Rule References at 1 December 2014	CASS Rule References at 1 June 2015
Both CASS 6 and 7					
TTCA - written agreements	We are requiring all firms to have a written agreement in place for all title transfer collateral arrangements ('TTCA').	6.2 to 6.15	N/A	6.1.6BR to 6.1.6CG, 7.2.3BR to 7.2.3CG, TP1.1(7A) and TP1.1(9B)	6.1.6BR to 6.1.6CG and 7.11.1R to 7.11.8G
TTCA - procedure for switching	We are prescribing the mechanism firms should follow if a client requests protections under CASS for assets and monies subject to TTCA.				
DvP exclusion for commercial settlement systems	The final rules set out exactly when a firm is allowed to cease to treat money as client money or cease to apply our custody rules to a custody asset, as applicable, while carrying out a 'delivery versus payment' ('DvP') transaction through a commercial settlement system and ensure clients agree to these arrangements.	6.16 to 6.32	N/A	6.1.12R to 6.1.12ER and 7.2.8AG to 7.2.8AER	6.1.12R to 6.1.12ER and 7.11.14R to 7.11.20R
Unclaimed client money	Clarifications to the existing rules providing firms with an optional mechanism to deal with allocated but unclaimed client money under our rules (i.e. gift to charity) if certain conditions are met (e.g. reasonable steps having been taken to trace the client). Firms will also be permitted to pay away de minimis amounts of client money (£25 for retail clients and £100 for professional clients) after following an abbreviated procedure.	6.33 to 6.51	N/A	7.2.18G to 7.2.26G	7.11.48G to 7.11.58G
Unclaimed custody assets	We are providing firms with an optional mechanism to deal with unclaimed custody assets under our rules (i.e. gift to charity) if certain conditions are met (e.g. reasonable steps having been taken to trace the client).	6.52 to 6.56	N/A	6.2.8G to 6.2.16G	
CASS 7 – client money rules					
Application of the client money rules	We are introducing certain amendments to the relevant rules and further guidance to clarify when the client money rules are applicable to firms' activities.	7.2 to 7.3	7.1.1AR to 7.1.1BG		7.10.1R to 7.10.2G
Banking exemption	We are clarifying the application of the exemption from the client money rules that banks may use and introducing new requirements around the notifications that banks must make to their clients.	7.4 to 7.19	N/A	7.1.8AR to 7.1.10CR	7.10.16R to 7.10.24G
Trustee firms	We are disappling the client money distribution rules to client money held by a trustee firm and introducing the ability of trustee firms to opt in to certain client money rules.	7.20 to 7.35	7.1.15FR to 7.1.15LG		7.10.33R to 7.10.40G

Key topics	High level summary of changes being introduced	Relevant paragraphs in this PS	CASS Rule References at 1 July 2014	CASS Rule References at 1 December 2014	CASS Rule References at 1 June 2015
DvP exclusion for collective investment schemes	Authorised fund managers will be permitted to cease to treat money as client money for a one-day window while carrying out a 'delivery versus payment' ('DvP') transaction for the purpose of settling a transaction in relation to units in a regulated collective investment scheme. Firms will also be obliged obtain clients' agreement to these arrangements.	7.36 to 7.53	N/A		7.11.21R to 7.11.24R
Payment of interest on client money	We are clarifying when firms are and are not required to pay clients the interest earned on client money.	7.54 to 7.56	7.2.14AR to 7.2.14BG		7.11.32R to 7.11.33G
Money ceasing to be client money	Certain clarifications and revisions to accommodate transfer of business, unclaimed client money and a firm's legal obligations to pay client money to a third party.	7.57 to 7.63	7.2.15R		7.11.34R to 7.11.40R
Transfer of business – handling client money	We are setting out requirements relating to assignment clauses in client agreements if they are to serve as client consent to transfer a client's client money to a third party in the context of a business transfer to allow assignment clauses to be used as an alternative to obtaining client consent at the time of the transfer.	7.64 to 7.80	N/A	7.2.17AG to 7.2.17GR	7.11.41G to 7.11.47R
Client bank accounts – due diligence and diversification	We are enhancing the due diligence requirements that firms must carry out on banks with whom they place client money, and requiring firms to periodically assess whether they are appropriately diversifying the third parties with which they place client money and following each assessment make adjustments (to the third parties and/or amounts placed at each) accordingly.	7.81 to 7.97	N/A		7.13.8R to 7.13.12R and 7.13.20R to 7.13.25R
Unbreakable term deposits	We are prohibiting firms from placing money in a deposit with an unbreakable term of more than 30 days.	7.98 to 7.106	7.4.11AR to 7.4.12G		7.13.13R to 7.13.15G
Immediate segregation	Except where firms are using the alternative approach to client money segregation, we are generally requiring firms to receive all client money directly into a client bank account. However, the final rules will permit firms who act as a clearing member of CCPs in certain situations to receive client money into a house account before transferring it to a client bank account so long as they maintain prudent segregation in their client bank account to address intra-day risk.	7.107 to 7.112	N/A		7.13.6R to 7.13.7G
Physical receipts	We are clarifying how firms should treat client money receipts in the form of cash and cheques and how these should be reflected in the internal client money reconciliation.	7.128 to 7.132	N/A		7.13.32R to 7.13.33R
Cleared funds	We are reiterating the principle that one client's money should not be used to fund another client's investment business.	7.133 to 7.140	N/A		7.12.3G

Key topics	High level summary of changes being introduced	Relevant paragraphs in this PS	CASS Rule References at 1 July 2014	CASS Rule References at 1 December 2014	CASS Rule References at 1 June 2015
Money due to client from firm	This was previously guidance but has been made into a rule.	7.145 to 7.147	N/A		7.13.39R to 7.13.40G
Prudent segregation	We are setting out procedures and recordkeeping requirements that firms must follow if they intend to prudently segregate money in a client bank account to address specific risks.	7.148 to 7.157	N/A		7.13.41R to 7.13.53R
Alternative approach to client money segregation	We are: (a) setting out clear procedures that a firm must follow to establish whether it considers that the use of the alternative approach to client money segregation is appropriate for a particular business line; and (b) requiring firms to use prudent segregation to address the risks to client money that may arise due to a firm using this approach.	7.158 to 7.167	N/A	7.4.17AG to 7.4.19CR	7.13.54G to 7.13.69G
Client money held at third parties	We are clarifying that in certain circumstances a firm may allow a third party to hold client money but still remain responsible to the client for that money, setting out the record and account keeping requirements in those circumstances.	7.198 to 7.203	7.5.1G to 7.5.3G		7.14.1G to 7.14.4G
Client money relating to custody assets held at a custodian	Revised rules to clarify that where a firm deposits custody assets with a third party, any client money derived from those assets should either be held in a client bank account or in a client transaction account, as appropriate.	7.204 to 7.206	N/A		7.14.5G to 7.14.9G
Client money recordkeeping and reconciliations	We are: (a) establishing clear requirements as to the steps a firm is expected to follow when undertaking an internal client money reconciliation (a 'standard method'); (b) clarifying the circumstances in which a firm is able to undertake a non-standard method of internal client money reconciliation; (c) mandating the minimum frequency at which firms should undertake client money reconciliations (both internal and external); and (d) introducing more detailed notification and recordkeeping requirements.	7.207 to 7.231	N/A		7.15 and 7.16 (7.6 and 7 Annex 1G will have been deleted in their entirety from 1 June 2015)
Auditor assurances	We are requiring firms that operate an alternative approach to client money segregation and/or a non-standard method of internal client money reconciliation to obtain before carrying out the proposed approach/method an auditor's report prepared on the basis of a reasonable assurance engagement. As part of this process, the auditor will be required to opine on whether the proposed approach/method will achieve the desired regulatory outcome (e.g. an appropriate internal client money reconciliation/correct calculation of the alternative approach mandatory prudent segregation amount).	7.168 to 7.184 and 7.232 to 7.240	N/A	7.4.17ER and 7.6.6AR	7.13.58R and 7.15.18R

Key topics	High level summary of changes being introduced	Relevant paragraphs in this PS	CASS Rule References at 1 July 2014	CASS Rule References at 1 December 2014	CASS Rule References at 1 June 2015
Acknowledgement letters	We are: (a) introducing a template firms must use when drafting and exchanging acknowledgment letters with the third parties with whom they deposit or place client money; (b) requiring firms in all circumstances to have an acknowledgment letter in place before they place client money in the relevant account; (c) providing guidance around the formalities involved when drafting and executing these letters in different circumstances; and (d) mandating how often and in what circumstances firms should review and update the letters they have in place.	7.280 to 7.348	N/A	7.8, Annex 2R, Annex 3R, Annex 4R and Annex 5G	7.18, Annex 2R, Annex 3R, Annex 4R and Annex 5G
CFTC Part 30 exemption order	We are providing additional guidance to clarify the obligations placed on firms in relation to FCA-regulated business conducted under the CFTC Part 30 exemption order.	7.349 to 7.355	12.1.1R to 12.2.6G		
CASS 7 and 7A - multiple client money pools					
Operation of multiple client money pools	We are introducing rules to permit clearing member firms of CCPs to offer multiple client money sub-pools in relation to net margined omnibus client accounts at CCPs.	4.1 to 4.29	7.19		
CASS 8 – mandate rules					
Non-written mandates	We are introducing revised rules to: (a) ensure firms keep appropriate records of non-written mandates; (b) remove the requirement on firms to hold records of all mandates indefinitely; and (c) clarify the form and content of records to be retained around mandates.	8.2 to 8.5	N/A		8.2.2G to 8.2.6G and 8.3.2R to 8.3.2HG
CASS 9 – information to clients					
Reporting to clients (on client assets)	We are: (a) requiring firms to honour client requests for information on their holdings of client assets, but will permit firms to agree to charge clients the reasonable costs for doing so; and (b) clarifying that where a firm provides a report to a client on its holdings of client assets for that client, a firm should ensure that it is clear from the report when assets or monies are, or are not, protected under either or both our custody rules and client money rules.	9.9 to 9.19	N/A		9.1.1R and 9.5.1G to 9.5.9G
Information to clients on safeguarding client assets	We are requiring firms to provide the same information to all client types, and for all types of custody assets, as is currently required to be provided to only retail clients, and for specific asset types, under our existing information requirements for firms holding client assets (see COBS 6.1.7R).	9.20 to 9.26	N/A	9.4.1G to 9.4.4G	

Key topics	High level summary of changes being introduced	Relevant paragraphs in this PS	CASS Rule References at 1 July 2014	CASS Rule References at 1 December 2014	CASS Rule References at 1 June 2015
Miscellaneous					
Consequential changes to other parts of the Handbook	A number of additional consequential changes are being made to our requirement for CASS RP (CASS 10), CMAR (SUP 16.4 Annex 29 and Annex 29A) and the client money distribution rules to reflect the changes being made above and provide additional clarification.	10.1 to 10.12	Various changes to 7A (e.g. relating to trustee firms and multiple client money pools)		Various changes to CASS 10, SUP 16 Annex 29R and 29A

Implementation timetable

- 2.5** We consulted on the changes to the Handbook discussed in the CP coming into effect six months after the publication of this PS.
- 2.6** We received a range of feedback on each of our individual proposals regarding the proposed transitional arrangements. Some suggested that for an individual proposal, or as a result of the net effect of all the proposals in the CP, six months would be insufficient time for firms to change their systems and processes to bring them into compliance. Others suggested that specific clarifications should be introduced into the Handbook sooner to remove ambiguities.
- 2.7** As a result, we are introducing a tiered approach to implementing the changes. We will introduce the changes in three stages: the changes in the first stage are either optional or impose a minimal regulatory burden on firms; the changes in the second stage may require firms to revise some existing documentation (e.g. firms are given six months until they will need to provide new clients with amended contract wording, but for existing clients will have 12 months to make these amendments); and we expect the changes in the third stage will impose a greater regulatory burden on firms and therefore we wish to provide a longer implementation timetable which will also help firms absorb and/or minimise costs. Table 2 summarises this approach and when each set of rules will come into force.
- 2.8** From **1 July 2014**, we will make changes to CASS in relation to the following topics:
- Clarifying the general application provisions of CASS (CASS 1) and the application of the collateral rules (CASS 3), custody rules (CASS 6) and the client money rules (CASS 7);
 - Removing the requirement for an auditor's confirmation in respect of alternative reconciliation methods for custody assets;
 - Changes to right to use arrangements for custody assets;
 - Changes to money ceasing to be client money;
 - Amending rules applying to trustee firms;
 - Prohibiting placement of client money in unbreakable term deposits with terms longer than 30 days;
 - Clarifications on payment of interest on client money;
 - Changes to client money held by third parties;
 - A revised definition of the 'standard method of internal client money reconciliation';

- Clarification of CFTC Part 30 Exemption Order;
- Certain clarifications to our client money distribution rules; and
- Introducing multiple client money pools.

2.9 We are also introducing specific rules from **1 December 2014** which firms will need to follow when operating the alternative approach to segregating client money and/or a non-standard method of internal client money reconciliation.

2.10 However, firms that are operating a non-standard method of internal reconciliation as of 30 November 2014 will be allowed to continue to comply with the existing requirements in this area (instead of the relevant changes being introduced in this PS) until 1 June 2015 or the date when they materially alter their non-standard method, whichever is earlier. Firms that are operating the alternative approach to segregating client money for particular business lines as of 30 November 2014 will be allowed to continue to comply with the existing requirements until 1 June 2015 in relation to those business lines (in relation to new business lines firms would be required to comply with the new rules from 30 November 2014).

2.11 Firms will be permitted to provide us the notifications and auditor's report required under the changes being introduced in this PS before operating the alternative approach/non-standard method and we expect that by **1 June 2015** all firms which intend to continue after this date to operate the alternative approach to client money segregation and/or a non-standard method of internal client money reconciliation will be in compliance with these new requirements (including their obligations to have provided us the requisite notifications and auditor's reports in advance of this deadline).

2.12 From **1 December 2014**, we will make further changes to CASS in relation to the following topics:

- Written custody agreements (impact on new or materially altered counterparty arrangements);
- Acknowledgment letters (impact on new client bank accounts and new client transaction accounts);
- Banking exemption (impact on new client relationships);
- TTCA - written agreements (impact on new client relationships);
- DvP commercial settlement systems (impact on new client relationships); and
- Information to be provided to clients before the provisions of investment services about client asset arrangements (impact on new client relationships).

2.13 In each of the above cases, firms will be permitted to comply with the relevant existing requirements until 1 June 2015 in relation to the arrangements the firm has in place with its counterparties and/or clients as of 30 November 2014. This means that from 1 December 2014, these new requirements will only apply to new arrangements and/or existing arrangements that have been materially altered after this date. However, from 1 June 2015 firms will need to fully comply with the rules being introduced in this PS for both their existing and new counterparties and/or clients.

- 2.14** From **1 December 2014**, we will make the following changes to CASS for which there will be no transitional provisions:
- Unclaimed custody assets;
 - Unclaimed client money; and
 - Transfer of business – handling client money.
- 2.15** From **1 June 2015**, all firms will need to fully comply with all the changes to the Handbook being introduced in this PS.²²
- 2.16** More generally, we note that firms may choose to begin complying with any of the requirements being introduced in this PS before the relevant requirement comes in force; compliance with any of these new requirements should not lead to a breach of the CASS rules and guidance in force on 1 July 2014.

²² We note that firms currently using UTDs that do not comply with the new rule will, following 1 July 2014 when the new rule comes into force, be required to terminate these as soon as they are permitted to do so under such existing UTD arrangements. We recognise that this may mean that certain UTDs currently in place will continue to be in place after 1 June 2015.

Table 2 = summary of commencement dates and transitional provisions:

Policy topic	Date of commencement	Any transitional
CASS 1 application provision	1 July 2014	
CASS 3 application	1 July 2014	
CASS 6 application	1 July 2014	
Multiple client money pools	1 July 2014	
Right to use arrangements	1 July 2014	
CASS 7 application	1 July 2014	
Trustee firms	1 July 2014	
Payment of interest on client money	1 July 2014	
Money ceasing to be client money	1 July 2014	
Unbreakable term deposits	1 July 2014	New rules apply to new contracts and firms must move to compliant contracts as soon as permitted
Qualifying money market funds	1 July 2014	
Client money held with third parties	1 July 2014	
CFTC Part 30 Guidance	1 July 2014	
Written custody agreements	1 December 2014	New rules will not apply to counterparty relationships established before 30 November 2014 until 1 June 2015, unless materially altered
Unclaimed custody assets	1 December 2014	
Unclaimed client money	1 December 2014	
TTCA – written agreement	1 December 2014	New rules relating to written client agreements will not apply to existing client relationships until 1 June 2015
DvP window – commercial settlement system	1 December 2014	New rules relating to agreement of client will not apply to existing client relationships until 1 June 2015
Banking exemption	1 December 2014	New rules relating to client notifications will not apply to existing client relationships until 1 June 2015
Transfer of business	1 December 2014	
Alternative approach to client money segregation	1 December 2014	New rules will not apply to a firm operating the alternative approach on the 30 November 2014 until 1 June 2015

Policy topic	Date of commencement	Any transitional
Non-standard client money reconciliations	1 December 2014	New rules will not apply to a firm operating a non-standard method on the 30 June 2014 until 1 June 2015
Acknowledgment letters	1 December 2014	New rules will not apply to existing client bank accounts and client transaction accounts until 1 June 2015
Information to clients on safeguarding client assets	1 December 2014	New rules relating to client disclosures will not apply to existing client relationships until 1 June 2015
Registration of firm and custody assets	1 June 2015	
Depositing assets when using third party custody services	1 June 2015	
Custody recordkeeping, record checks and reconciliations	1 June 2015	
TTCA – procedure for switching	1 June 2015	
DvP window – regulated collective investment scheme	1 June 2015	
Client bank accounts – due diligence and diversification	1 June 2015	
Immediate segregation	1 June 2015	
Physical receipts and allocation of client money	1 June 2015	
Cleared funds	1 June 2015	
Money due to client from firm	1 June 2015	
Prudent segregation	1 June 2015	
Client money relating to custody assets held at a custodian	1 June 2015	
Client money recordkeeping and reconciliations	1 June 2015	
Further consequential changes to the client money distribution rules	1 June 2015	
Non-written mandates	1 June 2015	
Reporting to clients	1 June 2015	
Consequential change to the CMAR and CASS RP	1 June 2015	

3. Client money distribution rules (CASS 7A)

- 3.1** We consulted on a number of proposals for changes to the client money distribution rules, namely:
- the 'speed proposal' or the codification of the existing client money distribution regime;
 - other changes to the client money distribution rules including, the application of 'hindsight' to the valuation of clients' open positions and the transfer of the client money pool; and
 - changes to the client money distribution rules that arise as a consequence of the proposed changes to the client money rules.

The speed proposal vs codification of the existing regime

- 3.2** We consulted on making changes to the client money distribution rules to increase the speed at which client money is returned to clients when an investment firm becomes insolvent. These proposals included introducing an initial distribution of client money shortly after a firm's failure solely on the basis of a firm's records, followed by the distribution of a 'residual pool' of client money via a claims process, the speed proposal.
- 3.3** We asked for views on this 'speed proposal', or whether it would be better to codify the existing regime such that some of the lessons learnt through firm insolvencies and case law are codified into the client money distribution rules. This would include, for example, codifying exactly what money constitutes the client money pool and the process that should be followed to determine clients' entitlements to the client money pool.
- 3.4** We set out that our proposals on the client money distribution rules recognised the limits of what we could do within our powers and that if the government introduced changes that could speed up the distribution of client money following the review of the SAR, then some of the proposals that concern the speed of distribution of client money may not be necessary, while others would be enhanced.
- 3.5** We received a significant amount of feedback from firms, lawyers, insolvency practitioners ('IPs'), industry associations and academics on the speed proposal. Various issues were raised, including the possibility that protracted litigation might arise in the event of the failure of a firm that had kept poor records which would hinder speedy distribution.

- 3.6** In parallel with the work that we have been carrying out in reviewing the client money distribution rules²³, a HMT-commissioned independent review of the SAR (special administration regime) has been in progress ('**SAR review**'). The final report was published in January 2014.²⁴ The report contains a large number of recommendations to improve the operation of the SAR, including changes proposed to the SAR legislation, CASS, the FSCS and how they interact. HMT is now considering the recommendations that fall within their remit and their response. In the CP we committed to reviewing and considering the possible need to re-consult on the client money distribution proposals in light of any changes HMT may introduce to the SAR following the publication of the final SAR review.

Our response

- 3.7** In light of the strength of the feedback received, setting out a significant number of legal concerns, we have reflected on the speed proposal and decided not to introduce it at present. We believe changes to the underlying legislative framework for CASS and the SAR would secure further improvements in the speed of return of client assets beyond the amendments we are making to our rules in this PS. As a result, we are now focusing our efforts on the many changes envisioned by the independent reviewer of the SAR and will conduct a further review of the client money distribution rules in line with HMT's implementation of the SAR review recommendations. On this basis, we intend to publish a further consultation on the client money distribution rules later this year.

Other changes to the client money distribution rules

- 3.8** We consulted on a number of changes to the client money distribution rules which were independent of the speed proposal. These included the transfer of the client money pool, the deletion of certain events as primary pooling events, the application of hindsight to the valuation of clients' open positions, the treatment of allocated but unclaimed client money entitlements and certain changes to the secondary pooling rules.
- 3.9** In light of our intention to publish a further consultation on the client money distribution rules later this year, we will reconsider these other changes in the context of any other proposal we consider making to the client money distribution rules.

Consequential changes to the client money distribution rules

- 3.10** We consulted on, and are introducing, a large number of proposed amendments to the client money rules. Some of these proposals result in consequential changes to the client money distribution rules. These include:
- disapplying the client money distribution rules to trustee firms in certain circumstances (discussed below²⁵);
 - clarifying that, where a firm has reduced its margined transaction requirement by using approved collateral in accordance with the client money reconciliation rules before a primary pooling event, this approved collateral must be liquidated and contributed to the client money pool when a primary pooling event occurs (discussed below²⁶); and

²³ At para. 3.1.

²⁴ See footnote 7.

²⁵ At paras. 7.20 to 7.28.

²⁶ At para. 7.256.

- amending the client money distribution rules to accommodate multiple client money sub-pools (discussed below²⁷).

3.11 The final rules we have made include these consequential amendments.

²⁷ At paras. 4.3-4.7.

4. Multiple client money pools

Background

- 4.1** In Part II of CP12/22²⁸ we consulted on permitting firms to establish and operate discrete ‘pools’ of client money, so that if a firm fails, each pool of client money would be distributed separately from any other pool of client money and only to those clients beneficially entitled to share in that pool. Any shortfall of client money would therefore be suffered by each pool individually and not shared across all clients of the firm.
- 4.2** We proposed to only allow those firms that are also clearing members of EMIR-authorized or recognised central counterparties (‘CCPs’) offering net omnibus client accounts at CCPs to operate multiple client money pools. Under the proposal, these firms would only be permitted to offer a client money ‘sub-pool’ in relation to a net margined omnibus client account (‘OCA’). This revised proposal was aimed at achieving the core objective to support the porting of net margined OCAs under EMIR as far as possible within the client money rules.

Operating multiple client money pools

Q9: *Do you agree with the amended proposal to allow clearing firms to operate multiple client money pools? If not, please provide reasons.*

- 4.3** The feedback from firms was generally supportive with the majority agreeing with the proposals. Some respondents neither agreed nor disagreed but provided comments and small minority disagreed. We intend to implement the proposals as set out in the final instrument in Appendix 1. We set out below some specific points raised in the feedback, our response to these and explanations of the changes made in response.

Operational complexity and litigation risk

- 4.4** A few respondents felt that, in spite of the revision of the proposal, the operation of client money sub-pools would still be too operationally complex. Other respondents felt that the operation by a firm of sub-pools would increase the risk of litigation if a firm failed, for example, as a result of clients trying to recover from pools to which they are not beneficiaries. Other respondents asked that sub-pools be permitted in other contexts such as where firms operate designated client bank accounts.

²⁸ CP12/22: *Client assets regime: EMIR, multiple pools and the wider review* (September 2012), available at: www.fsa.gov.uk/static/pubs/cp/cp12-22.pdf.

Our response

- 4.5** The operation of one or more sub-pools is optional for clearing member firms. Before establishing and operating a sub-pool, a firm must ensure that it meets all the internal controls, segregation, record and reconciliation keeping requirements set out in the final rules. If a firm cannot meet these requirements it should not be operating any sub-pools.
- 4.6** As in the case of any firm insolvency, we recognise that there is some risk of litigation if a firm operating sub-pools becomes insolvent and clients try to recover from pools to which they are not beneficiaries or try to claim that money in other pools belongs to their sub-pool. As far as possible, the final rules seek to minimise this risk. For example, the final rules make clear the conditions that must be met for a client to be a beneficiary of a sub-pool; they make clear precisely when a client will become a beneficiary of a sub-pool when moving from being a beneficiary of the general pool to being a beneficiary of a sub-pool and vice versa; that the beneficiaries of one pool (whether the general pool or a sub-pool) will not be permitted to make a claim on another pool (unless they are separately entitled to do this); and if a primary pooling event takes place before client money is paid from a client bank account maintained for a general pool to a client bank account maintained for a sub-pool (or vice versa), that money will not form part of the sub-pool (or the general pool, as the case may be).
- 4.7** Given the feedback we received of the operational complexities of operating a sub-pool we are not extending their scope to other contexts, but remain focused on permitting them only for clearing members operating net margined OCAs at CCPs. We understand that there may be other business models to which they may be suited and we may consider permitting sub-pools in other contexts in the future.

Diversification

- 4.8** A number of respondents asked for clarification on how the client money rules relating to diversification should apply to sub-pools and noted that the operation of a sub-pool would be less complex if firms were permitted to disapply the diversification requirements to sub-pools.

Our response

- 4.9** The client money segregation requirements in the final rules impose a requirement on firms not to place more than 20% of the client money they hold with an intra-group bank and an additional requirement that a firm must periodically assess whether it is appropriate to diversify its client money holding.²⁹ We consulted on the diversification requirements being applicable to each client money pool that a firm operates separately. In our view, given that the risks to client money as a result of not diversifying are the same irrespective of whether the client money is in a general pool or a sub-pool, these diversification requirements should apply separately to each pool that a firm operates, and firms should put in place appropriate systems and controls to ensure compliance with these rules.

²⁹ See current CASS 7.4.9AR and CASS 7.13.20R to 7.13.24G in Part 3 of the final rules in Appendix 1.

Clearing transactions of sub-pool beneficiaries and non-beneficiaries through the same omnibus client account

- 4.10** In response to feedback, we are making it clear in the rules that for a sub-pool relating to a net margined OCA, all the clients with positions being cleared through the relevant OCA will need to have consented to their client money being held in that sub-pool; clients who have not consented to being in the sub-pool will not be permitted to clear positions through the same OCA and the firm will have to put in place alternative clearing arrangements for those clients.

A single sub-pool relating to multiple CCPs

- 4.11** A few respondents noted that it would be helpful to firms if a sub-pool could relate to a number of net margined OCAs held at a number of different CCPs.

Our response

- 4.12** The objective of the multiple pools proposal is to allow the client money rules to facilitate the porting of net margined OCAs as far as possible. If a sub-pool could relate to OCAs at more than one CCP, this would mean that, at any time, client money pertaining to clients with positions in any number of OCAs could be mixed in the same client bank accounts. On the failure of a firm, it would be difficult for a firm to determine what sums of client money are held in the relevant client bank accounts in relation to the clients of a particular net margined OCA and therefore difficult to make this client money available to facilitate porting or return it to the relevant clients if porting fails. Also if multiple CCPs have direct access to money in a sub-pool client bank account this may create further issues on the failure of a firm if multiple CCPs reach into the same client bank account. Firms will be permitted to operate a single sub-pool in relation to a single net margined OCA at a CCP.

Operation of 'immediate segregation' in the context of sub-pools

- 4.13** As set out in the final rules, firms are required to apply the client money segregation rules³⁰ to the firm's general pool and each sub-pool that it establishes individually. This includes the provisions relating to the use of the normal approach in the context of regulated clearing arrangements.³¹ If a firm is operating a sub-pool in relation to a net margined OCA at a CCP and, due to the arrangements in place between the firm and the CCP, the firm is required to make and receive single payments that relate to both proprietary accounts and client segregated accounts at the CCP from/into a single bank account³², under the final rules the firm may use a house bank account to make and receive these payments and to maintain a prudent segregation in the relevant client bank account.³³ In the final rules this buffer is referred to as a 'clearing arrangement mandatory prudent segregation amount' ('**CAMPSA**'). This will ensure that client money segregated in a client bank account is not inadvertently used in relation to proprietary business and that clients are protected through the maintenance of the CAMPSA in the client bank account in respect of client money received into the firm's house account until it is moved into the relevant client bank account.

³⁰ CASS 7.4.1R and 7.19.12R in Part 1, and CASS 7.13.2R and 7.19.12R in Part 3, of the final rules in Appendix 1.

³¹ CASS 7.13.69R to 7.13.77G in Part 3 of the final rules in Appendix 1.

³² As described below at paras. 7.117 to 7.122.

³³ CASS 7.13.71R to 7.13.74R in Part 3 of the final rules in Appendix 1.

- 4.14** If a firm is operating a sub-pool and the client money margin relevant to the OCA is being channelled through a house bank account, the firm will be required to ensure that the client money element of the payment that has been received first into the house account for client positions in the net margined OCA, is transferred directly into a client bank account relating to that sub-pool promptly and in any event no later than the next business day after receipt in accordance with the relevant rules. The sub-pool client money should not first be transferred from the house account into a general pool client bank account before being moved into a sub-pool client bank account.
- 4.15** In addition, the requirement under this rule to maintain the CAMPSA of client money in client bank accounts, applies separately to a client money sub-pool operated by the firm. A firm will need to ensure that where the mixed payment that it receives into a house account includes an element of client money relating to the sub-pool, the CAMPSA of client money is maintained in the sub-pool client bank accounts (and is not part of the CAMPSA maintained in the general pool client bank account pursuant to the same rule). For an update on the costs and benefits associated with this 'carve out' from the requirement to receive client money directly into client bank accounts, please refer to the 'Immediate Segregation' section below.³⁴

Notification to the FCA

- 4.16** We consulted on requiring firms wishing to establish and operate a sub-pool to notify us not less than two months before the firm intends to start receiving client money for that sub-pool. A respondent queried what we were going to do with the notification.

Our response

- 4.17** Giving us notice means we have an opportunity to seek further information from the firm on how it intends to operate the sub-pool in compliance with the rules, should we wish to do so. Given the concerns raised in the feedback to the CP around operational complexities of operating sub-pools, this becomes particularly important.

Clients ceasing to be clients of a particular pool (but continuing to be clients of the firm)

- 4.18** In response to feedback, we have clarified in the final rules what procedure needs to be followed in relation to a client's client money holdings if: (i) an existing client of the firm wishes to become a client of a sub-pool; or (ii) an existing client of the firm wishes to cease to be a client of a sub-pool (but continue to hold client money with the firm).
- 4.19** If an existing client of the firm wishes to become a client of a sub-pool, before doing so, the firm will have to have obtained a signed copy of the relevant sub-pool disclosure document from the client. Similarly, if an existing client of the firm wishes to stop clearing positions through a particular OCA and consequently stop being a client of a particular sub-pool (but continue holding client money with the firm), the firm will be required to obtain the client's written instruction to this effect.

Sub-pool disclosure document

- 4.20** In response to feedback on CP12/22³⁵, we proposed in CP13/5 to require firms to use a template sub-pool disclosure document when establishing a sub-pool. While there are certain

³⁴ At para. 7.112.

³⁵ See footnote 28 above.

provisions that must be included in the disclosure document, we recognise that firms may wish to include other provisions. Therefore, we have made it clear in the final rules that certain provisions must be included in the sub-pool disclosure document. However, as the template sub-pool disclosure document is included in the final rules as guidance, and it is open to firms to include additional information that is relevant to the operation of the sub-pool.

- 4.21** The proposed rules in the CP defined who the beneficiaries of a particular sub-pool would be and separately required a firm to obtain the written consent of a client before receiving and holding that client's client money in a sub-pool. In the final rules, one of the core provisions in the sub-pool disclosure document is evidencing the consent of the client to the firm receiving and holding client money in the sub-pool (rather than there being a separate requirement to obtain this written consent). The final rules then make it clear that a beneficiary of a sub-pool must have signed a sub-pool disclosure document (including the consent) and returned it to the firm.
- 4.22** We consulted on firms having to notify clients of any material changes they wish to make to a sub-pool disclosure document. We have clarified the rules to more accurately reflect the policy intention that firms must notify clients if they intend to make a material change to the sub-pool itself, such as ceasing to operate a sub-pool or moving the business to another CCP. The final rules also make it clear that if a firm makes a material change to a sub-pool, the firm must consider its obligations under other applicable rules. For example, if a firm materially changes a sub-pool so that the sub-pool ceases to exist, and if clients will become client beneficiaries of the general pool as a result of the change, the firm must comply with the relevant rules. Similarly, if the firm is moving business to an OCA at another CCP and the firm will operate a sub-pool in relation to that OCA, a new sub-pool disclosure document will be required and the firm must comply with the relevant rules in obtaining the relevant clients' consent in the disclosure document.

Interaction with the client money distribution rules

- 4.23** Consistent with the speed proposal, in the CP we consulted on including a term in the sub-pool disclosure document that the firm's records were definitive for the purposes of determining beneficiaries' entitlement to a sub-pool. We also included references to this in other parts of the proposed rules. However, given feedback to the 'speed proposal' discussed above³⁶ and the fact that we are intending to further consult on the client money distribution rules later this year, we have deleted these references.

Our response

- 4.24** We have amended the current client money distribution rules so that they apply to the general pool and each sub-pool separately. In the event of a primary pooling event occurring, for the general pool, all the client money held in client bank accounts or client transaction accounts (apart from client transaction accounts that are individual client accounts or OCAs at CCPs) relating to the general pool, forms a single pool. This pool should be distributed in accordance with the rules.
- 4.25** Similarly, for a sub-pool, all the client money held in client bank accounts or client transaction accounts (apart from the OCA at the CCP) relating to the sub-pool forms a single pool. This pool should be transferred by the firm to effect or facilitate porting of the OCA or distributed in accordance with the rules.

³⁶ At paras. 3.2 to 3.7.

- 4.26** In the CP we consulted on amending the secondary pooling event rules so that certain client transaction accounts would not be pooled if a secondary pooling event occurred. These proposals will be considered further as part of the further consultation on the client money distribution rules later this year.
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Other

- 4.27** We wanted to take this opportunity to remind firms that if they operate client money sub-pools, a firm's CASS audit which confirms annually that the firm is in compliance with the client money rules will include compliance with the client money sub-pool rules. Also, the records that a firm maintains in relation to a sub-pool will form part of its CASS RP.
- 4.28** Given that these are optional requirements, these rules will enter into force on 1 July 2014. Please see Table 2 in Chapter 2.

Cost benefit analysis

- 4.29** Taking account of all the above changes, we expect that the costs will remain largely as estimated in the CP. We have made certain amendments to the proposal set out in the CP such as minor changes to the obligatory clauses in the sub-pool disclosure document, clarifications in relation to the procedures firms must follow to move a client from the general pool into a sub-pool (or vice versa) and amendments to the content of the notifications firms must make when making a material amendment to a sub-pool. We do not expect these amendments (individually or cumulatively) to significantly change firms' incentives or increase the cost of establishing or operating a sub-pool compared to what we set out in the CP.

5. Custody rules (CASS 6)

- 5.1** In this chapter we discuss the changes to the custody rules that will affect all investment firms that hold custody assets and some firms who do not hold, but arrange for others to hold, custody assets.

Application of the custody rules

- 5.2** We consulted on minor changes to the application provisions for the custody rules, including clarifying which rules apply to depositaries of AIFs and when a firm is arranging safeguarding and administration of assets. We received no comments on these changes and will introduce them as proposed in the CP.

Physical share certificates

- 5.3** We noted in the CP that we often receive queries on whether a firm that holds a client's physical share certificate, registered in a client's name, is captured within the activity of safeguarding and administering investments and subject to the obligations under our custody rules. A number of respondents wrote to us disagreeing that the loss or destruction of a share certificate could harm a client. We note that in many instances, a share certificate may not be the only means by which legal title to an asset is recorded. For example this may be through registration with the issuer. However, we reiterate that, although loss or destruction of a share certificate might not automatically create a loss of title to shares, a share certificate remains the client's asset and its loss or destruction could cause detriment to the client in certain circumstances. On this basis, we believe firms who are safekeeping physical share certificates fall within the scope of the 'safeguarding' part of the activity of safeguarding and administering investments under Article 40 of the RAO. As a result, where a firm is also administering an asset for which it is holding a physical share certificate (e.g. processing corporate actions), it will require the appropriate permissions and must comply with the custody rules in respect of those assets.

Registration of firm and custody assets

Q35: *Do you agree with our proposal to limit the circumstances where a firm may register or record legal title to its own applicable assets in the same name as that in which legal title to client safe custody assets are registered or recorded? If not, please provide reasons.*

- 5.4** We consulted on removing the ability of firms to register their own assets in the same name as the safe custody assets they hold for clients (**'custody assets'**), save for where the custody assets are permitted to be registered in the name of the firm itself. However, we proposed that the registration of custody assets in the name of the firm would continue to be permitted only in specified circumstances, namely where the asset is subject to local law or market practice outside of the UK.³⁷
- 5.5** Most respondents were supportive of the underlying principle behind this proposal: where a firm is acting for a proprietary purpose, it should be registering its proprietary assets in a separate name to the name in which it registers any custody assets it holds for a client. However, we received a number of comments on whether the proposed drafting achieved this principle and similar requests for further clarifications.
- 5.6** In particular, respondents noted there are a number of situations in which a firm may need to hold its own assets in the same name as the custody assets belonging to clients to facilitate, or as a result of, a transaction for a client, such as:
- correcting dealing or transaction errors that relate to client positions (e.g. if an error has occurred in relation to a transaction posted to a nominee account, a firm may need to pay its own assets into that same account (or a related control or suspense account held in the nominee's name) to reverse the transaction and/or correct the error);
 - processing or allocating assets for bulk deals (e.g. as a rounding mechanism when offering aggregated dealing services);
 - maintaining a small balance of the firm's own assets for purely operational or compliance purposes (e.g. as a float to cover custody breaks);
 - allowing clients to trade in fractional shares or units and when processing corporate actions attributable to a client's fractional entitlement; and
 - making good a shortfall in custody assets with a firm's own assets (discussed further below).³⁸
- 5.7** Other respondents pointed out it is often the case that where a firm uses a sub custodian in a particular overseas market that recognises nominee registration, it is likely that the sub custodian will register both the firm's own assets and any custody assets the firm held through that sub custodian in the same nominee name.
- 5.8** Some respondents were concerned that this proposal would prevent firms from being able to carry out proprietary transactions through a settlement system in which the settlement system is not itself the record of legal title to the assets being traded. For example, this might occur

³⁷ See para. 5.19 in the CP.

³⁸ At paras. 5.76 to 5.90.

where all assets traded through a particular overseas settlement system must be held by the same depositary and so have to be registered in the same name (e.g. the depositary's name), irrespective of beneficial entitlements/ownership.

- 5.9** One respondent noted that although they agreed with the proposal, for it to be more effective, we should require firms to obtain from the custodian an acknowledgment that they have complied with these registration requirements (similar to the requirement for specific acknowledgments from a third party bank before depositing client money).³⁹
- 5.10** A number of respondents also highlighted that the Individual Savings Account ('ISA') regulations allow firms to register assets held within an ISA wrapper in a way that might otherwise breach our custody rules (such as in the name of the firm).⁴⁰
- 5.11** A few respondents disagreed with our proposals in their entirety, stating they failed to see any 'logic' for the proposed changes as our rules already require firms to keep separate and accurate records of their holdings of custody assets. Others raised concern that there could be tax implications for firms in having to re-register proprietary assets into another name to comply with this rule and that a six-month transitional period would be too short for firms to re-register for these purposes.

Our response

- 5.12** We have redrafted these rules based on feedback. The revised rules generally restrict a firm from registering its own assets in the name of the client or any nominee in whose name a custody asset is also registered.
- 5.13** We are introducing this general restriction for two reasons. The *first reason* is to reduce the risk of custody assets being misappropriated, or client's rights in those assets being lost or diminished. We noted in the CP that allowing a firm to register or record legal title to its own applicable assets and custody assets under the same nominee name poses risks to those client assets – for example, an increased risk that the client's assets may not be separately identifiable from the firm's own assets, thereby delaying the return of custody assets and reducing client protection. The *second reason* is to increase the likelihood that the firm or an IP would be able to transfer client assets promptly before or after the failure of a firm to another entity. This is also consistent with the recommendations, recently published in the final report for the SAR Review, that firms be encouraged 'to use a wholly owned subsidiary as the nominee company to hold legal title to client investments (other than cash)' to facilitate the rapid transfer of client positions after the failure of a firm.⁴¹
- 5.14** Nevertheless, by way of exception and in response to feedback, the final rules will allow firms to register or record legal title to their own assets in the same name as that in which legal title to a custody asset is registered or recorded in two specific situations:
- First, where doing so arises incidentally to the investment business the firm carries on for the account of a client or to other steps taken by the firm to comply with the custody rules. We are also providing guidance to indicate that each of the situations discussed above⁴² are

³⁹ See the existing requirements in CASS 7.8 and CASS 7.18 in Part 3 of the final rules in Appendix I.

⁴⁰ See generally *The Individual Savings Account Regulations 1998* (SI 1998/1870), as amended.

⁴¹ See footnote 7 above, SAR independent review at para. 5.13.

⁴² At para. 5.6.

likely examples of where these conditions would be met. Nothing in these rules is expected to prevent firms from being able to undertake investment business for clients or to comply with other custody rules.

- Second, where doing so arises only as a result of the law or market practice of a jurisdiction outside of the UK. These revised rules do not prevent a firm, when operating in an overseas jurisdiction, from registering its own assets in the same name as custody assets where it is not possible or highly impractical to avoid doing so.

5.15 Where firms are able to make use of the exceptions set out above⁴³, they will still be prevented from registering or recording their own assets in the same name as any custody asset for any longer than is reasonably necessary. For example, as soon as practical after a dealing error in a nominee account has been corrected, the firm should ensure that any of its own assets that were registered to that account to correct the error, are re-registered into a different name. However, this rule should not prevent firms from retaining, on an ongoing basis, nominal amounts of their own assets registered or recorded in the same name as any custody assets where this can be clearly justified for the purpose of facilitating client transactions (for example, when an asset manager keeps a small float account for administrative purposes).

5.16 Additionally, in all circumstances, before a firm registers or records legal title to its own assets in the same name as a custody asset is registered or recorded, we expect the firm to consider whether there are any means to avoid doing so. Consistent with its obligations⁴⁴, each firm should be able to demonstrate that it considered each of the options available to it for the registration of its own applicable assets and, where permitted under the custody rules, the firm decides to continue to register its own assets in the same name as a client's asset, the firm's reasons for deciding not to proceed differently.

5.17 Together, these two changes⁴⁵ should not affect the CBA published in the CP. The exceptions reduce the regulatory burden on firms compared to what we proposed in the CP. We expect these changes should deliver benefits to clients, allowing firms to carry out specific transactions for clients whereas they could not have done so in compliance with the original proposals. However, we acknowledge there may be an increase in risk to custody assets compared to the proposal in the CP. To mitigate this concern the final rules prohibit firms from using the exceptions for any longer than is reasonably necessary and to consider whether there are any means of avoiding using the exceptions. The exceptions are only applicable in a narrow range of circumstances and therefore we do not expect a large proportion of custody assets to be affected by these exemptions. We also note that, when placing assets in overseas jurisdictions, firms will continue to be obliged to disclose these circumstances in specific situations to certain clients.⁴⁶ Given these reasons, we expect the benefits outlined in the CP should still be achieved.

5.18 We are also aware of the ISA regulations relevant to the registration of client assets⁴⁷ and note firms must comply with both the ISA regulations and our custody rules at the same time where their activities are subject to both sets of regulations.

⁴³ At para. 5.14.

⁴⁴ See also existing CASS 6.2.2R, 6.2.3R and SYSC obligations and CASS 6.2.3R to 6.2.6G in Part 3 of the final rules in Appendix I.

⁴⁵ See paras. 5.14 to 5.16.

⁴⁶ For example, under COBS 6.1.7R(1)(d) and (4), firms that hold designated investments or client money for a retail client or a professional client must provide that client with information that accounts that contain designated investments or client money belonging to that client are or will be subject to the law of a jurisdiction other than that of an EEA state, an indication that the rights of the client relating to those instruments or money may differ accordingly. Moreover, CASS 6.2.3R will continue to require firms to either notify or obtain the agreement of a client (depending on type) when that client's custody assets are registered in the name of a third party or the firm.

⁴⁷ See footnote 40.

- 5.19** Finally, based on feedback, all firms will be given until 1 June 2015 to bring their existing arrangements into compliance with these new requirements (see Table 2 in Chapter 2). Any firm which may face undue hardship in reregistering any of its own assets currently registered in the same name as a custody asset, should, as soon as possible, discuss this with its normal FCA supervisory contact.
-

Depositing assets when using third party custody services

- 5.20** We consulted on minor changes to the rules and guidance a firm must follow when depositing custody assets with a third party. This included a number of clarifications, a reordering of the rules to improve readability and amendments to the matters a firm should consider when selecting, appointing and periodically reviewing any third party with whom it deposits assets.
- 5.21** A few respondents requested that we ensure these rules remain consistent with the equivalent provisions in our client money rules for selecting, reviewing and appointing a bank for the deposit of client money.

Our response

- 5.22** We intend to implement the rules largely as proposed in the CP. Based on feedback and to ensure the policy proposed is achieved, we are making some minor amendments that clarify the specific factors we expect a firm to consider before choosing to use a particular third party to deposit its custody assets. We are also introducing a requirement to make it clear that not only must a firm keep records of the grounds upon which it satisfies itself of the appropriateness of its selection and appointment of a third party to hold custody assets, but the firm should also record each periodic review it makes of that selection. This requirement is important to ensure the firm's considerations are properly documented and we expect that most firms already do this. However, some firms may incur additional administrative and storage costs to comply with this requirement (from those consulted on in the CP), but we judge these costs to be minimal, as set out in Annex 1.
-

Written custody agreements

Q36: *Do you agree with our proposals for requiring written custody agreements and clarification on the terms and detail which ought to be included? If not, please provide reasons.*

- 5.23** We consulted on introducing an explicit requirement for firms to have a written agreement in place whenever they place custody assets with a third party custodian including the minimum terms a firm must include, and other details a firm should consider including, in such agreement. Investment firms will often place custody assets with third parties by 'depositing' them in the course of acting as their clients' custodian, or by arranging custody of them on their clients' behalf.

- 5.24** Most respondents agreed this was a sensible approach and a few were surprised that some firms might not already have a written agreement in place with each third party with whom they place custody assets. A few suggested the proposed rule was too prescriptive; one suggesting it may not work for commercial relationships in the wholesale markets. None of the respondents articulated a situation in which this proposal would be unworkable. However, several queried what sort of documentation would constitute a 'written agreement' and whether all firms would need to engage in a two-way document exchange with a third-party custodian. Some also asked us to clarify if 'third party' in these rules referred to an affiliate of the firm (i.e. another entity in the same group of companies as the firm), noting, as we have observed, many instances in which a firm may neglect to ensure its custody arrangements are in writing when custody services are provided by an affiliate. A couple of respondents were concerned that the matters set out in guidance for a firm to consider including in its written custody agreements would have to be included in every custody agreement, with one stating we should prescribe a template for these agreements and mandate that firms follow basic execution formalities.

Our response

- 5.25** We are implementing the rules we proposed in the CP with only minor changes to ensure clarity, highlighting that this rule will apply whenever a custody asset is placed by the firm with another person, whether or not the person is an affiliate of the firm. Also, we have clarified that the written agreement must set out: (1) the binding terms of the arrangement between the firm and the relevant third party; (2) be in force for the duration for that arrangement; and (3) clearly set out the custody service(s) that third party is contracted to provide. We will also continue to provide additional guidance on the other matters that a firm should consider incorporating into the agreement. To confirm, we are not stipulating the form or way in which a firm chooses to enter into agreement with the relevant third party, but rather only requiring that the terms of the parties' agreement are set out in writing. This means the parties might, instead of executing a formal written contract, be able to exchange their standards terms of business or other documentation which evidences in writing the parties agreement to the terms of the relevant custody arrangement. These minor clarifications should not impose incremental compliance costs on the affected firms above those already consulted on in the CP.
- 5.26** Based on feedback, we are also allowing firms until 1 June 2015 to bring their existing custody arrangements into compliance with these new requirements. However, firms that enter into new custody arrangements, or materially alter their existing custody arrangements, will be required from 1 December 2014 to ensure these new or altered arrangements are documented in writing in accordance with these explicit rules (see Table 2 in Chapter 2).

Right to use arrangements

- 5.27** We are introducing guidance to remind firms that they must consider their client's best interest when agreeing to a right to use arrangement with a retail client for that client's custody assets. We received no comments on this proposal. We note that we will keep firms' use of 'right to use arrangements'⁴⁸ under review and will take further action if we observe firms entering into inappropriate right to use arrangements, such as blanket arrangements that automatically require all retail clients to agree to right to use arrangements through a firm's standard terms of business.

⁴⁸ Under CASS 6.4.1AG to 6.4.2G in Part 1 of the final rules in Appendix I.

Custody asset recordkeeping, record checks and reconciliations

- Q37:** *Do you agree with our proposals to provide two different methods for the internal custody asset reconciliations? If not, please provide reasons.*
- Q38:** *Do you agree with our proposals in relation to the provision of an auditor's report before a firm can use the internal evaluation of custody records system method? If not, please provide reasons.*
- Q39:** *Do you agree with our proposals in relation to physical custody reconciliations? If not, please provide reasons.*
- Q40:** *Do you agree with our proposals in relation to the provision of an auditor's report before a firm can use 'the rolling stock' method? If not, please provide reasons.*
- Q41:** *Do you agree with our proposals for frequencies of custody reconciliations and those relating to the handling of discrepancies? If not, please provide reasons.*
- Q42:** *Do you agree with our proposals to require firms to document their own internal policies and procedures for their custody reconciliations? If not, please provide reasons.*

Overview

- 5.28** All investment firms that hold custody assets are currently required to maintain their records in a way that ensures their accuracy and, in particular, their correspondence to the custody assets they hold.⁴⁹ However, as noted in the CP⁵⁰, we continue to frequently identify instances of poor recordkeeping practices and firms with inadequate systems and controls to ensure the accuracy of their records. We observed that in many cases firms do not understand the requirements in place around custody asset recordkeeping, record checks and reconciliations.
- 5.29** We received comments on our proposals for custody recordkeeping, record checks and reconciliations from approximately 65 respondents. The feedback generally welcomed these proposals, citing our approach as proportionate, sensible and/or representative of best practices. Specific comments on the drafting of the proposed rules or requests for clarification are summarised in the following sections.
- 5.30** In this section, we discuss the changes and new requirements that we are introducing to increase clarity around our requirements for recordkeeping, improve firms' practices and ensure all firms have adequate systems and controls in place to ensure the accuracy of their records relating to custody assets.

⁴⁹ See existing CASS 6.5.1R and 6.5.2R and CASS 6.6 in Part 3 of the final rules in Appendix I.

⁵⁰ At paras. 5.25 to 5.29.

- 5.31** As a result of this PS, all firms subject to our custody rules will have additional recordkeeping obligations and the rules will clarify that at least one of the records a firm is obliged to maintain is a 'client specific safe custody asset record'. This is an internal record or account that identifies each of the custody assets the firm holds for each particular client.
- 5.32** Also, all firms will be required to undertake each of the following processes, where relevant, to ensure they comply with their custody assets recordkeeping obligations (see also diagrams 1 and 2 below):
- **Internal custody record checks**⁵¹ (all firms) – checks as to whether the firm's internal records and accounts of the custody assets held by the firm correspond with the firm's obligations to clients to hold those custody assets, performed by one of two methods:
 - **Internal custody reconciliation method** – a comparison on a particular date between two separately maintained records:
 - a 'client-specific safe custody asset record' – as set out above⁵²; and
 - an 'aggregate safe custody asset record' – an internal record or account of all the custody assets that the firm holds for clients;
 - **Internal system evaluation method** – establishing and running a process to evaluate: (a) the completeness and accuracy of the firm's internal records and accounts of custody assets held by the firm for clients, in particular whether *sufficient information* is being completed and accurately recorded by the firm to enable it to identify the custody assets held by the firm for each particular client (i.e. comply with its obligation to maintain a client-specific safe custody asset record), and readily determine all the custody assets that the firm holds for its clients; and (b) whether the firm's systems and controls correctly identify and resolve all discrepancies in its internal records and accounts of custody assets held by the firm for clients;
 - **Physical asset reconciliations**⁵³ (all firms that physically hold custody assets) – comparisons between a firm's internal records and a count of the actual physical safe custody assets held by the firm for its clients, performed by one of two methods:
 - **'total count method'** – the count being of all physical custody assets held by the firm on a particular date; and
 - **'rolling stock method'** – the count of all physical custody assets held by the firm being undertaken in several stages, with each stage referring to a count of a line of stock or group of stock lines (e.g. all the shares with an issuer whose name begins with the letter 'A' or all the stock lines held in connection with a particular business line being counted at the same time); and
 - **External custody reconciliations**⁵⁴ (all firms that either deposit or otherwise register custody assets with a third party) – reconciliations between a firm's internal accounts and records of custody assets and those of any third parties by whom those custody assets are held or registered.

⁵¹ See paras. 5.35 to 5.52 below.

⁵² See para. 5.31.

⁵³ See paras. 5.53 to 5.58 below.

⁵⁴ See paras. 5.62 to 5.70 below.

Diagram 1 – illustrative example of the custody record checks and reconciliations a firm with an integrated record-keeping system must undertake:

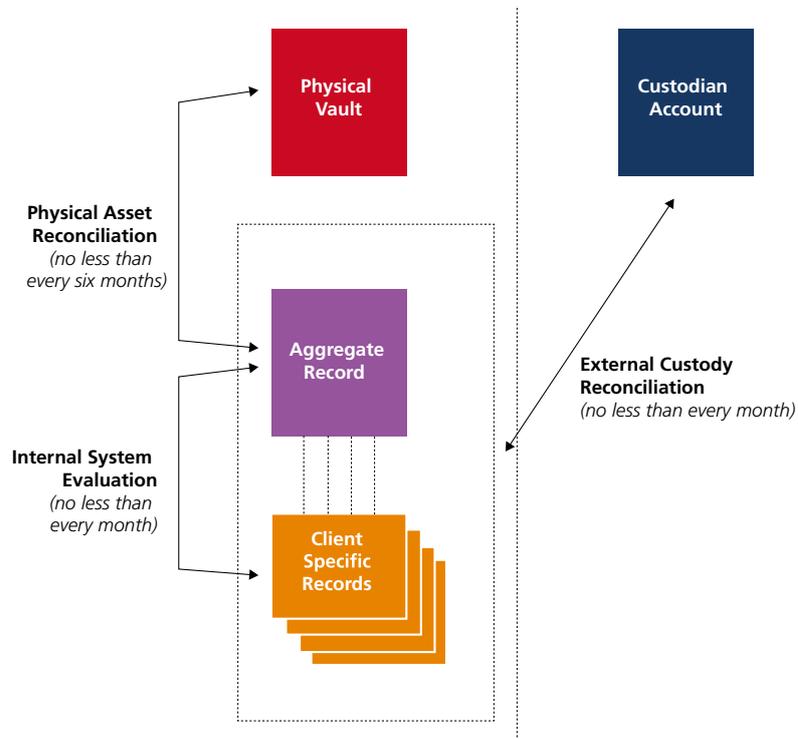
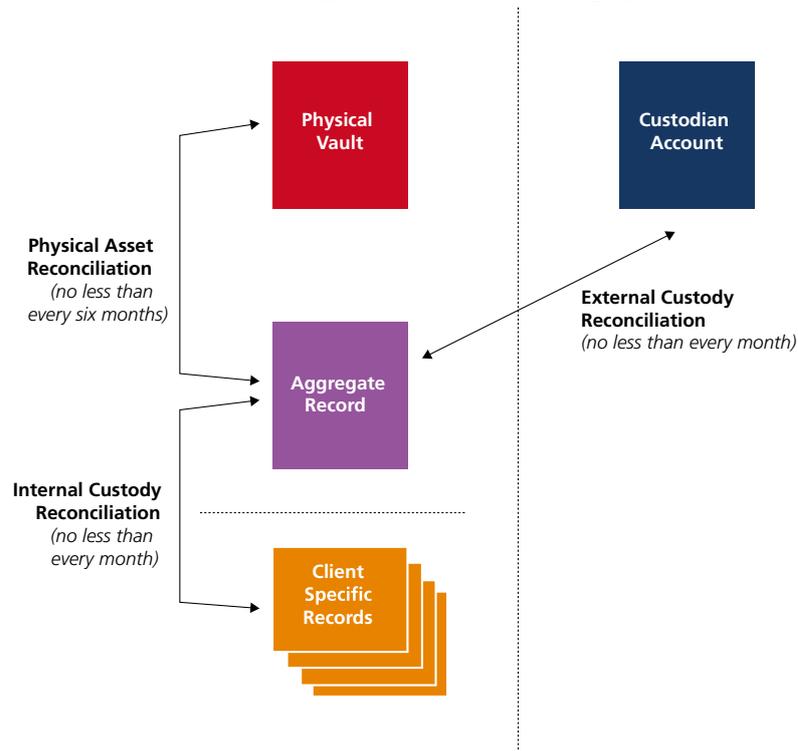


Diagram 2 – illustrative example of the custody record checks and reconciliations which a firm without an integrated record-keeping system may undertake:



5.33 Each of the above processes will need to be carried out whenever necessary and at least at the minimum frequencies set out in the rules.⁵⁵ Each of these custody record checks and reconciliations also will require a firm to promptly investigate and resolve without undue delay any discrepancies which arise in the records the firm reviews.⁵⁶ Separate requirements, discussed below⁵⁷, set out what a firm is required to do when a discrepancy gives rise to a shortfall in the custody assets the firm should be holding for its clients.

5.34 Firms will be permitted to undertake each of the above processes without first seeking a confirmation or any other report from an independent auditor.⁵⁸

Internal custody record checks

5.35 In the CP, we noted that some firms use integrated systems to maintain their custody records and, as a result, may be unable to perform internal custody reconciliations. With this in mind, we consulted on replacing the existing provisions in our custody rules for internal custody reconciliations, with a general requirement for firms to periodically undertake an '**internal custody record check**'.⁵⁹

5.36 The rules proposed in the CP set out that a firm may undertake internal custody record checks by one of two methods:

- 1.** carrying out an internal reconciliation between two independent, and separately maintained, internal records - one recording the custody assets held for each individual client, and another recording the aggregate total of custody assets held by the firm on its premises and/or deposited or registered with third parties (the '**internal custody reconciliation method**'); or
- 2.** carrying out an evaluation of the completeness and accuracy of the firm's internal records systems in order to assess whether it records the custody assets belonging to each client and the total custody assets held by the firm and investigates and resolves the discrepancies identified (the '**internal system evaluation method**').

5.37 We also consulted on setting out that all firms, regardless of which method they used, would be required to undertake an internal custody record check as often as necessary and no less often than at least every 25 business days.⁶⁰

5.38 Respondents were appreciative that the revised rules endeavoured to accommodate firms that might operate an integrated recordkeeping system for custody assets. On this basis, the feedback we received was supportive of us replacing our existing requirements and guidance for internal custody reconciliations, with a general obligation to undertake internal custody record checks.

5.39 Quite a few respondents requested more guidance around when a firm would be considered to have two sufficiently independent and/or separate internal records of its holdings for individual clients and its aggregate total holdings in custody assets. Many of these respondents stated they would need our rules and guidance to be sufficiently clear so as to enable a firm to decide whether or not it should be undertaking its internal custody record checks by means of either an '**internal custody reconciliation method**' (which will necessitate separate internal records)

⁵⁵ See paras. 5.52, 5.54 and 5.68 below.

⁵⁶ See para. 5.82 below.

⁵⁷ See paras. 5.76 to 5.90 below.

⁵⁸ See paras. 5.59 to 5.61 below.

⁵⁹ See proposed CASS 6.5.4BR in the CP.

⁶⁰ Consistent with the requirements in place before our implementation of MiFID – see CASS 2.6.2R (last in force 31 December 2008).

or an 'internal system evaluation method' (where an internal reconciliation is not possible). Others highlighted that more guidance would encourage a greater level of consistency across the industry.

- 5.40** Many respondents provided comments on the drafting of the proposed rules for an 'internal system evaluation method'. Most of the comments focused on suggestions to clarify the steps a firm must follow if using this method of internal custody record check, for example whether this method was intended to be the controls a firm would put in place to ensure the accuracy of its records, or whether it was intended to simply evaluate the controls the firm should already have in place (irrespective of the evaluation being taken). Another respondent requested that we confirm what risks the internal system evaluation method was intended to mitigate.
- 5.41** A number of respondents raised questions around whether a firm that operates an integrated system for its records of custody assets would still be required to maintain its records as independent from, or separate to, any third party with whom it deposits or registers those assets. For example, some respondents suggested that it was unclear whether a firm was allowed to share the same recordkeeping system, or set of records, with its custodian/sub custodian (the person with whom the firm deposits its custody assets) or registrar (the person with whom it registers or records legal title to its custody assets).
- 5.42** A few respondents commented generally on the proposed frequency at which firms would be expected to undertake internal custody record checks. One respondent noted a monthly internal system evaluation may not be justified if previous evaluations (carried out under the rules) have not revealed any discrepancies or other issues with the firm's recordkeeping systems.

Our response

- 5.43** We are introducing our proposals for internal custody record checks as consulted, but with a number of important clarifications to the rules proposed in the CP.
- 5.44** A firm will only be able to carry out internal custody record checks by way of the internal custody reconciliation method, where it separately maintains two sets of internal records or accounts relating to its holdings of custody assets: the *first* internal record must be one which identifies the particular assets the firm holds for each particular client (a '**client-specific safe custody asset record**'); and the *second* internal record must be one which records all the assets the firm holds for its clients (an '**aggregate safe custody asset record**'). These two sets of records need not be 'independent' of each other (as set out in the CP) in the sense that the information used to create these records may be related or that these two records may be created or updated simultaneously whenever a firm undertakes a transaction in custody assets for its clients. However, for the internal custody reconciliation method to provide a meaningful control, our rules will require that these two records be separately maintained (that is to say that these records must exist separately to each other) and be capable of being compared. Where these records are not separately maintained, an internal reconciliation which compares these two records is of limited benefit to the firm as a control to ensure their accuracy.
- 5.45** Firms intending to continue to undertake internal custody reconciliations that meet our requirements for internal custody record checks will need to carefully consider how they operate and maintain their records relating to custody assets. Given the wide range of firms and business models under which a firm may come to hold custody assets, we are not providing specific examples of recordkeeping systems or procedures to which an internal custody

reconciliation may be suited. However, as suggested in the CP⁶¹, where a firm operates an integrated recordkeeping system, it is likely the firm will be unable to extract from that system separate client-specific safe custody asset records and aggregate safe custody asset records. In these circumstances, the firm will be unable to use the internal custody reconciliation method to meet our requirements for an internal custody record check.

- 5.46** We also confirm that all firms, regardless of type and business model, will be permitted to undertake their internal custody record checks by way of the internal system evaluation method. Although this method has been introduced to accommodate firms who are unable to undertake internal custody reconciliations, it is not our policy to prevent a firm from adopting the internal system evaluation method of carrying out internal custody record checks even where it may also be able to carry out internal custody reconciliations as contemplated under our rules.
- 5.47** Our requirements for the internal system evaluation method do not stipulate what internal systems and controls a firm should have in place to ensure the accuracy of its records. All firms remain subject to a general obligation to determine and put in place whatever systems and controls are necessary to meet their obligations to maintain their records in a way that ensures their accuracy and, in particular, their correspondence to the custody assets held for clients.⁶² The internal system evaluation method will require that firms, on a periodic basis, evaluate whether the systems and controls they have in place are sufficient to meet this general obligation.
- 5.48** Our requirements for the internal system evaluation method also do not stipulate how a firm carries out the requisite evaluation, but rather provide the outcomes the firm must achieve through use of the method. This includes evaluating:
- the completeness and accuracy of the firm's internal records and accounts of custody assets held by it for clients; and
 - whether the firm's systems and controls correctly identify and resolve all discrepancies in its internal records and accounts of custody assets held by firm.
- 5.49** In particular, and based on feedback, we have clarified that this method will require firms to consider whether *sufficient information* is being completely and accurately recorded to enable the firm to:
- a. comply with its obligation to maintain a client-specific safe custody asset record (discussed above⁶³); and
 - b. readily determine the total of all the custody assets that the firm holds for clients. If carried out correctly, the use of this method should verify that the firm's systems and controls are sufficient to ensure the accuracy of the firm's internal records and accounts as they relate to custody assets.
- 5.50** The purpose of the internal system evaluation method is to detect weaknesses in a firm's systems and controls and any recordkeeping discrepancies, which the firm's systems and controls should otherwise already be seeking to prevent, and to ensure that when identified, the firm takes action to address those weaknesses or resolve and prevent those discrepancies

61 At para. 5.30.

62 See existing CASS 6.5.2R and CASS 6.6.3R in Part 3 of the final rules in Appendix I.

63 At paras. 5.31 and 5.44.

from reoccurring. We are retaining the guidance we proposed, setting out a non-exhaustive list of the types or causes of discrepancies which this system evaluation should verify that the firm's system and controls are correctly identifying and resolving on an ongoing basis.

- 5.51** The revised recordkeeping rules being introduced in this PS also clarify that the records firms are required to maintain in respect of custody assets must be internal records of the firm which are separate to any records the firm may have obtained from any third parties, such as those with whom it may have deposited, or through whom it may have registered legal title to, custody assets. It is important firms have their own records for custody assets in case of a dispute between, or the failure of, any relevant third party and/or the firm.
- 5.52** Finally, based on feedback, we are requiring all firms to undertake internal custody record checks as regularly as is necessary but at least on a monthly basis (as opposed to once every 25 business days). We understand some respondents' concern that, if while utilising the internal system evaluation method of internal custody record checks, previous evaluations have revealed no issues, then a monthly check is perhaps unnecessary. However, this check is an important part of the way in which we expect a firm to confirm that its systems and controls for maintaining accurate records are working. This change does not have any CBA implications.

Physical asset reconciliations

- 5.53** We consulted on clarifying the rules that all firms which hold physical assets will be expected to undertake a '**physical asset reconciliation**' across all the physical custody assets held by the firm for clients by one of two methods: either the '**total count method**' or the '**rolling stock method**'. Each method would require a firm to compare the total number of custody asset recorded in the firm's internal records against the total number of assets the firm is physically holding for clients. The total count method requires the firm to count all of the assets held by it at the same time and the rolling stock method allows a firm to count different stock lines or groups of assets over a period of time.
- 5.54** We also consulted on stipulating that all firms are required to undertake a physical asset reconciliation for all the physical custody assets held by the firm for clients as often as necessary, and no less often than every six months.
- 5.55** Respondents were broadly supportive of these proposals and noted that the revised rule provided greater clarity. A few suggested that we clarify that the firm (rather than its auditor) must consider whether its proposed use of the rolling stock method would adequately mitigate the risk of 'teeming and lading'. One asked that we clarify whether we would view the entire firm to be undertaking the rolling stock method, if in practice it applies the total count method to each of its business lines, except for one to which it applies the rolling stock method.

Our response

- 5.56** We are largely introducing the rules we proposed in the CP for physical asset reconciliation without change (except for the proposed auditor's report, which is discussed below⁶⁴).
- 5.57** As consulted, a firm that hold physical custody assets for clients can choose to apply either the total count method or the rolling stock method across all the physical assets it holds for clients. Where a firm completes a physical asset reconciliation in a single stage (i.e. by performing a single count of all the physical safe custody assets it holds for clients across all business lines and at the same time) it will be undertaking the total count method. Where a firm completes a physical asset reconciliation in two or more stages (i.e. by performing two or more counts of the physical safe custody assets it holds for clients – each on a separate occasion and relating to a different stock line or groups of stock lines) it will be undertaking the rolling stock method. Examples of the ways in which a firm using the rolling stock method might select stock lines or groups of stock lines include selections based on all the shares with an issuer whose name begins with the same letter and selections based on all the stock lines held in connection with a particular business line.
- 5.58** Based on feedback, we have clarified that where a firm undertakes a rolling stock method, the firm must first establish and document its reasons for concluding that the firm has systems and controls in place that will effectively mitigate the risk of the firm's records being manipulated or falsified (e.g. to address the risk of 'teeming and lading').

Auditor assurances – custody record checks and reconciliations

- 5.59** We consulted on requiring that, before a firm uses either: (1) the 'internal system evaluation method' of carrying out an internal custody record check; or (2) the 'rolling stock method' of physical asset reconciliation, it must first send to us a report prepared by its auditor. The report was intended to cover the adequacy of the design of the firm's proposed methods and to be prepared on the basis of a reasonable assurance engagement.
- 5.60** Quite a few respondents, although noting our existing requirements for firms to obtain an auditor's confirmation when they undertake a rolling stock method of physical asset reconciliation, were of the view that we should remove any requirement for a firm to involve an auditor before undertaking either an internal system evaluation method or a rolling stock method. Many of these respondents argued that, since the revised rules will stipulate how a firm is expected to conduct the internal system evaluation method and the rolling stock method⁶⁵, there may be limited benefit to us in obtaining an auditor's input before the firm's implementation of the relevant method. This feedback highlighted that a firm's auditor should review the firm's processes in place to undertake internal custody record checks or physical reconciliations when preparing its annual client assets report.

Our response

- 5.61** Based on feedback, we have decided not to proceed with our proposals to require specific auditor's assurance within our custody rules. A firm will be permitted to use the internal system evaluation method and/or the rolling stock method without first seeking a written report from its auditor. However, we expect the firm to be performing reconciliations or checks which

⁶⁴ At paras. 5.59 to 5.61.

⁶⁵ Unlike the situation in which a firm may undertake a non-standard method of internal client money reconciliation (for which we do not stipulate how the firm carries out its internal client money reconciliations).

achieve the stated purposes. Also, a firm's auditor will be reviewing the method of internal custody record check (whether internal reconciliation or internal system evaluation) and physical asset reconciliation (whether rolling stock or total count) the firm used for compliance with the custody rules when it prepares its annual client assets report. This change to the proposals in the CP will reduce the burden on firms. Moreover, as long as these annual auditor checks are carried out, we do not expect that this change will impact on our policy objective of increasing protection of client assets through increased speed of return of client assets and reductions in shortfalls on firm failure. As such we do not need to revise the estimated benefits set out in the CP.

External custody reconciliations

- 5.62** We consulted on clarifying how an external custody reconciliation should be carried out. For example, where a firm deposits custody assets with a third party, we proposed clarifying that the external reconciliation must be carried out from the firm's internal records against those provided by the relevant third party. Similarly, we proposed that where a firm does not deposit a custody asset with a third party, that firm must carry out an external reconciliation by comparing its internal records with the records of whichever third party is responsible for the registration of legal title to custody assets (for example, and as appropriate, central securities depositories, operators of collective investment schemes, and administrators of offshore funds).
- 5.63** We also consulted on stipulating that all firms be required to undertake an external custody reconciliation as often as necessary and no less often than at least every 25 business days.⁶⁶
- 5.64** Most respondents supported these proposals and, in particular, confirmed that it was already standard market practice to undertake an external custody reconciliation at least monthly. A few noted it was helpful to clarify that even where a firm does not deposit a custody asset with a third party, it must still carry out an external custody reconciliation if a third party is responsible for registration of legal title to the custody asset.
- 5.65** A number of respondents noted we had consulted on different minimum frequencies for external client money reconciliations (once a month) and external custody reconciliations (once every 25 business days) and suggested that both client money and custody external reconciliations should be subject to the same minimum frequency. Others disagreed with the proposal entirely, suggesting we should allow each firm's management to decide what frequency is necessary (with no minimum) and that a mandated minimum would be too prescriptive. One respondent argued that the business models of private equity and venture capital firms, in particular, were unique and that these types of firms merited different treatment given that this type of firm was more likely to engage in transactions with custody assets on an infrequent basis. Others suggested generally that if a firm engages in infrequent transactions in custody assets, it should not have to undertake an external custody reconciliation on at least a once every 25 business days or a monthly basis. On the other hand, another suggested all firms should be required to undertake an external custody reconciliation at least once every ten business days.
- 5.66** A few respondents, representing firms operating in the fund management industry and with overseas depositories, commented that it may not be possible to obtain statements from third parties with whom they deposit or register custody assets on a sufficiently regular basis.
- 5.67** Others queried whether a firm holding a paper share certificate would be obliged to undertake an external custody reconciliation as between its records and those of the issuer.

⁶⁶ See para. 5.39 in the CP and footnote 60 above.

Our response

- 5.68** We are introducing our proposals for external custody reconciliations as set out in the CP. However, based on feedback, we are requiring all firms to undertake external custody reconciliations as regularly as is necessary but at least on a monthly basis (as opposed to once every 25 business days). This is to bring this proposal into line with the frequency at which we expect firms to undertake external client money reconciliations. This change does not have any CBA implications.
- 5.69** In response to feedback, we are also clarifying that for the purposes of an external reconciliation a firm may use any information (including statements or other confirmations) provided by a third party with whom the firm deposits or through whom the firm registers custody assets (as the case may be). We note, that where the relevant third party is also subject to CASS (i.e. accepts assets or monies from the firm as either custody assets under our custody rules or client money under our client money rules), that third party may be also subject to our requirement to provide the firm statements on its holdings with that third party at whatever frequency the firm requests (see below⁶⁷).
- 5.70** We can confirm that where a firm is physically holding a custody asset, such as a paper share certificate, the custody rules will not specifically require the firm to undertake an external custody reconciliation in respect of that asset. Nevertheless, as part of its organisational arrangements, a firm should consider, from time to time, performing 'spot checks' on whether title to an appropriate sample of physical custody assets that it holds is registered correctly under our rules.

Determining appropriate frequencies for custody record checks and reconciliations

- 5.71** We consulted on the basis that firms, subject to minimum frequencies⁶⁸, remain best placed to determine the frequency at which they should be undertaking internal custody record checks, physical asset reconciliations and external custody reconciliations under our custody rules. For this purpose, we proposed that all firms be required to consider particular factors when determining the appropriate frequency at which that firm should be carrying out these processes and to review these frequencies on at least an annual basis.
- 5.72** We also proposed guidance clarifying that where a firm holds custody assets electronically with a central securities depository, it is likely that firm should be conducting external custody reconciliations on a daily basis.
- 5.73** A few respondents queried whether this guidance applied to firms who do not hold their custody assets directly with a central securities depository, but rather pass them to another intermediary who in turn holds the assets directly with the central securities depository. Another was concerned it may not be possible for a firm to undertake daily external custody reconciliations with a central securities depository if the firm is unable to obtain sufficient information from the central securities depository about the assets deposited with it on a daily basis.

⁶⁷ At paras. 9.14 to 9.19.

⁶⁸ At paras. 5.52, 5.54 and 5.68.

Our response

- 5.74** As proposed in the CP, firms will generally be required to review, on at least an annual basis, the frequency at which they undertake internal custody record checks, physical asset reconciliations and external custody reconciliations under our custody rules with regard to specific factors. However, in response to feedback, a firm will not be required to separately review its arrangements for the frequency that it undertakes each internal custody record check, physical asset reconciliation or external custody reconciliation if the firm already undertakes the relevant process daily in respect of all custody assets.
- 5.75** We have also revised our guidance around the frequency at which firms should be undertaking external custody reconciliations for assets held electronically with a central securities depository, to confirm that a daily reconciliation is only viewed to be best practice where the depository is able to provide the firm with adequate information on its holdings on a daily basis. This guidance is not applicable where a firm does not hold its custody assets electronically with a central securities depository.

Handling discrepancies and shortfalls in custody assets

- 5.76** We consulted on guidance to clarify when a discrepancy in a firm's records is considered to be resolved and a requirement that, where a discrepancy gives rise to a shortfall in the custody assets the firm should be holding and the firm is unable to immediately make good the shortfall, then the firm must use its own assets, or segregate its own money as client money, to the value of the shortfall until the discrepancy is resolved. We set out that a firm would only be allowed to segregate money as client money if it had confirmed that the relevant clients were entitled to client money protection. We also proposed that firms should be required to consider whether they should notify an affected client of the situation if the shortfall is not immediately made good.
- 5.77** A number of respondents raised concern that it was not clear from our proposed rules whether firms were expected in all circumstances to cover a shortfall in custody assets with its own money or assets, even where a third party might be responsible for that shortfall having arisen or the discrepancy was due to a timing difference. One respondent said that it would be desirable if firms were required to cover shortfalls in all circumstances regardless of fault or the actions of others. Others suggested a firm should not be held responsible for a shortfall for which it is not responsible (e.g. delivery of securities to settle a trade is delayed by a counterparty or an incorrect amount of securities are delivered (in each case through no fault of the firm)) and highlighted the potential cost impact if they were required to cover all shortfalls irrespective of fault.
- 5.78** Some respondents requested clarification as to how we expect firms to cover a shortfall in custody assets if the firm otherwise normally operates under the 'banking exemption'⁶⁹ or uses title transfer collateral arrangements⁷⁰ for monies it receives or holds on behalf of clients.
- 5.79** A few also questioned in what circumstances a firm would be expected to notify its clients of circumstances where a shortfall has arisen which the firm has not, when permitted, covered with its own assets or money. Some noted that it may not always be apparent when it would be in a client's best interest or otherwise practical to do so (for example, in respect of 'gone-away' clients).

⁶⁹ See existing CASS 7.1.8R, and CASS 7.1.8AR to 7.1.10CR in Part 2 and CASS 7.10.16R to 7.10.24R in Part 3 of the final rules in Appendix I.

⁷⁰ See existing CASS 7.2.3R to 7.2.7G and CASS 7.11.1R to 7.11.13G in Part 3 of the final rules in Appendix I.

- 5.80** We received other drafting comments on how to improve the clarity of the rules, including suggestions to: (i) bring out the difference between discrepancies and shortfalls; (ii) clarify when a discrepancy is considered to be resolved; and (iii) confirm the timeframes in which firms are expected to investigate and resolve discrepancies and cover shortfalls.

Our response

- 5.81** We have made a number of amendments to the proposed rules for handling recordkeeping discrepancies and shortfalls in custody assets to reflect feedback. This includes changes made to ensure clarity and provide additional guidance where appropriate.
- 5.82** Where a firm, as a result of the internal custody record checks and reconciliations specified in the rules⁷¹, identifies a discrepancy in or between its or any relevant third party's records which relates to the firm's holdings of custody assets, that firm will be required to promptly investigate the reason for discrepancy and to resolve that discrepancy without undue delay. Where a firm identifies a discrepancy in any other circumstances, that firm will be required to take all reasonable steps to investigate the reason for the discrepancy and resolve it.
- 5.83** Following feedback, we are clarifying that a discrepancy will not be considered to be resolved until the firm is holding the correct amount of custody assets and its records, and those of any third party, accurately reflect this position. Where a discrepancy gives rise to a shortfall in the custody assets the firm should be holding, this will necessitate the firm making sure it makes good that shortfall (e.g. by obtaining assets to replace any custody assets which are missing). If the firm does not immediately make good the shortfall and it is unable to conclude that another person is responsible for the discrepancy, it is required to cover the shortfall in the interim with either its own assets or an equivalent value of money until the firm is able to resolve the underlying discrepancy. We have revised the proposed rules to clarify the steps a firm must take when it appropriates its own assets or money to cover a shortfall, each of which requires the firm to ensure those assets or monies are held in way so that they will be realised for the benefit of relevant clients if the firm were to fail.
- 5.84** Where a firm concludes that another person is responsible for the discrepancy which has given rise to a shortfall (or that discrepancy is due to a timing difference between the accounting systems of that other person and the firm), in light of the feedback, the final rules do not require the firm to cover the shortfall although the firm may do so. However, we underscore that firms in this situation will need to take all reasonable steps to quickly resolve the situation with the relevant party and consider whether to notify any affected clients of the situation.
- 5.85** Examples of the situations in which a firm might need to notify the affected client include where: (a) after initial enquires, the firm and the relevant third party disagree on the number of custody assets the third party should be holding for the firm; (b) the firm has been notified by a third party of the loss of a custody asset; and (c) the firm is required to notify under the terms of its agreement with the client.
- 5.86** Other factors which may be relevant for a firm to consider include: (a) the materiality of the relevant discrepancy which has given rise to a shortfall; (b) the number and value of the custody assets which are missing or in dispute with the third party; and (c) the length time which has elapsed since the firm first became aware of the relevant discrepancy.

⁷¹ For example, as part of carrying out an internal custody record check (discussed above at paras. 5.35 to 5.52), a physical asset reconciliation (discussed above at paras. 5.53 to 5.58) and/or an external custody reconciliation (discussed above at para. 5.62 to 5.70).

- 5.87** This change in approach does not require us to revisit the costs and benefits we estimated in the CP. We recognise that this change will reduce the burden on firms from the position set out in the CP, reducing the cost they may incur in handling custody recordkeeping discrepancies which give rise to a shortfall. Separately, we note the final rules will require firms to promptly investigate discrepancies, resolve them without undue delay and, in some circumstances, to notify the client concerned. As a result, we do not believe this change in approach will significantly reduce the benefits (better protection of custody assets and faster, more complete return of custody assets on the failure of the firm) to clients set out in the CP.
- 5.88** Where a firm is obliged to cover a shortfall until the discrepancy which gave rise to the shortfall is resolved and chooses to do this by segregating its own money as client money, the firm will also need to ensure that the relevant clients affected by the shortfall are entitled to protection under the client money rules and that the firm has the relevant permissions to hold client money before it may segregate an amount of its own money as client money. The result of this requirement is that firms that might otherwise accept monies from clients in accordance with the banking exemption, holding the money on deposit (instead of as a trustee under our client money rules), or under a title transfer collateral arrangement, either of which may have the effect of disapplying or otherwise changing the application of our client money rules, then those firms will need to ensure that they have systems and controls in place to enable compliance with the client money rules in respect of that money and ensure that any client to whom the shortfall is attributable would be entitled to client money protection. If a firm in these circumstances wishes to use its own money to cover shortfalls in custody assets, then it may be the case that the firm will need to repaper its agreements or other documentation with the client concerned to ensure that money may be held for the client's benefit as client money under our rules. We set out in Annex 1 the cost implications of repapering that we expect may arise from all the changes being introduced in this PS.
- 5.89** Consistent with our existing guidance for reporting to us on the CMAR, we are not stipulating the means by which a firm must value any custody asset it is holding, or any shortfall in those assets. Firms may use the previous day's closing mark to market valuation, or if in relation to a particular asset none is available, the most recently available valuation. However a firm values a particular shortfall, we expect that firm will revisit the valuation as regularly as necessary to ensure it continues to segregate a sufficient amount of its own assets or money to cover the shortfall until the underlying discrepancy is resolved. In practice, we expect this is likely to mean no less often than each time it undertakes a reconciliation in which that valuation is used. For example, where a firm segregates its own money as client money to cover a custody shortfall, that firm will, as part of its internal client money reconciliation, need to revisit the valuation each day to ensure it is segregating the correct amount of client money to cover the shortfall each business day. Also, where a firm sets aside its own assets to cover the shortfall, those assets will then form part of the custody assets included in the next internal custody record check the firm undertakes (being no less often than once a month).
- 5.90** Finally, where a firm covers a shortfall in custody assets with its own monies or assets, the final rules clarify that the firm will need to keep specific records, including a description of the applicable assets and/or monies appropriated for this purpose. Firms will separately be obliged to update this record whenever the underlying shortfall is resolved. We expect many firms already comply with this change. However, some firms may incur additional costs associated with the extra staff time required to prepare these records. Nevertheless, we judge these additional costs to be minimal, as set out in Annex 1.

Recordkeeping and notifications

- 5.91** We consulted on additional requirements, and guidance, relating to the records firms should be making and retaining in respect of their holdings of custody assets and the steps they take and controls they have in place to comply generally with our recordkeeping requirements for custody assets. We also proposed more prescriptive notification requirements.
- 5.92** Respondents were generally supportive of these proposals. A few respondents queried what the difference in situation would be in which a firm 'will be unable' to comply with a requirement and one in which the firm 'materially fails' to comply in respect of our proposed notification requirements.⁷² Some others requested additional guidance relating to which circumstances a breach would be considered to be material.

Our response

- 5.93** We are introducing all the recordkeeping requirements we proposed in the CP. Records which a firm will be required to make and retain include copies of each custody record check and/or reconciliation the firm undertakes, each review it conducts of these arrangements and its policy and procedures for complying with our requirements, including those around recordkeeping and reconciliations.
- 5.94** In response to feedback and consistent with the existing requirements, we are also clarifying that all firms holding custody assets are required to maintain a client-specific safe custody asset record (discussed above⁷³). This is a record identifying each of the particular assets that the firm is holding for each particular client.
- 5.95** We have also made minor amendments to the proposed notification requirements to ensure consistency with similar requirements found in our client money rules which we believe lead to no change in costs to firms or benefits to clients compared to what we estimated in the CP. Where a firm will be unable to comply with a specified requirement (i.e. a firm has not yet breached the relevant rule but becomes aware that it will in the future, either continuously or for a specified period, be unable to comply with that rule) or where the firm materially fails to comply with a rule (a breach of the rule has occurred), the firm will be required to notify us. A materiality threshold applies to actual breaches, meaning not all breaches need to be notified to us. We are not providing additional guidance on when a firm's failure to comply with a specific requirement is material. What is material will depend on the circumstances and firms will need to consider this on a case-by-case basis.

Transitional provisions

- 5.96** A number of firms stated that a six-month implementation timetable would be insufficient to allow them to make the necessary changes to their systems and processes to implement our proposals generally around recordkeeping, notification and reconciliations for custody assets. A number of respondents cited anywhere between 12 and 18 months as a more achievable timetable.

⁷² See CASS 6.5.13R as proposed in the CP.

⁷³ At paras. 5.31 and 5.44.

Our response

- 5.97** Please refer to Table 2 in Chapter 2. Based on feedback, we are allowing firms a longer period of time to bring their recordkeeping systems and practices into line with these new requirements. Each of the above rules will come into force on 1 June 2015. However, firms may choose to comply with any of these new requirements before this date.
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6.

Changes relevant to both CASS 6 and 7

- 6.1** In this chapter we discuss changes relevant to both the custody rules and the client money rules, which may affect all investment firms.

Title transfer collateral arrangements – written agreements and procedure for switching

Q13 and Q43: Do you agree with our proposals in relation to TTCA? If not, please provide reasons.

- 6.2** In the CP we proposed new rules relating to how a firm should document its title transfer collateral arrangements ('**TTCA**'), requiring each TTCA to be set out in a written agreement. We also proposed a process to be followed should a client request (and the firm agrees to that request) that its monies or assets previously covered by TTCA be brought into the protections of the client money rules or custody rules, as appropriate. These proposals included the firm setting out and agreeing with the client the procedure the firm would follow should the firm agree to a request for protection under CASS. On agreeing to a request for protection, the firm would be obliged to notify the client of its agreement and to state when the protection would come into effect, taking into account the time required to:
- i. update its records; and
 - ii. return the assets or monies to the client; or
 - iii. where applicable, segregate the relevant assets (amending registration details if necessary) as custody assets under the custody rules or segregate the relevant monies as client money under the client money rules.
- 6.3** For client money, we also suggested that, if the notification failed to specify when the firm would terminate the TTCA after a request, a firm should be obliged to protect the client's monies as client money within one business day following the firm's agreement to the request.
- 6.4** The intention behind these proposals was to introduce requirements which, if followed, reduce the potential for disputes when a firm enters into insolvency proceedings as to the status of assets or monies held, or previously held, under TTCA.
- 6.5** Approximately 30 respondents provided feedback on these proposals. The overwhelming majority were supportive. A number of respondents asked us to confirm that firms would not be obliged to agree to a client's request to switch out of TTCA; some worrying that these proposals might otherwise provide clients with a 'false sense of security', or at least that an agreement to terminate TTCA need not require termination of the whole agreement within which TTCA might be established. Others noted that if a client requested they terminate TTCA,

this may necessitate renegotiating the terms of the entire relationship between the firm and the client.

- 6.6** A few respondents shared concerns about the interaction of these proposals with market standard documentation for derivative transactions or stock lending activities. For example, one queried whether the client's agreement would need to be separate to any other agreement which establishes the TTCA.
- 6.7** Some respondents also raised questions about the type of documentation a firm would need to have in place with its client to comply with this rule and queried whether this would oblige the firm to notify the client of the TTCA in place on either a one-way or two-way basis.
- 6.8** A few respondents noted our proposal that a firm record a client's request to terminate TTCA and suggested it also be clear the firm must record how it responds to that request (irrespective of whether it agreed or denied the request).
- 6.9** A number of respondents also highlighted that, in light of the package of proposals set out in the CP, six months may be insufficient time for firms, where necessary, to repaper their existing client relationships.

Our response

- 6.10** We are implementing this proposal as set out in the CP and will:
 - a.** require all firms to have a written agreement in place for TTCA; and
 - b.** stipulate the process firms must follow should a client request protections under CASS for assets and monies otherwise subject to TTCA. This process includes the firm ensuring both the client's request and, based on feedback, the firm's response are documented. On agreeing to a request for protection the firm will also be obliged to notify the client of its agreement and to state when the protection would come into effect.
- 6.11** When a firm notifies a client of the date on which a termination of TTCA is to take effect, we expect the firm will consider how much time it reasonably requires to take into account any contractual commitments between the firm and client. We confirm also that the termination of TTCA need not amount to a termination of the entire agreement between that client and the firm in which the TTCA may have been established. Moreover, nothing in the final rules will require a firm to agree to terminate TTCA if the client so requests. We also recognise that in some circumstances, in the event that a firm agrees to terminate the TTCA in line with a client's request, the parties might need to first renegotiate the overall terms of their contractual relationship (which could take a substantial period of time) before the current TTCA is terminated. We note that any need to renegotiate is not as a result of our rules, but would be needed regardless of whether or not this proposed rule was in place.
- 6.12** To limit the uncertainty among clients and reduce the number of disputes and queries relating to a TTCA following the failure of the firm, it is important that there is documentation demonstrating the parties' agreement to the TTCA and any correspondence between the parties relating to termination, whether possible or actual, of TTCA. For this purpose and based on feedback, the final rules clarify that the written agreement must cover the client's agreement to the terms of the TTCA, any terms under which ownership of the client's assets or monies may transfer back from the firm to the client, and any terms for the termination of the TTCA or for the overall agreement through which the TTCA was agreed. Firms are reminded

generally of the existing requirements for them to be fair, clear and not misleading in their communications with clients.⁷⁴

- 6.13** The changes to our rules do not prescribe how and in what form the firm obtains its client's agreement to TTCA, so long as that agreement is documented in writing. We are also aware that TTCA may be agreed to through the use of market standard documentation (such as in connection with derivatives transaction or securities lending activities). However, we are not aware of, and nor did the feedback suggest, any conflict would arise between our proposals and firms use of market standard documentation.
- 6.14** In addition to the position set out in the CP, a firm will also be required to document how it responds to a client's request (i.e. whether it agrees or disagrees). We expect the cost impact of this change to be minimal as firms will already need to have procedures and systems in place to document client requests and the firm's agreement to such a request, as set out in the CP.⁷⁵ Annex 1 also sets out a summary of the general repapering costs some firms may incur as a result of the proposals set out in this PS, including the proposal to ensure TTCAs are documented in a written agreement.
- 6.15** Finally, these rules will come into force in two stages:
1. all firms will be required to ensure their TTCA with new clients are documented in written agreements in accordance with the final rules from 1 December 2014, however, firms will have until 1 June 2015 to repaper their client agreements (if necessary) with existing clients; and
 2. firms will have until 1 June 2015 to ensure compliance with the remaining requirements we are introducing around the steps firms will need to follow when a client requests to switch out of TTCA. Please see Table 2 in Chapter 2⁷⁶ for further information.

Delivery versus payment exclusion – transactions through a commercial settlement system

Q13 and Q43: Do you agree with the proposal of clarifying the requirements around the DvP window? If not, please provide reasons.

- 6.16** In certain circumstances, firms are allowed to take money and assets from clients out of the protection of the custody rules and client money rules in respect of a delivery versus payment transaction through a commercial settlement system (the '**DvP window**'). In the CP, we noted that we have seen some firms holding money and assets under this 'window' for significant lengths of time.⁷⁷ On this basis, we consulted on amending the rules to set out exactly when the DvP window begins and ends to ensure that firms are aware of when they must comply with the custody rules and the client money rules in respect of assets and monies they hold for

⁷⁴ See COBS 4.2.1R.

⁷⁵ At paras. 4.23 and 5.49.

⁷⁶ See p.20.

⁷⁷ At paras. 4.27 and 5.7.

clients. We also proposed defining 'commercial settlement system' and proposed a requirement to ensure clients agree to these arrangements.

- 6.17** Respondents generally supported the proposal to clarify the rules; only a few providing requests for further clarifications.
- 6.18** One respondent asked for clarification of whether the DvP window starts when client money or custody assets are received by the firm for the purpose of a transaction, or when the money or assets are received into the settlement system. Another respondent asked for clarification of how firms that will be subject to the proposed 'immediate segregation' requirements for client money⁷⁸ will comply with the DvP window in the context of clients' sale transactions.
- 6.19** Most respondents supported defining 'commercial settlement system' although one noted that care should be taken not to inadvertently limit its scope.
- 6.20** A few respondents asked for clarification of what kind of agreement they would be required to obtain from their clients.

Our response

- 6.21** We are implementing these requirements as proposed in the CP with only a few changes to improve clarity and reflect the feedback we received.
- 6.22** The firm has the duration of the 'DvP window' as described in the rule during which it need not comply with either the custody rules or the client money rules, as appropriate, in respect of the relevant assets or monies.
- 6.23** In respect of a client's purchase (assuming all the other conditions of the rule are met), the DvP window will start from the date of the client's fulfilment of its payment obligation to the firm. The DvP window will then close at the earlier of the date the relevant delivery versus payment transaction settles or the third business day following the date the client fulfils its payment obligation to the firm. Where delivery of the asset to the client has not occurred by the close of business on the third business day following the date of the client's fulfilment of its payment obligation to the firm because the transaction has not yet settled, the firm will need to treat the money as client money in accordance with the client money rules until such time the delivery by the firm to the client occurs.
- 6.24** In respect of a client's sale (assuming all the other conditions of the rule are met), the DvP window will start from the date the client fulfils its delivery obligation to the firm. The DvP window will then close the earlier of the date the relevant delivery versus payment transaction settles or the third business day following the date the client fulfils its delivery obligation to the firm. Where payment to the client has not occurred by the close of business on the third business day following the date of the client's fulfilment of its delivery obligation to the firm, because the transaction has not yet settled, the firm will need to treat the custody asset in accordance with the custody rules until such time the payment by the firm to the client occurs.
- 6.25** In respect of either a client's purchase or a client's sale, we consider it will often be a matter of agreement between the firm and the client as to how and when the client fulfils its payment obligation or delivery obligation, respectively, to the firm. This could be, for example, by using client money or custody assets previously held by the firm for that client.

⁷⁸ See below, at paras. 7.107 to 7.112.

- 6.26** To the extent that the transaction has not settled and the firm still holds for the client money or assets following the date the DvP window closes (as set out above⁷⁹ the DvP window may not be available for the same length of time in relation to each transaction, but in all cases will be no longer than three business days), the firm will be required to segregate the client money or custody assets promptly and comply with the client money rules or hold the asset under the custody rules, as appropriate.
- 6.27** If the transaction settles before the end of the window, in respect of a client's sale, the firm must segregate client money it receives on settlement promptly⁸⁰, and in respect of a client's purchase, the custody assets the firm receives on settlement must be treated in accordance with the custody rules.
- 6.28** Until a delivery versus payment transaction in respect of a client's sale settles, a firm may, if its regulatory permissions allow, segregate its own money as client money, instead of the custody asset, in an amount equivalent to the value at which that client's custody asset is reasonably expected to settle. However, if a firm does this, as discussed above in the context of covering custody shortfalls⁸¹, the firm must first confirm that the relevant client for whom the firm would otherwise be holding the custody asset is entitled to protection under the client money rules. Similarly, the firm will need to ensure it incorporates this money into its internal and external client money reconciliations (discussed below⁸²).
- 6.29** Similar to our requirements for covering custody shortfalls⁸³, where a firm segregates its own money as client money, instead of a custody asset, the final rules clarify that the firm will need to keep specific records describing the safe custody assets in question, identifying the relevant affected client(s) and specifying the amount of money that the firm appropriates to cover the value of the safe custody asset. We expect many firms already comply with this change. However some firms may incur additional costs associated with the extra staff time required to prepare and update these records. Nevertheless, we judge these additional costs to be minimal, as set out in Annex 1.
- 6.30** We have also amended the final rules to make it clear that a firm will be required to ensure each client agrees to the holding of its assets or monies within the DvP window. Firms will be separately obliged to ensure this agreement is documented in writing and is retained for the duration of the time that the firm uses, or intends to use, the DvP window in respect of transactions for that client. We expect some firms might be able to comply with these requirements by making reference to their use or intended use of the DvP window in their standard terms of business with clients.
- 6.31** Annex 1 also sets out a summary of the general repapering costs some firms may incur as a result of the changes being made in this PS, including the requirement for firms to ensure they document the agreement of each client to hold that client's assets and/or money within the DvP window.
- 6.32** Finally, these rules will come into force on 1 December 2014. By this date, all firms will be required to ensure that any new clients have agreed to the firm's use of the DvP window in accordance with the rules and that this agreement is documented in writing. However, based

79 At para. 6.23 to 6.24.

80 See also paras. 7.107 to 7.112 below.

81 At paras. 5.76 to 5.90.

82 At paras. 7.207 to 7.267.

83 Discussed above at paras 5.76 to 5.90.

on feedback, firms will have until 1 June 2015 to ensure their existing clients have agreed to, and the firm has documented, these arrangements (as necessary). Please see Table 2 in Chapter 2 for further information.

Unclaimed custody assets and client money

Q19: *Do you agree with our proposals in relation to allocated but unclaimed client money? If not, please provide reasons.*

Q20: *Do you agree that unclaimed sums of less than £10 should cease to be client money if they are paid away to charity in accordance with the proposals above? If not, please provide reasons.*

Q34: *Do you agree with the proposal relating to unclaimed custody assets? If not, please provide reasons.*

6.33 In the CP we proposed to revise our rules for how firms may deal with unclaimed client money and introduce a similar option within our custody rules relating to unclaimed custody assets. This included mandating that a firm wait at least six years in respect of client money, or 12 years for custody assets, with no activity on the client's account before the firm has the ability to implement a procedure to pay or transfer client money or custody assets, or the liquidation proceeds, away to a registered charity.

6.34 In both the custody rules and client money rules, the procedure proposed included requiring the firm to:

- a. take into account the arrangements under which a client's custody assets and/or client money is held before disposing of the relevant unclaimed assets or monies; and
- b. take reasonable steps to return the unclaimed monies or assets to the client concerned.

We also provided an evidential provision setting out steps we would expect a firm to take to contact the client concerned before paying away unclaimed client money, or liquidating and paying away the proceeds of unclaimed custody assets, to charity. This evidential provision contemplated that firms might have to attempt to contact the 'gone-away' client up to six times, including placing an advertisement in local media if necessary, before paying away the client's monies, or the liquidated proceeds of its assets, to charity.

6.35 We also proposed a number of recordkeeping obligations and a requirement that the firm, or a member of its group, provide an undertaking to make good any valid claims which might arise after the firm has paid away unclaimed client money, or the proceeds of liquidated unclaimed custody assets (in this PS, we refer to unclaimed client money, unclaimed custody assets and the proceeds of liquidated unclaimed custody assets as '**unclaimed client assets**'), to charity.

- 6.36** Approximately 70 respondents commented on these proposals. The majority were in support of the approach proposed and, in particular, the introduction of a mechanism in our custody rules for dealing with unclaimed custody assets. However, a number of concerns were raised about the procedure firms would be expected to follow before paying the liquidation proceeds of unclaimed custody assets, or a balance of client money, to charity.
- 6.37** A number of respondents, noting that these proposals would require that their existing arrangements with clients expressly permit them to pay away unclaimed client assets to charity before being able to do so, stated that these proposals would provide no meaningful benefit to firms in respect of any unclaimed client money and unclaimed custody assets they currently hold, as the firms would not be able to obtain the agreement of 'gone-away' clients to pay their unclaimed client assets to charity.
- 6.38** Some respondents thought the proposed evidential provisions established too onerous a procedure for tracing and attempting to return unclaimed client assets to 'gone-away' clients. In particular, a few stated that an advertisement in local media should not be expected in all cases as this could be cost prohibitive; raise data protection and/or fraud concerns; and might be of limited benefit to a firm that is not necessarily local to its clients and therefore has no idea where the client is located and, as a result, in which areas to advertise.
- 6.39** A couple of respondents queried whether firms should be expected to continue to attempt to contact a client, if they know the contact details they hold, if used, will have no success in reaching the client.
- 6.40** Others suggested there are different means by which a firm might attempt to trace a 'gone-away' client, including carrying out searches of public records or mortality screening and using credit reference agencies or tracing agents. A few of these respondents stated a combination of using mortality screening, credit reference and tracing agencies can be both cost-effective and have a success rate of up to 80%.
- 6.41** A number of respondents questioned whether our proposals, if implemented, would create a new liability of the firm to the client after the client's monies or assets are paid away to charity. A couple of respondents stated that if a firm remains liable to the client after paying away their monies or assets to charity, then it is unlikely the firm would make use of the proposals to pay away the unclaimed client assets.
- 6.42** A number of respondents suggested a fundamental change to primary legislation may instead be needed before firms will be able to pay away unclaimed client assets to charity, noting primary legislation would be able to address the nature of firms' liability to clients after paying away unclaimed client assets to charity. A few of these respondents noted that there exists in various US states processes of escheatment for unclaimed client assets, allowing payment to a state treasurer, or other similar legislative schemes, allowing payment to specified charities. These schemes operate to reduce the legal liability firms might otherwise incur from having disposed of unclaimed client assets.

Our response

- 6.43** As proposed in the CP, under the final rules, firms will be required to take into account the arrangements they have in place with their clients before paying away unclaimed client assets. However, we have amended the language in the final rules to make it clear that with respect to both unclaimed client money and unclaimed custody assets, the firm may pay away those monies and assets if this is consistent with their arrangements with clients.

- 6.44** We have also clarified that any payment away of unclaimed client assets must be permitted by law.
- 6.45** Similarly, as proposed, the final rules require firms to take reasonable steps to trace clients and return the unclaimed client assets before paying these monies and assets away to charity. A firm uncertain about whether paying unclaimed client assets to charity, or otherwise following the steps required under our rules, is consistent with its arrangements with clients (whether in a contractual, trustee or other relationship) or permitted by law should consider seeking professional advice.
- 6.46** In light of feedback, we are introducing a number of changes to the evidential provision which a firm may rely on when establishing whether a particular course of action is likely to comply or contravene the requirement for that firm to take reasonable steps to trace a client and return unclaimed client assets. *First*, the position we consulted on would have obliged most firms to attempt to contact a 'gone-away' client up to six times before disposing of unclaimed client assets. In response to feedback we have amended the rules so that firms will instead be expected to, after determining, as far as reasonably possible, the current contact details for a client, attempt to communicate with that client three times before disposing of the client's unclaimed monies or assets. We expect the initial and final means of communication will be in writing (by post or electronic mail), but firms will be free to use other means, including by telephone or local media, so long as at least 28 days fall between each communication, or attempted communication, with the relevant client. We note the revised rules contemplate that a firm may, but is not required to, use media advertisements to ascertain the current contact details for, or otherwise attempt to communicate with, a 'gone-away' client. We understand that using media advertisements may in some circumstances be an effective way to reach 'gone-away' clients but agree that it will not be in all cases and, as a result, are not mandating their use.
- 6.47** *Second*, firms will not be expected under the evidential provisions to continue to attempt to contact a client, if, after determining, as far as reasonably possible, the current contact details for a client, it receives confirmation that those contact details are inaccurate or, if used, unlikely to reach the client. One example of this situation may include where a firm has only been able to determine that a client might be contacted at a postal address and after writing to that client at that address the letter is returned or the firm receives a written reply confirming that the client no longer lives at that address. However, where a firm has determined that there is more than one way to contact the client (e.g. where the client might be contactable at multiple postal addresses, phone numbers or email addresses), we expect the firm to continue to attempt to contact the client with the other contact details it may hold.
- 6.48** We believe these revision to the evidential provision are proportionate to the costs a firm might incur in tracing or otherwise communicating with the relevant clients. We note, from feedback, that the costs a firm would incur from the proposed steps in the CP (e.g. requirement for a media advertisement) could have been expensive and potentially ineffective (i.e. some of the proposed steps are likely to have had a limited likelihood of successfully tracing the client concerned). In other words, we consider that the changes being made in this PS are likely to be as successful in tracing and contacting the same number of clients as would have been the result of the proposals in the CP, but at a reduced cost to firms.
- 6.49** More generally, there might be various means available to a firm to determine, as far as this is reasonably possible, the current contact details for a 'gone-away' client. A firm may use any means available to it. The firm may need to consider each of the sources of data available, such

as other internal records the firm may hold, public records, mortality screening, credit reference agencies or tracing agents or other means to solicit a reply from the client such as placing general advertisements in local media or telephoning the client.

- 6.50** For unclaimed client assets that are paid away to charity, the final rules will require a firm to unconditionally undertake to make good any valid claim or to ensure that an unconditional undertaking to make good any valid claim is made by a member of the firm's group (i.e. an affiliate). Firms will need to ensure that this undertaking is legally enforceable by any person with a valid claim to the custody asset or the balance of client money in question at the time that asset or balance is released or divested by the firm⁸⁴ and that they retain the requisite records indefinitely. This rule is intended to create a legally enforceable claim to enforce the undertaking, independent of any other private right of action the client may have, in relation to the loss of those assets and monies which were paid away to charity under these rules. We noted in the CP that a firm might obtain insurance coverage for this purpose, but we recognise that this may not always be possible.
- 6.51** The final rules we are introducing on this topic will only impact a firm's obligations as an authorised person under our requirements and as a trustee of the statutory trust of client money created under our rules.⁸⁵ A firm will need to consider carefully any obligations it may have to a client when deciding whether it is able to proceed with paying away unclaimed balances of client money or disposing of unclaimed custody assets.

Unclaimed custody assets

- 6.52** A number of other respondents commented that firms should be allowed to pay the actual unclaimed custody assets to a charity instead of having to liquidate the asset and pay the proceeds to charity.
- 6.53** Many respondents also suggested the 'waiting period' (the time between when a client last had contact with the firm and when a firm is able to make use of the procedures under our rules to pay away the client's monies or assets to charity) should be the same across both our client money and custody rules, noting we proposed six years for client money and 12 years for custody assets. Some stated that if a client has 'gone-away', it is likely the firm is holding both assets and monies for the client or that six years would be appropriate for both unclaimed client money and unclaimed custody assets and is comparable to both the recordkeeping requirements placed on firms⁸⁶ and the provisions of the Limitations Act 1980 which restrict the time in which different causes of action can be brought.⁸⁷ A small number of respondents also suggested that 12 years was excessive and increased the likelihood that the 'gone-away' client would be more difficult to trace.

⁸⁴ For example, in England and Wales, this might be achieved by the execution of a deed.

⁸⁵ See existing CASS 7.7 and CASS 7.17 in Part 3 of the final rules in Appendix I.

⁸⁶ For example, see MiFID implementing Directive, Article 51 (obligation on member states to require investment firms to retain all the records required under the directive and its implementing measures for a period of at least five years), available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1398413558699&uri=CELEX:32006L0073>.

⁸⁷ See *Limitation Act 1980*, Part 1, Sections 2 and 5, as amended. Original version available at: www.legislation.gov.uk/ukpga/1980/58.

Our response

- 6.54** Following feedback, the final rules will allow firms to initiate steps to either pay unclaimed custody assets to charity in specie or liquidate those assets and pay the proceeds to charity.
- 6.55** However, as proposed in the CP, this procedure will not be available for an unclaimed custody asset until at least 12 years since the firm last received instructions concerning any custody assets from or on behalf of the client concerned. Our rules give firms a way to dispose of unclaimed client money after six years of no movement on the client's account. This difference in approach is based on the different nature of monies and assets and the different circumstances in which an investment firm may come to hold unclaimed monies and assets. Although client monies should usually only be held by an investment firm for short periods (e.g. in transit between the settlement of a purchase/sale and payment to the client), by contrast, clients may have a reasonable expectation that a firm providing custody services may hold on to that client's custody assets for a significant period of time with limited contact with the client.
- 6.56** We acknowledge a number of respondents separately noted that a longer 'waiting period' of 12 years could increase the likelihood that the 'gone-away' client would be difficult to trace. Nonetheless, consistent with the FCA Principles⁸⁸ and, where applicable, the clients best interest rule⁸⁹, we note that firms should be taking steps earlier than the end of this 12 year period to ensure they are holding up-to-date contact details for their clients.

Costs associated with handling unclaimed client money and custody assets

- 6.57** A number of respondents suggested firms should be allowed to deduct their costs before paying away unclaimed balances to charity. This included costs from tracing the client, liquidating unclaimed assets, paying away balances of client money or custody assets to charity and obtaining insurance to cover potential claims.

Our response

- 6.58** Under the rules we are introducing for the treatment of unclaimed client money and unclaimed custody assets, any costs the firm incurs must be paid out of the firm's own funds. This includes any costs the firm incurs in:
- a. tracing a client;
 - b. liquidating unclaimed assets;
 - c. arranging transfer of unclaimed balances, liquidation proceeds or unclaimed assets to clients; or
 - d. obtaining insurance to cover any claims arising from the actions the firm may undertake under these rules. This approach is consistent with the responsibilities firms generally have to their clients as a consequence of holding their monies and assets, including, where appropriate, those firms' duties as trustee.

⁸⁸ In particular, Principle 10.

⁸⁹ COBS 2.1.1R.

De minimis amounts of unclaimed client money and custody assets

- 6.59** In the CP we proposed allowing firms to pay unclaimed client money balances of less than or equal to £10 for any one client to charity after following a process with fewer steps than would otherwise be required. Firms would be expected to make at least one attempt to contact the client and return the money. If a firm chooses to use this mechanism, that de minimis amount of money would cease to be client money. We did not propose to introduce a similar threshold for handling de minimis amounts of unclaimed custody assets.
- 6.60** We received a considerable amount of feedback on this proposal. One respondent queried whether firms could use any means of communication to get in touch with the client. A large number of respondents argued that the de minimis threshold should be higher than £10. Many of these respondents noted that their reasoning for this was that the cost of returning that money to clients was disproportionate to the amount of money actually being returned to those clients. Other respondents suggested that the de minimis amount should be tiered by client type, arguing that when contemplating whether to retrieve money from a CASS investment firm the considerations made by a professional client (for example the operational, commercial or tax implications of reclaiming the money) are likely to differ from those of a retail client, and that in some instances this leads to professional clients being less likely to respond to a firm's efforts to return the unclaimed balances. A few respondents suggested that the de minimis level for retail clients should be £25 and higher for other clients. A few respondents suggested that professional clients would not accept returned amounts of less than £100 as the costs of receiving such amounts would be greater than £100. A few respondents argued that any de minimis threshold should be applied on a product or business line basis as it would be onerous to apply a de minimis threshold at a client level.
- 6.61** A number of respondents also suggested that we should introduce a similar de minimis threshold for handling unclaimed custody assets.

Our response

- 6.62** The final rules do not specify the type of communication that should be used by firms in the context of de minimis balances of unclaimed client money. Nonetheless, the final rules do clarify that a firm must wait at least 28 days after the communication has been made before releasing the balance of unclaimed client money. Also, as part of its record keeping requirements a firm will be required to keep details of the communication the firm had, or attempted to have, with the client.
- 6.63** In response to feedback, the final rules set a de minimis threshold for unclaimed client money of £25 for retail clients and £100 for other clients. Taking into account that balances of unclaimed client money will have been held for six years by firms before the procedure in our rules will be available to them to pay the unclaimed sums to charity, we agree that increasing the de minimis thresholds is appropriate. In addition, taking into account that retail clients are likely to be receiving these balances for themselves whereas professional clients may be receiving each balance on behalf of multiple underlying clients (such that the amount would be divided between a number of its underlying clients), we agree that tiering and increasing the de minimis thresholds for depending on client type is proportionate. We agree that £25 for retail clients and £100 for professional (or other) clients is a reasonable de minimis level.
- 6.64** We are not introducing a de minimis threshold in relation to unclaimed custody assets. This is because custody assets are by nature usually less fungible than money and the value of a custody asset can fluctuate, sometimes significantly, over time.

7. Client money rules (CASS 7)

- 7.1** In this chapter we discuss changes to the client money rules, which will affect all investment firms who hold client money.

Application of the client money rules

Q10: *Do you agree with our proposal to clarify the application of the client money rules in this way? If not, please provide reasons.*

- 7.2** We consulted on clarifying the application provisions in the client money rules by making amendments to the existing rules and inserting new guidance highlighting particular rules and guidance elsewhere in the CASS sourcebook that firms should be aware of when their activities are caught by the client money rules.
- 7.3** The majority of those who responded to this question welcomed the clarifications. One respondent noted that with respect to certain margined transactions that a firm carries out for a client, a client equity balance may become due to a client for those transactions without the firm having first received a margin payment from a client into a client bank account. In response to this feedback, the final rules include guidance reminding firms that their internal client money reconciliations should take into account any client equity balances they owe to their clients in relation to margined transactions.

Banking exemption

Q11: *Do you agree with our proposals in relation to the banking exemption? If not, please provide reasons.*

- 7.4** In the CP we consulted on making the rules clear that, for firms who are able to disapply our client money rules through the use of the banking exemption, the default position should be that money relating to investment business is held by that firm on deposit or in an account with themselves under the 'banking exemption'⁹⁰. The banking exemption is available to banks allowing them to hold money relating to investment business which would otherwise be client money as deposits in the course of a banking relationship. We further consulted on the firm being required to provide certain notifications to clients including:

⁹⁰ See existing CASS 7.1.8R, and CASS 7.1.8AR to 7.1.10CR in Part 2 and CASS 7.10.16R to 7.10.24R in Part 3 of the final rules in Appendix I.

- i. when applicable, that the money will be held by the firm as banker and not as trustee and that the client money distribution rules will not apply; and
- ii. when applicable, that the firm client money will be held in accordance with the client money rules and that the client money distribution rules will apply to that money on the failure of the firm. We further consulted on these firms being required to consider the situations in which money from clients would cease to be treated under the banking exemption and be treated as client money and agree these with their clients.

7.5 We received feedback from firms, trade associations and auditors on these proposals. The majority of respondents agreed that where an investment firm is a credit institution the use of the banking exemption should be the default position. We also received requests for a number of additional clarifications.

7.6 A number of respondents asked for clarification of the circumstances in which money would cease to be treated within the banking exemption and be treated as client money. Others asked whether they would be required to obtain express consent of the client to these circumstances or whether an amendment to the firm's terms and conditions with no requirement for consent would be sufficient. Another respondent asked whether, if there were no circumstances in which a firm intended to hold money in accordance with the client money rules, a one-way notification of this to its client would be sufficient. We also received feedback that the rules were drafted in a way that suggests that the application of the banking exemption is conditional on firms meeting the notification requirements. One respondent noted that there might be further costs associated with the proposal if they had to renegotiate their client contracts.

7.7 A few respondents asked for clarification of how the notification requirements in relation to the use of the banking exemption interact with the notification requirements relating to where a firm intends to hold money as trustee in accordance with the client money rules, and whether these could apply at the same time.

7.8 A few respondents commented that the rules were not clear as to what was meant by holding money 'on a firm's balance sheet' and argued that a balance sheet should not be the definitive test of whether monies were held under the banking exemption. For example, some noted that there would be a time lag between amounts of money being recorded in a firm's books and records and reaching the balance sheet and that therefore the firm's books and records were a better, more up to date, record to use.

Our response

7.9 We are introducing these proposals largely as set out in the CP with some minor changes to improve clarity.

7.10 In our supervisory activities, we have come across firms using the banking exemption transferring money to third parties in situations which amounted to them ceasing to use the exemption and meant they should have been protecting clients' money under the client money rules. We recognise that not all situations involving the transfer of money to a third party in respect of client investment business will cause the firm to fall out of the banking exemption, for example where a firm transfers an equivalent amount of money to a third party but continues to recognise a deposit for that client. Firms should ensure that they have assessed their own activities to determine whether they do fall outside the banking exemption.

- 7.11** The provision to clients of updated terms of business to reflect the circumstances (if any) in which money would cease to be treated within the banking exemption and be treated as client money is sufficient for the purposes of meeting our requirement for notifications to clients when operating under the banking exemption. If, having assessed their situation, firms do not believe there are any circumstances in which they will cease to treat money within the banking exemption, they do not need to specifically address this point in their terms of business.
- 7.12** When using the banking exemption firms will be obliged to make the requisite notifications to clients. However, although failure to do so will mean that the firm is in breach of the rules, it should not of itself affect the status of the money.
- 7.13** Also, if a firm chooses to use the banking exemption for some of its business and it also holds client money as trustee in accordance with the client money rules in relation to other business for that client, the firm will be required to make both notifications to the relevant clients. This includes where a firm has identified situations in which it will cease to hold money under the banking exemption and will hold the money as trustee, it will need to notify clients of what this means in accordance with the rules.⁹¹
- 7.14** This proposal does not impose a requirement on firms to renegotiate their terms of business with clients and we would not expect this to be the result of the final rules. The final rules require firms to be more transparent in their terms of business about how they treat the money they receive from clients, but we are not expecting these firms to change their business models. Providing clients with updated terms of business to reflect the practices of the firm is sufficient for the purposes of meeting our notification requirements under the final rules. Therefore, we do not expect firms to incur any additional costs renegotiating client contracts.
- 7.15** Finally, we have removed the references in the rules to money being held 'on a firm's balance sheet'. However, we do expect the bank's liability to its clients to be properly recorded.
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Allocation of monies received while operating under the banking exemption

- 7.16** We consulted on guidance that where a firm using the banking exemption receives money which, but for the exemption, would otherwise be held by that firm as client money in accordance with the client money rules, that money should be allocated promptly to the client, and we would expect this to be done within five business days of receipt.
- 7.17** A number of respondents suggested that allocation within five business days would be difficult to achieve. Others requested clarification as to how money that a firm failed to allocate within the time specified in the guidance should be treated.

⁹¹ See CASS 7.1.8DR in Part 2, and CASS 7.10.19R in Part 3 of the final rules in Appendix I.

Our response

- 7.18** In response to this feedback that allocation within five business days would be difficult to achieve, we have amended the guidance to say that we would expect firms to allocate these receipts of money promptly and no later than ten business days following receipt. The specification of 'no later than ten business days' gives these firms longer than five business days and is consistent with the time that investment firms are permitted for the allocation of client money (see below⁹²). Given that under this guidance firms should still allocate client money promptly, we do not believe that the amendment to allow firms a maximum period of ten business days will reduce the benefits to clients from the package of proposals consulted on in the CP.
- 7.19** The final rules do not specify the way a firm should treat sums of money that it fails to allocate within the time set out in the guidance. We do, however, expect firms to operate systems which enable them to meet this timeframe. Where the firm acts as banker to its clients under the banking exemption⁹³, failure to allocate the money to clients promptly should not of itself affect the status of how the money is held.

Trustee firms

Q12: *Do you agree with our proposals in relation to how trustee firms should hold client money when they are acting as such? If not, please provide reasons.*

- 7.20** A trustee firm is a firm that acts as a trustee or personal representative (a '**trustee firm**'). The rules that relate to trustee firms apply to such firms in relation to client money received in the context of their carrying out designated investment business that is not MiFID business (for this PS '**trustee firm client money**'). For example, these rules may apply to client money received by trustee firms that also establish, operate or wind up a self-invested personal pension scheme ('**SIPP**'). We note that the client money rules may be applicable to client money received by the same firm in the context of other activities (such as MiFID business) carried out by the firm other than in its capacity as a trustee (for the purposes of this PS, '**non-trustee firm client money**'). The application rules for CASS⁹⁴ make it clear how the CASS rules apply to trustee firms.
- 7.21** We consulted on disapplying the client money distribution rules (both the primary pooling event rules and the secondary pooling event rules) to trustee firm client money. This is because we consider it more appropriate that on the failure of a trustee firm its trustee firm client money is dealt with in accordance with the terms of the trust instrument under which it is held and in accordance with general trust law.
- 7.22** We also consulted on permitting trustee firms to elect to comply with all the requirements relating to the segregation of client money⁹⁵, all the requirements relating to client money records, accounts and reconciliations⁹⁶ and the acknowledgment letter requirements⁹⁷ rather

⁹² At paras. 7.141 to 7.144.

⁹³ Discussed above at paras. 7.4 to 7.15.

⁹⁴ See CASS 1.4.6R to 1.4.8R.

⁹⁵ CASS 7.4.

⁹⁶ Existing CASS 7.6 and Annex 1G and CASS 7.15 and 7.16 in in Part 3 of the final rules in Appendix I.

⁹⁷ Existing CASS 7.8 and CASS 7.18 in Part 3 of the final rules in Appendix I.

than only the minimum requirements explicitly set out in the rules. This proposal was aimed at enabling a firm that is also subject to the client money rules other than in its capacity as a trustee firm to be able to use the same systems and controls for its trustee firm client money and its non-trustee firm client money.

- 7.23** In addition, in the context of trustee firm client money, we consulted on allowing trustee firms to apply the relevant CASS provisions separately to each trust of which they are the trustee. If a trustee firm elects to do this it is required to segregate client money held for each different trust, conduct separate reconciliations for each different trust and rectify any shortfall in each trust separately.
- 7.24** All those who responded to this question in the CP were in broad agreement with our proposal, welcoming the added flexibility for trustee firms. All respondents supported the proposal to disapply the client money distribution rules for trustee firms as it was agreed that in the case of a primary pooling event firms should turn to the terms of the trust. Respondents also noted that the clarifications to the application of the CASS rules for trustee firms would be helpful in removing any confusion surrounding the compatibility of the CASS regime and the pension regime.

Our response

- 7.25** We are implementing these proposals largely as set out in the CP but with some changes. *First*, the final rules disapply our client money distribution rules to trustee firm client money, but we note that this means the client money distribution rules will still apply in relation to any other non-trustee firm client money that the firm holds other than in its capacity as a trustee.
- 7.26** *Second*, the final rules will still allow trustee firms the ability to opt in to complying with all the requirements relating to the segregation of client money, all the requirements relating to client money records, accounts and reconciliations and/or the acknowledgment letter requirements rather than only the minimum requirements explicitly set out in the rules. In addition, the final rules will also allow firms to elect to comply with all the rules relating to client money held by a third party.⁹⁸
- 7.27** *Third*, given the differing application of the client money distribution rules to trustee firm client money and non-trustee firm client money, the final rules make it clear that when firms hold both trustee firm client money and non-trustee firm client money, these 'pots' of client money must be segregated from each other and the relevant rules (those rules that firms are required to comply with and those opted into by the firm) must be applied to each 'pot' separately. The final rules also include guidance to remind firms that when they are designing their systems and controls they must consider the fact that the client money distribution rules will only apply in relation to any non-trustee firm client money that the firm holds and any other legislation that may be applicable.
- 7.28** *Finally*, the final rules will allow trustee firms to elect to apply the relevant CASS provisions separately to each trust of which they are the trustee firm.

⁹⁸ Existing CASS 7.5 and CASS 7.14 in Part 3 of the final rules in Appendix I.

Trustee firms – acknowledgement letters

7.29 A few trustee firms have fed back that even though they are not required to do so under the current rules, they have obtained acknowledgement letters in line with the rules in respect of their client bank accounts (holding trustee firm client money). These trustee firms have queried whether they will therefore be required under the new rules to put new acknowledgment letters in place.⁹⁹ Trustee firms will be able to choose to comply with our requirements for acknowledgment letters going forward. However, if they choose to do so, they will be required to comply fully with the new rules for acknowledgment letters.¹⁰⁰ If trustee firms do not elect to comply with the new rules on acknowledgement letters and they already have acknowledgement letters in place that meet the current requirements (in spite of the fact that these rules do not currently apply for trustee firm client money), these firms should consider whether they need to take steps to ensure it is clear what rules the firm has chosen to comply with going forward (i.e. they have not opted in). Our proposals for acknowledgment letters are discussed further below.¹⁰¹

Trustee firms – unbreakable term deposits and diversification of client money

7.30 In feedback to our proposal to prohibit the placement of client money in unbreakable term deposits ('**UTDs**')(discussed below¹⁰²), a small number of respondents raised concerns as to whether trustee firms and SIPP operators would be required to comply with this requirement. Respondents suggested that it may be unreasonable to prohibit a trustee firm from holding a client's money in an UTD where that client specifically requests it given that this money will not be subject to the client money distribution rules. Furthermore it was noted that there could be a conflict with the pension regime as the use of UTDs within SIPPs is currently not prohibited by HMRC rules.

Our response

7.31 As highlighted below¹⁰³, the two primary risks we are concerned about in relation to firms using UTDs are:

1. that firms are prevented from reacting to market information by moving client money from a bank when they consider it prudent to do so; and
2. that client money will not be returned quickly to an IP appointed to distribute client money to clients pursuant to the client money distribution rules should the firm fail.

7.32 Under the final rules the client money distribution rules will not be applicable to trustee firm client money. As a result, the risks that arise in the context of the use of UTDs for other firms do not arise in the same way for trustee firm client money. For example, if a third party bank holding trustee firm client money deposited with it in UTDs were to fail (which, if the client money distribution rules were applicable, would amount to a secondary pooling event), there would be no requirement under the client money rules for all the clients of the firm to share in any losses of client money that result from this failure. We are also aware that in the context of trustee firms' businesses, particularly SIPPs, it is common for a client to instruct a firm to deposit money at a particular institution for an unbreakable term. In addition, with SIPPs, clients may intend to leave their money with the firm on a long term basis, rather than moving it in and out of investments.

⁹⁹ Existing CASS 7.8 and CASS 7.18 in Part 3 of the final rules in Appendix I.

¹⁰⁰ See CASS 7.18 in Part 3 of the final rules in Appendix I.

¹⁰¹ See paras. 7.280 to 7.348.

¹⁰² At paras. 7.98 to 7.106.

¹⁰³ At para. 7.106 et. al.

- 7.33** Given this combination of factors and the fact that, as authorised entities these firms are required to, where applicable, act in clients' best interests¹⁰⁴ and to comply with the FCA Principles¹⁰⁵, in the final rules we have made it clear that trustee firms are carved out of the prohibition on placing client money in UTDs in relation to trustee firm client money.
- 7.34** Given that we have carved trustee firms out of the prohibition on placing client money in UTDs in relation to trustee firm client money, we have reduced the regulatory burden compared to the proposal in the CP which applied to all firms that hold client money. Given that trustee firm client money is subject to the terms of a trust instrument and general trust law principles, the impact of carving out this group of firms on our estimated benefits is expected to be minimal.
- 7.35** Further, as our understanding is (as explained above) that it is common for a client to instruct a trustee firm to deposit money at a particular institution, if this situation could put a firm in breach of its diversification requirements, a firm should consider speaking with its normal FCA supervisory contact about this.

Delivery versus payment exclusion – regulated collective investment schemes

Q15: *Do you agree with the proposal to remove the DvP window for delivery versus payment transactions for the purpose of settling transactions in relation to units in a regulated collective investment scheme? If not please provide reasons.*

- 7.36** We consulted on removing the window for delivery versus payment transactions in regulated collective investment schemes under which authorised fund managers ('AFMs') are allowed to disapply our client money rules (the '**DvP CIS window**'), so that AFMs are required to treat money received in the course of purchasing or redeeming units in regulated collective investment schemes for clients as client money under the client money rules.
- 7.37** We received significant feedback from firms and trade associations on this proposal. While there was some general agreement with the intention of the proposal, firms raised a number of concerns. Due to the significant impact of the proposal on the industry and the strength and depth of the feedback, we convened a number of meetings with firms and trade associations to further discuss the proposal with industry representatives.
- 7.38** A number of firms felt that AFMs would face serious intra-day funding issues as a result of the removal of the DvP CIS window. They noted that this was due to a combination of factors:
- 1.** under the collective investment scheme sourcebook ('**COLL**') rules, unit holders must have received redemption proceeds within a time frame that is specified in the COLL rules, usually T+4 (where T is the day on which clients give the instruction to the AFM to redeem). The way the payment flows between trustee/depositary and AFM are currently set up means that to ensure that these timeframes are met, AFMs must transfer redemption proceeds to clients before they have received these funds from the trustee/depositary, although they would expect to receive the funds the same day. This set up therefore creates the need for firms to fund this deficit intra-day; and

¹⁰⁴ COBS 2.1.1R.

¹⁰⁵ In particular, Principle 10.

2. as AFMs are not currently required to treat most money received from clients in the course of subscriptions for units and most money received from a trustee/depositary in the course of redemptions of units any differently from their own money, this money can be used to provide the AFM with the liquidity needed to meet its payment obligations (to the fund or the unit holders) and fund any intra-day deficits. AFMs' concern is that the removal of the DvP CIS window would remove at least some of this liquidity as some of the money would be client money within the meaning of the client money rules and therefore it would need to be segregated from firm money.
- 7.39** A few respondents also pointed out that in order to meet the T+4 time frame in COLL it is key that an AFM makes redemption payments early in the day on T+4 as there is often a chain of intermediaries through which the monies have to pass before being credited to an account of the ultimate unit holder. A number of respondents asked for clarification about whether they would be required to protect the value of the redemption proceeds owed to clients during the period between T and T+4.
- 7.40** A number of respondents queried whether 'principal transactions' carried out by the AFM would be caught by the client money rules. Several respondents noted that this proposal would mean that they may hold significantly higher sums of client money than they do under the current client money rules and that this may increase their CASS classification with consequential regulatory impacts, for example being required to appoint a CF10a and complete a CMAR.
- 7.41** A number of respondents noted that this proposal would require major systems changes and AFMs would need much more than six months to implement this proposal.

Our response

- 7.42** As a result of the feedback, we have decided to retain a DvP CIS window in the client money rules. The final rules instead allow AFMs a 'one day window':
1. when a firm receives money (that, but for this rule, would otherwise be client money) from a client in relation to the issue of units in a regulated collective investment scheme, if the AFM has not, by the close of business on the business day following receipt, passed this money to the trustee/depositary, the AFM must segregate this money and treat it in accordance with the client money rules; and
 2. when a firm receives money (that, but for this rule, would otherwise be client money) in the course of redeeming units in a regulated collective investment scheme, if the AFM has not, by the close of business on the business day following receipt, passed this money to the unit holder/client (or, where instructed, a third party on behalf of the unit holder), the AFM must segregate this money and treat it in accordance with the client money rules.
- 7.43** For example, if an AFM receives money from a client on T for a client's purchase of units in a regulated collective investment scheme but that AFM will not be transferring that client's money to the trustee/depositary until T+3 (assuming this money is client money¹⁰⁶), the AFM will be required to ensure that that client money is held under the client money rules by the close of business on T+1 until such time as that client money is used to purchase the client's units.

¹⁰⁶ See para. 7.45.

- 7.44** In the context of redemptions, if on T an instruction is received by an AFM to redeem units on behalf of a client and on T+4 the redemption proceeds are received by the AFM, if the AFM continues to hold those redemption proceeds for the client on T+5, from the close of business on T+5 the firm will be required to ensure that that money is held pursuant to the client money rules.
- 7.45** Under the DvP CIS window currently in force, in the context of the issue of units, an AFM is not required to treat money it receives from a client as client money unless the price of the units has not been determined by the close of business on the next business day following receipt of the money from the client. If the price has not been determined by that time, the AFM can no longer take advantage of the window in respect of that money. In the final rules in the Appendix 1, firms will have a similar one day window following receipt of money from clients (although the window will 'close' on T+1 irrespective of unit price determination). Similarly, under the DvP CIS window currently in force, an AFM is not required to treat money it holds in the course of redeeming units as client money where the proceeds of that redemption are paid to a client within the time frame specified in COLL (which is in most cases acknowledged to be T+4). In the final rules in Appendix 1, firms will be required to treat any redemption proceeds it continues to hold for clients at the close of business on the business day following receipt as client money under the client money rules.
- 7.46** To be clear, the final rules do not require AFMs to protect the value of any redemption proceeds as client money before the AFM receives that money.
- 7.47** It is for AFMs to assess on the basis of their business models and relevant client money rules when their activities are subject to the client money rules. The application provisions make it clear that the client money rules apply to a firm that receives money from or holds money for, or on behalf of, a client in the course of, or in connection with, its MiFID business and/or designated investment business (exemptions may apply). A number of respondents queried whether money received from clients in the context of 'principal transactions' carried out by an AFM would be caught by the client money rules. Respondents described 'principal transactions' in a number of ways. Some respondents also asked for clarification on whether, in the context of other types of transactions, if a client were to become legally entitled to units in a regulated collective investment scheme on the trade date, client money received by an AFM in subscription for these units would be client money within the client money rules. Where an AFM is carrying out principal or other transactions for its clients and the client is legally entitled to a unit(s) in a regulated collective investment scheme either before or when the AFM receives money from the client, the money may not be client money under the client money rules as the money is owed to the AFM on receipt. However, firms must assess their own business models against the client money rules.

Interaction with the immediate segregation requirements

- 7.48** In the event that an AFM is required to segregate client money (e.g. because the AFM receives money from a client on T in the course of the AFM issuing units and by the close of business on T+1 it still holds that money and the client has not become legally entitled to units), the final rules do not prohibit AFMs from transferring client money from a client bank account and into a firm account before making a payment to a third party. In addition, guidance in the final rules makes it clear that in the event that AFMs, having first received money into their house accounts during the DvP CIS window, are then required to segregate this money as client money, they will not be in breach of the immediate segregation requirements to receive client money directly into client bank accounts. Guidance in the final rules also makes it clear that where a firm makes a payment of redemption proceeds to a client by cheque, the cheque should be issued from a client bank account.

Client agreement

- 7.49** The final rules require firms to evidence each client's agreement in writing to the firm's use of the DvP CIS window. This agreement must be retained for the duration of the time that the firm makes uses, or intends to make use of the exemption for that client. We expect some firms might be able to comply with these requirements by making reference to their use or intended use of the DvP window in their standard terms of business with clients.

Cost benefit analysis update

- 7.50** As a result of these amendments, the costs to firms to comply with these revised requirements are likely to be no more, if not considerably less, than the costs associated with the proposal for the DvP CIS window in the CP. We still expect firms to incur one-off costs as a result of systems changes as a result of the final rules (which in the CP CBA we estimated as between £4,000 and £750,000). Respondents to the original costs survey set out in the CP estimated that on any given day they would expect to hold between £6,000 and £20m if the proposal in the CP were implemented and that there would be up to £200,000 in ongoing costs associated with segregating this amount of client money. Allowing firms the window in the final rules (during which they are not required to treat money as client money) will reduce the amount of client money that a firm holds on any given day and we would therefore expect the ongoing costs to firms associated with having to segregate reduced amounts of client money in client bank accounts to be reduced. While the proposal in the CP should have meant that client money received by AFMs would always be protected by the AFM in accordance with the client money rules, the amended proposal permits the firm only until the close of business on the day following receipt of that money not to comply with the client money rules, meaning the money is only exposed to the firm's failure for a short period.

- 7.51** The proposal in the CP was on the basis that the most beneficial position for clients to be in was that their client money was protected under the client money rules from the moment it is received by the AFM. However, as outlined above, we recognise that this is not an outcome that AFMs can feasibly deliver at this time. Therefore, had we implemented this proposal, a consequence for clients may have been a reduction in number of AFMs in this market, reducing clients' choice of provider and thereby reducing benefits to clients. The amended proposal will mitigate this concern. It should improve client money protections compared to the current regime, by exposing client money to the risk of firm failure for a shorter period in some instances as explained above. On balance therefore, we estimate that there will only be a minimal reduction in benefits to clients compared to what we set out in the CP.

- 7.52** We did not include in the CBA published in the CP the cost of evidencing each client's agreement to the firm's use of the DvP CIS window. Annex 1 sets out a summary of the general repapering costs some firms may incur as a result of the proposals in this PS, including this requirement for firms to ensure they have in writing the agreement of their clients to hold their custody assets and/or client money within the DvP CIS window.

Transitional provisions

- 7.53** Due to feedback that firms will need time to analyse their business models and change their systems to accommodate the rule changes, these rules will come into force from 1 June 2015. Please refer to Table 2 in Chapter 2 for further information.
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Interest

Q16: *Do you agree with our proposal to clarify the rule in relation to the payment of interest and introduce guidance setting out the segregation and allocation requirements of interest? If not, please provide reasons.*

- 7.54** We consulted on clarifying the application of this rule and to further enhance it through additional guidance on the segregation and allocation requirements when a firm receives interest or contractually agrees to pay interest to clients.
- 7.55** We received feedback from many respondents who felt that the proposed rule changes would mean firms would be limited to either paying clients all interest earned on client money or no interest at all, which would not allow for the current practice of firms agreeing with their clients the amount of interest that will be paid. We received a range of comments requesting further clarification on when interest should be segregated under the proposed rule, for example in situations where interest on client money held at a number of banks is received by firms at different frequencies or where a firm deducts contractually agreed charges from the interest earned. We also received feedback from a few firms who felt the proposal to require firms to pay interest on client money within one business day wherever no written agreement between the client and the firm is in place would be operationally unfeasible in some circumstances, for example where a third party holding client money does not provide the firm with daily statements.

Our response

- 7.56** We have amended our proposals to make sure that it is clear in the final rules that firms are able to contractually agree how much interest on client money they will pay to clients. Where a firm is not going to pay all the interest on the client money to the clients, the clients must be notified of this in writing. In response to the comments on when interest earned on client money should be segregated we have made it clear that wherever interest is paid to a client it should be segregated in accordance with our client money segregation requirements or when contractually agreed with clients.¹⁰⁷ For example, where firms have contractually agreed with clients that interest will be due and payable to clients on a certain date each month, firms should comply with the segregation rules relevant to when money is due from a firm to a client.¹⁰⁸ We note that this new rule does not have the effect of prohibiting firms from agreeing the frequency at which they will pay interest within their client agreements. Similarly, in order to ensure consistency within CASS, we have clarified that interest should be allocated to clients in accordance with the allocation requirements in the client money segregation rules.¹⁰⁹ We do not consider this proposal to have any CBA implications.

Money ceasing to be client money

Q17: *Do you agree with these proposals on money ceasing to be client money? If not, please provide reasons.*

¹⁰⁷ Existing CASS 7.4 and CASS 7.13 in Part 3 of the final rules in Appendix I.

¹⁰⁸ Existing CASS 7.4.29G and CASS 7.13.39R in Part 3 of the final rules in Appendix I.

¹⁰⁹ See CASS 7.4.28AR proposed in the CP and CASS 7.13.36R in Part 3 of the final rules in Appendix I.

- 7.57** We consulted on amending the rules relating to money ceasing to be client money¹¹⁰ to address certain risks that we had seen emerging in the market, including where transfers of money were being made into bank accounts set up in the names of clients without the knowledge or consent of the clients involved. We also proposed amending the rules on money ceasing to be client money to include the situations where:
- i. the firm pays money into a bank account in the name of the client if the clients have instructed or consented to the payment¹¹¹;
 - ii. client money is paid to a third party when the firm is obliged to do so under an applicable law (e.g. to HMRC);
 - iii. client money is transferred under the ‘transfer of business’ rules by operation of a transfer clause in client agreements or operation of the rules relating to the transfer of de minimis sums (discussed below¹¹²); and
 - iv. where client money is paid away to charity under the unclaimed client money/de minimis rules (discussed above¹¹³).
- 7.58** While the respondents (including auditors, banks industry associations and firms) generally agreed to the amendments and recognised that a number of the changes being made here were as a consequence of other proposals, we received a number of comments on the proposal requiring firms to obtain the instruction of specific consent of a client to pay client money into a client’s own bank account. Some respondents asked for clarification of the policy rationale for this as the risk we were seeking to address was not clear. A number asked for clarification on the meaning of ‘specific consent’ and noted it would be administratively burdensome to obtain instruction or consent to each transfer. Others asked what status the money transferred would have if it were transferred without the firm having obtained the instruction or specific consent.
- 7.59** We received some feedback that the rules should be compatible with other rules to which the firms in question might be subject to, such as HMRC rules on bulk transfer of ISAs.

Our response

- 7.60** We are introducing these rules largely as proposed in the CP with some changes to reflect feedback. First, the final rules will now make it clear that money will cease to be client money if it is paid into a bank account of the client (i.e. an account not in also in the name of the firm) without the need to obtain the client’s instruction or specific consent to each payment. The policy rationale behind the proposal in the CP was to address the risk that we had seen of transfers of money being made into bank accounts set up in the names of clients for administrative purposes without the knowledge or consent of the clients involved. However, rather than requiring client instruction or specific consent for payments into a client’s own bank account, we have addressed this risk by prohibiting firms from making payments into a bank account of a client that has been opened without the consent of the client. If the firm were to pay client money into such a client bank account, that money will continue to be client money.

¹¹⁰ Existing CASS 7.2.15R and CASS 7.11.34R in Part 3 of the final rules in Appendix I.

¹¹¹ See CASS 7.2.15R(3) as proposed in the CP.

¹¹² At paras. 7.64 to 7.70.

¹¹³ At paras. 6.33 to 6.64.

- 7.61** This change should not represent any change in the benefits to clients from the package of proposals we consulted on in the CP because the same objectives are being achieved in a different way as explained above.¹¹⁴ The amendment reduces the burden on firms and any costs a firm might have incurred in obtaining instruction or consent to each payment into a client's bank account as such instruction or consent to each payment are no longer required.
- 7.62** We consulted on including a rule that money ceases to be client money where a firm pays that money to a third party further to an obligation under applicable laws. We are introducing this rule as a slightly re-worded version of this rule so that money ceases to be client money where a firm pays that money to a third party further to an obligation that arises from an enactment relevant to the business they are conducting for that client.
- 7.63** We note that these transfer of business rules are different from the HMRC rules for transfers of ISAs to alternative providers, imposing additional requirements to obtain consent/instruction from clients. While we acknowledge that firms will have an additional burden when complying with both sets of regulations, they are designed for different purposes. If a firm wishes to discuss individual circumstances it should raise this with its normal FCA supervisory contact.

Transfer of business

Q18: *Do you agree with our proposals in relation to the transfer of client money to a third party? If not, please provide reasons.*

- 7.64** To facilitate the transfer of client money as part of a business transfer, we proposed rules setting out the content of 'transfer clauses' that firms can put into their client agreements and a process that can be followed by firms so that they are not required to obtain consent from each client at the time of the business transfer. We further proposed that in the context of a business transfer, in respect of clients for whom a firm holds up to a 'de minimis' amount of client money, the transferring firm need not obtain the clients' consent to the transfer either at the time of the transfer or by way of a transfer clause in a client agreement. We proposed that where firms complied with these rules, the relevant monies would cease to be client money of the transferring firm.
- 7.65** The majority of respondents supported the proposal. There were a number of specific points of feedback.

Transfer clauses

- 7.66** A few respondents commented that the rule was not clear as to whether firms would be required to amend their client agreements to include a clause at the time the business transfer was taking place and that if this were the case this seemed to undermine the purpose of the proposal. Other respondents asked whether they would be required to repaper all their clients to include such a clause. Another respondent queried whether the inclusion of this type of clause in client agreements might give rise to unfair contract terms concerns.

¹¹⁴ At para. 7.60.

Our response

- 7.67** The final rules clarify that there are three ‘ways’ in which a firm may transfer client money to a third party in the context of a transfer of business and in doing so that money will cease to be client money:
1. it may obtain client consent at the time of the transfer;
 2. it may include in its client agreement a clause which allows the firm to transfer the client’s client money to a third party in the future should the situation arise (where the conditions in the rules are met, including notification requirements); or
 3. if the client holds less than or equal to a de minimis amount of client money per client, neither form of consent is required (but notification requirements apply).
- 7.68** Under the final rules, firms will have the choice over whether they want to include a transfer clause within their written client agreements. If firms wish to ensure that the option to transfer client money pursuant to such a clause is available to them in the future, they can repaper their client agreements with the appropriate wording. If at the time of transfer firms do not have such clauses in their client agreements, they will be required to obtain the consent of their clients at the time of the transfer and/or apply the ‘de minimis’ provisions to the extent possible.
- 7.69** We have given consideration to the unfair contract terms concern. Under the final rules, firms should have regard to legal obligations to clients including requirements under the Unfair Terms Regulations. In addition, in choosing to insert a transfer clause into client agreements, firms are required to commit: to transferring the sums to another firm who will hold those sums under the client money rules or to exercising all due skill, care and diligence in assessing whether the person to whom the client money is being transferred will apply adequate measures to protect the sums being transferred. Also, in the event of the transfer taking place, the final rules require the firm to ensure that clients are notified of how the money will be held by a transferee firm and that the clients are given the option to have the sums transferred to be returned to them.¹¹⁵
- 7.70** Amending client agreements in this way is optional to firms. However, we set out in Annex 1 to this PS the estimated costs associated with repapering the proposals set out in the PS including this one.

Type of transferee

- 7.71** A few respondents queried whether a transferee receiving the business would be required to be a firm offering clients client money protection under the client money rules.

Our response

- 7.72** The final rules do not restrict the type of transferee that client money can be transferred to. We recognise that restricting a transfer clause to being effective only in the context of a transfer to another CASS firm would limit the use of the rule. The rules require firms to exercise all due skill, care and diligence in assessing whether the person to whom the client money is being transferred will apply adequate measures to protect the sums being transferred. The rules also require the transferring firm to notify the clients of how the money will be held by a transferee firm and the relevant applicable compensation scheme. In addition, firms must give clients the

¹¹⁵ See para. 7.64.

option of having the sums transferred returned to them. These factors mitigate risks to the client money of being transferred out of protection under the client money rules, ensure clients are provided with the relevant information about how their money will be held and reflect the commercial reality that not all transferee firms will be subject to the same client money regime.

Post transfer notifications

- 7.73** A few respondents commented that firms affecting a transfer of business should be given more than seven days to make the notifications required under the rule to clients. Other respondents asked for clarification as to whether the transferring firm or the transferee firm would be required to make notifications to the clients following the transfer.

Our response

- 7.74** The final rules require the transferring firm to ensure that certain notifications are made to the clients no later than seven days after the transfer has taken place. The notifications include: how the money will be held by the transferee firm; the relevant applicable compensation scheme; and the option for a client to have transferred sums returned as soon as possible. It is important that clients are notified in a timely fashion of the transfer to ensure that they can continue to conduct business with the new provider or to enable them to request the return of their money and move their business elsewhere. The final rules continue to require these notifications to be made within seven days of the transfer (at the latest) but leave it open to the firm to notify clients at any time up to that point, including prior to the transfer taking place. It is up to the firms concerned as to which firm makes the notification to clients. However, the transferring firm has the obligation under the final rules to ensure that the notifications are made.

De minimis

- 7.75** A few respondents commented that the de minimis of £10 is too low and suggested that £25 would be a more proportionate figure. Other respondents suggested a tiered approach should be taken to the de minimis amount, having a lower figure for retail clients and a higher figure for professional clients.

Our response

- 7.76** In keeping with the reasoning set out in relation to de minimis levels in the rules relating to allocated but unclaimed client money¹¹⁶, the final rules set the de minimis levels in relation to the transfer of business at £25 for retail clients and £100 for other clients. The final rules also make it clear that clients with de minimis balances can be transferred as part of a transfer of business without the need to obtain explicit consent at the time of the transfer or consent in the form of a transfer clause in the client agreement. However, transferring firms are required to ensure that these de minimis clients receive the required notifications¹¹⁷ no later than seven days after the transfer has taken place.

¹¹⁶ See para. 6.63.

¹¹⁷ Discussed above at para. 6.47.

Money ceasing to be client money

- 7.77** One respondent asked for clarification of exactly when money ceases to be client money 'in the hands' of the transferring firm in the context of a transfer.

Our response

- 7.78** The final rules make it clear that money ceases to be client money in the context of a transfer when the sums are transferred to the third party transferee in accordance with the relevant rules. However, in this context, before money ceases to be client money, the firm must have ensured that the transfer arrangements are such that the clients can opt to have their client money returned to them. We have made it clear in the final rules that the money ceasing to be client money is not linked to the notifications having been made. This is because where client money has already been transferred, to the extent that the transferee is subject to CASS, that firm will become a fiduciary of that money on receipt, and even if the transferee is not subject to CASS, it should become responsible for it on receipt into its bank account. Although that money will cease to be client money 'in the hands' of the transferring firm that firm will still have a regulatory obligation under the rules to ensure that the notifications are made to the relevant clients.
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Interaction between transfer of business rules and rules relating to allocated but unclaimed client money

- 7.79** A few respondents asked for clarification as to how client money relating to clients who could not be contacted should be treated in the context of a business transfer.

Our response

- 7.80** The rules relating to allocated but unclaimed client money provide a process for firms to follow in order to deal with sums of money they hold for 'gone-away' clients. The rules covering transfer of client money to another firm provide a means for a firm to transfer client money as part of a business transfer. Where relevant, firms can use the rules relating to allocated unclaimed client money to deal with sums in respect of 'gone-away' clients and the transfer of business rules in respect of active clients.
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Client bank accounts

Q21: *Do you agree with our proposal to clarify the requirements around client bank accounts? If not, please provide reasons.*

Diversification

- 7.81** The current rules place firms under an obligation to ensure that a maximum of 20% of the client money that they hold is deposited with intra-group institution (the '**20% limit**'). This is to limit the amount of client money at risk should the group fail. We consulted on expanding this diversification rule to require firms, in addition to the 20% limit, to 'appropriately diversify the third parties with which they deposit client money' and in guidance we set out that firms

should consider the appropriateness of depositing client money at a number of different third parties and the appropriateness of limiting the amounts of client money held with third parties in the same group as each other.

- 7.82** We received feedback requesting clarification of situations when it would be appropriate to diversify and when it might be appropriate not to diversify. Some respondents raised concerns about operating in jurisdictions with a limited choice of banks, operating in stressed market conditions or whether they would be expected to diversify client bank accounts used for frequent client money operations. Some respondents pointed out that our proposal to prohibit the use of unbreakable term deposits might further limit the number of banks willing to accept deposits of client money, thus making it more difficult for them to meet the proposed diversification requirements. A few respondents also suggested that firms be required to have formal diversification policies and to adequately document their decisions around the diversification of client money.

Our response

- 7.83** Firms will continue to be subject to the 20% limit on intra group deposits. Given the risks that can arise through concentrating a firm's holdings of client money with only a few banks, diversification of client money holdings across third party banks generally is an important part of the client money protection. In the context of the 20% limit on the intra-group deposits we have amended the definition of a relevant group entity so that it no longer refers to a qualifying money market fund ('QMMF') or an entity operating or managing a QMMF. This is because a firm cannot deposit client money with either of these in the way that it would with a bank and where a firm purchases units in a QMMF, these are usually held for particular clients under the custody rules.
- 7.84** However, we understand that the risks to which client money held by different firms is exposed differ depending on (amongst other factors) the business models the firms operate and the markets in which they operate.
- 7.85** In response to the feedback, the final rules will clarify that a firm will be required to periodically assess whether it is appropriate to diversify (or further diversify) the third parties with which it deposit some or all the client money it holds. In carrying out these periodic assessments the firm should give consideration to:
- whether it would be appropriate to deposit client money in client bank accounts opened at a number of third parties;
 - whether it would be appropriate limit the amounts of client money it holds with third parties who are in the same group as each other;
 - whether risks arising from the firm's business models create any need for diversification;
 - its obligations to arrange adequate protection for clients' assets;¹¹⁸
 - the outcome of the due diligence it is required to carry out on banks; and
 - the market conditions at the time of the assessment.

¹¹⁸ PRIN 2.1.1R(10) and existing CASS 7.3.1, and CASS 7.12 in Part 3 of the final rules in Appendix 1.

Following a periodic assessment, the firm must make any adjustments it concludes are appropriate to the third parties it uses and to the amounts of client money deposited with each of them.

- 7.86** In response to feedback, we will also require firms to make a record of each periodic assessment, including its considerations and conclusions. Firms will be required to keep this record for five years following the conclusion of an assessment. Given that the current rules involve a firm considering the need for diversification of risks as part of its periodic due diligence reviews and firms are required to keep a record of these reviews, we do not expect that most firms will incur any significant additional costs from being required to keep a record of each periodic assessment. Firms may incur minimal additional costs from being required to retain this record for a period of five years. We set out an assessment of these additional retention costs in Annex 1.
- 7.87** We address the feedback on the interaction between the diversification rules and the unbreakable term deposit proposals in the section relating to unbreakable term deposits.¹¹⁹

Due diligence

- 7.88** We consulted on enhancing the due diligence firms are required to conduct in respect of the banks with which they choose to deposit client money. This was in response to us having found that a number of firms are not carrying out sufficient due diligence of these banks.
- 7.89** Many respondents agreed with the proposals overall but provided feedback on specific points of the proposal. A few respondents suggested that the banks should be required to publish the data that would allow firms to carry out the necessary due diligence under the rules¹²⁰ or that the FCA should publish this data as some of it is difficult for firms to obtain. Another respondent asked for clarification of what is expected from firms from the addition to the list of due diligence matters the ‘consideration of the extent to which deposits with banks outside the UK would be protected by national depositor preference schemes’. A few respondents asked for clarification of the meaning of ‘financial soundness’.
- 7.90** One respondent noted that the list of due diligence matters to consider does not take into account the insolvency approach or regulatory framework of the jurisdiction of the bank in question. Another asked that we specify the frequency that firms should carry out the periodic review of the banks with which they place client money. A few respondents also asked what the rationale was behind replacing ‘credit rating’ with ‘credit-worthiness’ in the proposed rules.

Our response

- 7.91** We are implementing these proposals as set out in the CP with only one change and some revised drafting to reflect feedback.
- 7.92** The only notable change includes the introduction of an explicit requirement for firms to make a record of each periodic review of a bank and to keep that record from the date it conducts the periodic review until five years after the firm ceases to use that bank to hold client money. We understand that some firms may already keep such a record however, other firms are likely to incur minimal costs as a result of this new requirement in addition to those consulted on in the CP. Please refer to Annex 1 for a breakdown of costs associated with record production and retention.

¹¹⁹ See paras. 7.30 to 7.35 and 7.100 to 7.106.

¹²⁰ Existing CASS 7.4.8R and CASS 7.13.8R in Part 3 of the final rules in Appendix I.

- 7.93** More generally, the current rules already require firms to determine at what frequency the ‘periodic review’ is carried out. Although this requirement applies to all firms the rules do not specify the frequency of the review or the period that the review should cover. This obligation derives from MiFID which does not specify the frequency of the review. How frequently one firm should carry out such a review will differ from the frequency that might be appropriate for another firm. Some factors a firm might consider in how often it should undertake a periodic review under this rule include the amount and proportion of the firm’s client money held at that particular institution and the market conditions in the jurisdiction in which the bank is based.
- 7.94** The final guidance makes it clear that the matters identified for a firm to consider are only some of those that firms should consider and that each of these matters need only be considered where appropriate. Some of the information the firm should consider is publicly available (as, for example, it is published by banks) and other items are qualified by ‘to the extent that the information is available’. With this in mind, in our view there is sufficient information available to firms to carry out due diligence on their counterparties.
- 7.95** Following review of the feedback, we are deleting the reference to ‘financial soundness’. Firms would be required to consider a number of matters, including those listed in the list of due diligence matters in the final rules¹²¹, to be able to assess the financial soundness of a bank, and therefore ‘financial soundness’ it is already covered by the rules and there is no need to include this as a separate matter on the list.
- 7.96** When a firm carries out due diligence (under either our current rules or the changes being introduced in this PS) it is also required to take into account ‘any legal requirements... relating to the holding of client money that might adversely affect clients’ rights’.¹²² We expect this to include the insolvency approach or regulatory framework of the jurisdiction of the bank in question.¹²³
- 7.97** The reference to ‘credit rating’ was replaced with the concept of ‘credit worthiness’ on the basis of feedback we received from firms prior to the consultation asking whether they could use a more general view of the credit-worthiness of a bank rather than the narrower credit rating as they were moving away from solely using credit ratings. We expect that some firms will still choose to use credit ratings when evaluating a bank or other third party’s credit worthiness.

Unbreakable client money term deposits

Q22: Do you agree with our proposal to prohibit the use of unbreakable term deposits? If not, please provide reasons.

- 7.98** To ensure that when depositing client money firms are able to react to market developments affecting the financial institutions with whom they place those deposits, and to ensure that client money is available for distribution to clients when it is due to them following the failure of a firm, we proposed in the CP to prohibit firms from placing client money in unbreakable

¹²¹ Existing CASS 7.4.9G and CASS 7.13.11G in Part 3 of the final rules in Appendix I.

¹²² Existing CASS 7.4.8R(2) and CASS 7.13.10R(2) in Part 3 of the final rules in Appendix I.

¹²³ See also the discussion of obtaining acknowledgement letters from overseas counterparties in paras. 7.315 to 7.321.

term deposits ('UTDs'). We proposed to achieve this by requiring that firms be able to make withdrawals of client money promptly and in any event within one business day of making a request for withdrawal.

- 7.99** A large number of firms and industry associations provided feedback on this proposal. A number of respondents raised the issue that lower interest rates would be available when depositing client money if the use of UTDs was prohibited, leading to a loss in income for potentially both the firm and the clients.¹²⁴ There was feedback that this income loss had not been accounted for in the cost benefit analysis undertaken for the CP. This was raised within the wider feedback we received from firms concerned that the prudential requirements for deposit taking institutions would lead to an environment of lower interest rates for on-demand deposit accounts. A few respondents felt that the prohibition would be in conflict with the proposed diversification rules, as this proposal would potentially limit the number of banks prepared to accept client money deposits.

Our response

- 7.100** Our view remains that the use of UTDs with lengthy terms to hold client money is incompatible with the purpose of the client money regime. The client assets regime aims to ensure client money held by a firm is well protected and in the case of a firm insolvency as much of the client money as possible can be returned to the client as quickly as possible. Holding client money in accounts where the money cannot be accessed for long periods of time is incompatible with these overall aims. However, in light of the feedback we have received, our rules will now permit the use of UTDs for short terms only.
- 7.101** In the CP, we noted that following a survey of firms, it was reported that firms would on average incur a median cost of nil in relation to this proposal. We understand further that only a small percentage of firms currently place any client money in UTDs. However, following feedback on the potential impact of this proposal for some firms, we conducted further analysis on the potential loss of income to firms and clients if we were to prohibit the placement of client money in UTDs. We estimate that the loss of income for firms with the largest client money holdings in UTDs could be between £150mn and £225mn (representing around 1.5% of total firm turnover) and for firms with the smallest reported client money holdings in UTDs could be between £3,000 and £5,000 (representing around 3.5% of total firm turnover).¹²⁵ However, these costs affect only a small percentage of firms and as such we expect the median costs for the population of firms as reported in the CBA published in the CP to still be applicable.
- 7.102** Irrespective of these costs, the risks of placing client money in UTDs still remain: potential for client money not being available for distribution to clients in the case of a firm insolvency and the inability of a firm to react to market information, putting all client money in an UTD at risk of diminution. However, we have considered both the general timeframe of a CASS firm insolvency and what the longest unbreakable term would be that would allow a firm to be sufficiently responsive to changing market conditions in determining an acceptable maximum UTD length. In light of this analysis, and the potential income losses to firms and clients, we

¹²⁴ The client money rules (existing CASS 7.2.14R and CASS 7.11.33R in Part 3 of the final rules in Appendix I) permit firms to agree with their clients how much interest earned on client money they pass on to clients.

¹²⁵ We took data from surveys conducted in 2012 in which firms had reported their holdings of client money in unbreakable term deposits. Using market data we calculated the potential differential between the interest rates on unbreakable term deposits and instant access accounts. We divided the population according to the amount of client money firms held in unbreakable term deposits, then calculated the estimated income loss that would result from the lower interest rate for the two populations using the following calculation: (estimated holding of client money in unbreakable term deposit accounts) x (interest rate differential) = estimated income loss. We then considered how this loss measured against firms' total turnover to give some perspective on the size of the loss for a firm.

have amended the proposal to allow firms to place client money in UTDs for up to a maximum unbreakable term of 30 days. This may reduce potential income losses by allowing firms to access higher interest rates than firms may have been able to under our proposal in the CP to prohibit all UTDs. Firms are not prohibited from holding client money in longer term deposits which are breakable.

- 7.103** We have taken on board the feedback that the proposal to prohibit the use of UTDs may potentially limit firms' choice of banks for the placement of client money and therefore potentially conflict with the client money diversification requirements. However, while we received general feedback that the prohibition on firms using UTDs is likely to mean that banks are less willing to accept client money deposits, we have not seen any concrete evidence that this will be the case.
- 7.104** As explained above¹²⁶, under the final rules trustee firms are not prohibited from placing trustee firm client money in UTDs (although the prohibition in the final rules is applicable to client money that these firms hold other than in their capacity as trustee firms).
- 7.105** The client money rules apply to money received or held by a firm for or on behalf of a client in the course of or in connection with its MiFID business or its designated investment business. If a firm receives money from a client that is neither in the course of, nor in connection with, its MiFID business or its designated investment business, the client money rules are not applicable and this money should not be mixed with client money to which the rules are applicable.¹²⁷
- 7.106** In response to firm feedback we have revised our CBA to include costs associated with loss of income.¹²⁸ In response to concerns about the potential cost of this proposal for some firms we have revised the proposal, with the effect of reducing the regulatory burden on affected firms. We expect final rules to maintain a similar level of benefits to clients as the proposal in the CP because only a small proportion of firms use UTDs, and although the change means firms are likely to have to wait until the UTD matures (after 30 days) before responding to market information or before distributing client money in the event of firm failure, the change means firms will be able to be more responsive to market information and clients will get money back more quickly in the event of a firm failure than in the absence of this rule (e.g. where firms may have been tied into UTDs with longer terms e.g. 60 days or longer). We also highlight that in the final rules firms are allowed to hold client money in long term breakable deposits.

Immediate segregation

Q23: *Do you agree with our proposal to clarify the existing requirements around the immediate segregation of client money? If not, please provide reasons.*

- 7.107** We consulted on an 'immediate segregation' proposal which requires firms to receive client money directly into a client bank account (unless the firms are using the alternative approach to client money segregation), meaning that these firms should not first receive any client money into the firm's own accounts. We noted in the CP that this would not stop these firms from

¹²⁶ At para. 7.33.

¹²⁷ Although it may be the client money rules in CASS 5 or CASS 11 that may be applicable.

¹²⁸ See para. 7.101 above.

making payments from the firm's own accounts into their client bank account when such sums are due and payable by the firm to the client.

- 7.108** The majority of respondents agreed with the proposal. However, a large number of respondents commented that this proposal would result in the firm inadvertently breaching the client money rules, for example, if a client makes a payment into the incorrect account. Others suggested that achieving 'immediate segregation', when amounts of money become due and payable from a firm to client(s), would be challenging for a number of reasons including firms' inability to control the time at which third party banks action payment orders or the order in which they action such orders and the fact that third party banks have cut-off times after which transfers between bank accounts will not be possible until the following day.
- 7.109** A few respondents commented that they would incur costs associated with this proposal relating to recordkeeping, system and process changes. However, none of these respondents stated the costs they would incur might exceed the costs we stated might arise in the CP.

Our response

- 7.110** We are implementing these proposals largely set out in the CP. The risk of clients or third parties making payments into a house account rather than a client bank account is likely to diminish over time as firms circulate amended settlement instructions and implement changes to systems and controls.
- 7.111** As set out in the CP, the 'immediate segregation' proposal does not stop firms from making payments from their own accounts into their client bank accounts when, for example, such sums are due and payable by the firm to the client. The use of the word 'immediate' is used to describe the proposal but does not appear in the rules and need not be taken to imply that money that becomes due and payable from a firm to a client must be instantly segregated into a client bank account. Nevertheless, the final rules¹²⁹ now make it clear that a firm should promptly, and in any event no later than one business day after the money becomes due and payable, pay the money to the client or segregate that money in a client bank account.
- 7.112** In the costs survey carried out prior to publication of the CP, firms were asked what costs they anticipated incurring as a result of this proposal including 'initial operational or systems costs'. While the majority of respondents said they would incur no costs from this proposal, those that thought they would incur costs cited operational or systems costs and these figures fed into the estimate provided. We do not consider that further costs estimates are therefore required here.

Overseas bank accounts

- 7.113** A few respondents asked for clarification of how the immediate segregation requirements should be applied in the context of firms using bank accounts at banks in other jurisdictions in relation to which the firm is unable to obtain the required acknowledgement letters.

¹²⁹ See CASS 7.4.29AR as proposed in the CP and CASS 7.13.39R in Part 3 in the final rules in Appendix I.

Our response

- 7.114** As set out in the final rules and the section below relating to acknowledgement letters¹³⁰, where firms cannot obtain acknowledgement letters from banks with whom they wish to open client bank accounts, they are not permitted to hold client money in those bank accounts and any receipt of client money into such accounts would be a breach of those rules. This extends to bank accounts at banks in any jurisdiction. Similarly, receipts of client money into bank accounts which do not meet the client bank account requirements within the meaning of the client money rules, will breach the requirement to receive client money into a client bank account.

Use of certain payment service providers

- 7.115** A few respondents queried whether using certain payment service providers such as e-money issuers to facilitate payments from clients would result in firms breaching the immediate segregation requirement to receive client money into a client money bank account.

Our response

- 7.116** The final rules are clear that a firm should ensure that all client money it receives is paid directly into a client bank account at a bank (or a qualifying money market fund where relevant). The client money rules do not prevent a firm from receiving money from clients via a payment service provider. However, if a firm uses or is considering using such a payment service provider, it should consider how this will impact on all its obligations under the client money rules. For example, as discussed below¹³¹, the final rules set out explicit guidance that states that a firm should ensure its organisational arrangements are adequate to minimise the risk that client money held by the firm may be paid for the account of a client whose money is yet to be received by the firm. A firm may wish to use its own money to fund clients' trades (for example, in advance of receiving funds from clients). If the firm wishes to do this through the client bank account, it may be able to make use of the prudent segregation rules¹³² to mitigate the risk of using one client's money for another client's trades. It may instead wish to do so directly from its own bank accounts.

Interaction with the European Market Infrastructure Regulation

- 7.117** During the consultation period a trade association and a number of firms raised an issue that certain firms, that are also clearing members of CCPs, are facing. In the context of the arrangements that are being put in place between clearing members and CCPs, clearing members are at times likely to be required by CCPs to make and receive single payments that relate to both proprietary accounts and client segregated accounts at the CCP from/into a single bank account. This bank account will be used to make payments from the firm to the CCP in respect of margin covering all of the firm's accounts (including client segregated accounts) as well as to receive payments from the CCP to the firm.

¹³⁰ At paras.7.311 to 7.321.

¹³¹ At para. 7.136.

¹³² At para. 7.148 to 7.157.

- 7.118** This essentially amounts to firms being required to both make payments that are part client money and part proprietary money (mixed payments) from, and receive mixed payments into, a single bank account. The immediate segregation rules proposed in the CP would require these firms (assuming they are operating the normal approach to client money segregation) to receive all client money into client bank accounts and subsequently transfer out any money that is not client money.
- 7.119** Clearing member firms commented that in order to comply with the immediate segregation requirements they would have to receive these mixed payments into a client bank account in spite of knowing that a significant proportion of the mixed payments would be house money. Similarly, they would be making mixed payments from these client bank accounts potentially putting all of the client money in those accounts at risk of being used by a CCP to meet margin payments on house accounts.

Our response

- 7.120** We considered the risks that this issue presents to client money where mixed payments are received into and paid out of a client bank account. In the context of receiving mixed payments, the firm will have potentially large amounts of house money being received into the client bank account which essentially amounts to the firm conducting its own proprietary business through that account. In the context of making mixed payments out of a client bank account there is a risk that client money is, accidentally or otherwise, used to meet margin payments on house accounts.
- 7.121** As a result, in the final rules, we make specific allowance for this scenario. We are requiring clearing member firms to use reasonable endeavours to ensure that the arrangements they have in place with CCPs allow them to make or receive payments relating to proprietary business from or into house bank accounts and to make or receive client money payments relating to client business from or into client bank accounts. However, where clearing member firms, notwithstanding their reasonable endeavours are required as a result of the CCP's arrangements to receive mixed payments into and make mixed payments out of a single bank account, the account they use for this must be a house account. This will minimise the risk of client money being used to cover margin calls on proprietary accounts at the CCP. In addition, firms will be required to transfer the client money element (of the mixed payments received into the house account) into a client bank account promptly and in any event by the close of business the next business day following receipt. Also, these firms will be required to maintain a prudent segregation of client money (which we are calling a 'clearing arrangement mandatory prudent segregation amount' ('**CAMPSA**')) in their client bank accounts to address the risk that on any given day insufficient client money is held in client bank accounts as a result of the client money element of the mixed payment being received into, and held for a period in, the house account.
- 7.122** To ensure that the CAMPSA is segregated effectively such that it legally becomes part of the client money trust, firms will be required to create and maintain an 'clearing arrangement mandatory prudent segregation record'. This will record the dates on which the firm determines each CAMPSA amount and these amounts, the dates and amounts of payments into and withdrawals from client bank accounts to adjust the CAMPSA and the fact that the payment or withdrawal was made in accordance with the CAMPSA rules. Firms will be required to review the CAMPSA that they hold at least quarterly. This means that a firm will be required to repeat and complete the process of determining the CAMPSA and paying any additional amounts of its own money into the client bank account as part of an amended CAMPSA (or removing any excess, as the case may be) at least on a quarterly basis. Firms will have a period of ten business days to carry out each review and complete any adjustments to the CAMPSA in the client bank

account. The final rules will not prevent firms from carrying out this review more frequently. From the feedback we have received, we understand that this issue is likely to impact a number of firms. However, while firms and CCPs are in the process of finalising their arrangements to become EMIR compliant, it is unclear how many CCPs will impose these arrangements on firms and the proportion of clearing business that will be impacted. With this in mind we have been unable to estimate a cost to firms of this rule change. However, we expect that by allowing clearing member firms this 'carve out' from the immediate segregation requirement we are reducing the regulatory burden on these firms compared to the CP as, in this context, firms will not be required to restructure their arrangements to ensure that client money is received into a client bank account. In addition, these firms will be permitted more flexibility than under the proposal in the CP which may have prevented firms from providing client money protection in this business. To ensure the benefits as set out in the CP are achieved we are minimising the risks to client money from being held in a house account by requiring firms that use this carve out to prudently segregate. Through supervisory work we are aware that a number of firms carrying out clearing on behalf of clients currently prudently segregate in relation to this business.

Interaction with the DvP window for transactions in commercial settlement systems

- 7.123** A respondent noted that under the proposed rules, in respect of sales transactions carried out by firms using the DvP window, client money received in settlement would need to be received into a client bank account pursuant to the immediate segregation requirements. They noted that the way that some commercial settlement systems operate, firms may need to receive settlement proceeds into their own account prior to making payments to clients or making payments into client bank accounts.

Our response

- 7.124** We have considered this feedback and acknowledge that this is how some commercial settlement systems operate. As a result, the final rules clarify that client money received in settlement of a client's sale that a firm carries out through a commercial settlement system using the DvP window must be paid segregated promptly and in any event by the close of business on the business day following receipt into a client bank account.

Qualifying Money Market Funds (QMMF)

Q24: *Do you agree with our proposed clarification of how client money segregated into units in a QMMF should be treated? If not, please provide reasons.*

- 7.125** We consulted on clarifying how units in a QMMF should be held and recorded by the firm and how they should be treated in the event of a firm failure.
- 7.126** The consultation process revealed some challenges to the clarifications being proposed under the constraints of MiFID. In light of these challenges, we will not be making the proposed amendments at this time, but will keep this matter under review.

- 7.127** In the context of the 20% limit on the intra-group holdings we have amended the definition of a relevant group entity so that it no longer refers to a QMMF or an entity operating or managing a QMMF (discussed above).¹³³

Physical receipts and allocation of client money

Q25: *Do you agree with our proposals in relation to physical receipts and the allocation of client money? If not, please provide reasons.*

Paying physical receipts into a client bank account

- 7.128** We proposed that firms who receive physical payments of client money such as cash and cheques should record their receipt immediately and deposit the client money in a client bank account promptly and no later than on the business day after the money has been received. The proposals also made it clear that if a firm needs to hold cash or a cheque overnight, it must hold it in a secure location in line with Principle 10.
- 7.129** We received some feedback that where firms are taking on new clients, they may receive a cheque from a client before having carried out the required 'know-your-client' procedures and checks under the Money Laundering Regulations ('MLRs') and that in those instances a firm may not be permitted under the MLRs (or other legislation) to pay the money into a client bank account by the next business day following receipt in accordance with the proposal.

Our response

- 7.130** We are introducing these rules largely as consulted. However, the final rules make it clear that where a firm is unable to meet the requirement to pay a cheque into a client bank account no later than the business day after receipt because of restrictions under the regulatory system or law regarding the receipt and processing of money (such as the MLRs), it must record the receipt, hold the cheque in a secure location and deposit the cheque as soon as possible.
- 7.131** The final rules now set out explicitly how firms should treat post-dated cheques that they receive and do not return to clients. If a firm receives a post-dated cheque, the final rules allow a firm to keep the cheque in a secure location, but the firm must record receipt of the money in its books and records and the cheque must be deposited in a client bank account by no later than the date on the cheque (if that is a business day or, if not, the next business day after the date on the cheque).
- 7.132** The final internal client money reconciliation rules also now provide guidance on the treatment of cheques received but not yet deposited in a client bank account (discussed below¹³⁴).

¹³³ At para. 7.83.

¹³⁴ At para. 7.275.

Cleared funds

- 7.133** In the CP we proposed to set out explicitly in the rules that firms cannot carry out business for a client using that client's client money until that money has cleared into a client bank account. We noted further that while firms may use their own money to fund clients' transactions, they may not use one client's money to fund other clients' transactions; that is, Peter's money should not be used to pay for Paul's transactions.
- 7.134** We received a considerable amount of feedback on this proposal. The majority of respondents agreed with the principle that 'Peter's money should not be used to pay for Paul's transactions'. However, a large number of firms asked for clarification of what we mean by 'cleared' noting that this term meant a number of different things to banks. Firms asked for clarification as to whether we intended that clients could not *trade* before their funds cleared into client bank accounts or whether their trades could not be *settled* before that time. A number of firms noted that this rule would require them to be able to monitor receipts into bank accounts on a real time basis and that neither the firms' nor the banks' systems were capable of this.

Our response

- 7.135** We are pleased that firms agree with the principle that one client's money should not be used to pay for another client's transactions as it is a principle that is fundamental to the client money rules.
- 7.136** Having considered the feedback we agree that in practice it will be difficult for firms to determine precisely when clients' funds have been received into a client bank account and be available for use. We have revised the rules so, instead of creating a general restriction on the ability of firms to undertake business for clients with their money until that money has *cleared* into a client bank account¹³⁵, the final rules set out explicit guidance that states that a firm should ensure its organisational arrangements are adequate to minimise the risk that client money held by the firm may be paid for the account of a client whose money is yet to be received by the firm.¹³⁶ These organisational requirements may include firms considering the amount of time it may take for different types of payments (e.g. credit card payments, automated payments and cheques) to become available to the firm for use, taking these periods into account when setting up systems and establishing safeguards to ensure that payments out of client bank accounts do not take effect before the relevant amount of client money has become available for use. The final rules also reiterate that the statutory trust does not permit a firm to use client money to advance credit to the firm's clients, to itself, or to any other person.¹³⁷
- 7.137** As set out in the CP, the rules do not prohibit firms using their own money to fund clients' trades (for example, before receiving funds from clients). If the firm wishes to do this through the client bank account, it may be able to make use of the prudent segregation rules to mitigate the risk of using one client's money for another client's trades. It may instead wish to do so directly from its own bank accounts.
- 7.138** The CBA in the CP set out that there would be no material costs associated with this proposal. We received some feedback that there would be costs associated with being required to monitor transactions through a client bank account on a real time basis, and that due to the fact that firms would be unable to monitor their client bank accounts on a real time basis, this would mean that firms would be required to fund their client bank accounts on an intra-day

¹³⁵ See CASS 7.4.22AR as proposed in the CP.

¹³⁶ See CASS 7.12.3G in Part 3 of the final rules in Appendix I.

¹³⁷ See CASS 7.17.5G in Part 3 of the final rules in Appendix I.

basis using firm money and that this would come at a cost that did not appear to have been taken into account in the CBA. We have taken on the feedback that firms' and banks' systems are not capable of such 'live' monitoring and this is not something that the final rules require. Nor do they *require* firms to fund a client bank account with firm money on an intra-day basis, so these costs will not arise as a result of the final rules.

- 7.139** Where a firm agrees that it will carry out transactions for clients in advance of receiving money from those clients, firms will be able to carry out those transactions for clients using their own monies, but they will not be able to do so using other clients' money.
- 7.140** These changes mean firms should not, as a result of this proposal, incur any incremental compliance costs they might have incurred through monitoring client bank accounts for *cleared* funds, and through the final rules reinforcing existing principles, we do not consider that the amended proposal increases incremental compliance costs to firms compared to those outlined in the CBA published in the CP. The benefits of the proposal, that is ensuring that one client's money is not used for another's trades, are being delivered through providing guidance on existing requirements and reinforcing trust principles.

Allocation of client money receipts

- 7.141** We consulted on requiring firms to allocate client money to the relevant clients within five business days of receipt. We also consulted on permitting firms to treat any 'unidentifiable' receipts of money as client money if they consider it prudent to do so while taking steps to identify if the money belongs to the firm or its clients.
- 7.142** A number of respondents raised that requiring firms to allocate all client money within five business days of receipt would be difficult given that firms are often reliant on receiving the information necessary to allocate receipts from third parties and this information is not always provided in a timely fashion. A number of respondents noted that while in many cases they may be able to allocate within five business days, in the cases where they could not, they did not want to breach the rule and that the existing ten business days for allocation was more reasonable.

Our response

- 7.143** We have amended the proposal in response to feedback. Under the final rules firms will be required to allocate client money receipts promptly, and in any case, within ten business days of receipt of the money, and record this money as 'unallocated client money' while working to allocate the payment. Where a firm is unable to identify money it receives as client money, the final rules will permit firms to treat this as 'unidentified client money' in accordance with the client money rules while taking all necessary steps to identify the money as belonging to the firm or its clients.
- 7.144** In light of the feedback that in many cases firms will be able to allocate within five business days of receipt and that the final rule will still require firms to allocate client money promptly, we do not believe that the amendment to allow firms a maximum period of ten business days to allocate client money will reduce the benefits to clients from the package of proposals consulted on in the CP.

Money due to a client from a firm

- 7.145** We consulted on amending the guidance in the client money segregation rules that relates to the payment by a firm of money to a client when it becomes due.¹³⁸ We consulted on making the guidance into a rule and clarifying what steps a firm must take to segregate client money for a client if a liability to the client arises.
- 7.146** A few respondents asked for clarification of this rule. One respondent noted that the proposed rule no longer referred to the normal approach but captured firms carrying on all designated investment business and queried whether this would bring firms previously out of scope, for example those firms using the banking exemption, into scope of the rules. Another queried whether this would capture overpaid fees.

Our response

- 7.147** We have considered the feedback and are not proceeding with the proposed amended wording. However, given that firms should segregate monies that become due to clients in line with this provision, we will carry forward our proposal to make this into a rule (rather than guidance).

Prudent segregation of client money

Q26: *Do you agree with our proposals to clarify the proper use of prudent over-segregation of client money? If not, please provide reasons.*

- 7.148** In the CP we consulted on clarifying the process firms should follow when they assess that it would be prudent to segregate an additional amount of money in a client bank account in respect of certain identifiable risks. We proposed that a firm would be required to establish a written policy approved by its governing body setting out the types of risks it would address through use of prudent segregation. We also proposed that a firm should make a written record of why a payment made under the rule is a reasonable estimate of the risk to which it relates and that the money so paid will be client money. We also set out guidance on the types of risks that a firm may wish to address by prudently segregating such as to address the risks of a systems failure or the costs that may be borne by the client money pool following firm failure. We also proposed a process for removing amounts previously prudently segregated from client bank accounts.
- 7.149** A number of respondents welcomed the clarification that the use of prudent segregation is acceptable.
- 7.150** A few respondents suggested ways that the written prudent segregation policy could be enhanced. Other respondents requested clarification of the way that amounts prudently segregated should be calculated. A respondent asked whether the amounts prudently segregated should be included in firms' daily reconciliations. A few respondents queried whether the amounts prudently segregated need to be linked to specific risks or whether an amount could be linked to risks generally.

¹³⁸ Existing CASS 7.4.29G and CASS 7.13.39R in Part 3 of the final rules in Appendix I.

- 7.151** Some respondents stated that allowing firms to prudently segregate amounts in relation to costs of firm failure would give rise to problems such as challenge from creditors and inconsistency among industry participants about how much to segregate in respect of this.

Our response

- 7.152** The final rules include further detail on the contents of the policy document and the requirements to keep records of all prudent segregation payments made. In addition to setting out the specific risks that would be prudent for the firm to address through prudent segregation, the final rules require the written policy to set out why the firm considers the use of prudent segregation is a reasonable means of addressing each risk and the method that the firm will use to calculate the amount segregated to address each risk.
- 7.153** In response to feedback and to ensure that amounts prudently segregated legally become part of the client money trust, we have amended firms' recordkeeping requirements under this rule. Firms will be required to maintain a 'prudent segregation record' relating to segregation payments made into a client bank account and amounts withdrawn when no longer necessary under the relevant rules. The document will record amounts of payments and withdrawals, why such payments or withdrawals are made, that each payment or withdrawal was made in accordance with the policy and the relevant client money rules and the total amount of client money segregated pursuant to the rules. This record must be retained for a period of five years after the firm ceases to prudently segregate.
- 7.154** In terms of the calculation of the amounts that firms prudently segregate, due to the variety of risks that firms may wish to address using this rule, it is for firms to determine the best way of calculating the prudent segregation amount in relation to each of these. The final rules require amounts prudently segregated to be included in firms' client money reconciliations.
- 7.155** The final rules require amounts that are prudently segregated to be linked to specific types of risks rather than risk generally. It is open to firms to consider that there are a number of risks in relation to which they wish to prudently segregate. However, the firm's policy should set out each risk, why the firm considers that prudent segregation is a reasonable means of addressing each risk and the method that the firm will use to calculate the amount segregated to address each risk. The total amount segregated should reflect the sum of these calculations. Firms will be permitted to prudently segregate for an ad hoc risk which its policy does not at that time cover but the policy must be created or amended as soon as reasonably practicable after the segregation. The final rules also make it clear that prudent segregation should not be used by firms as a substitute for accurate and timely record keeping in accordance with other requirements in the client money rules.¹³⁹
- 7.156** In response to feedback and in contemplation of the client money distribution rules review that we are carrying out later this year, our guidance on the types of risks that a firm may wish to address by prudently segregating does not include the costs that may be borne by the client money pool following firm failure. These issues and whether additional guidance on this point is merited will be considered as part of the client money distribution rules review later this year.

¹³⁹ For example, existing CASS 7.6 and CASS 7.15 in Part 3 of the final rules in Appendix I.

- 7.157** Finally, the maintenance of a prudent segregation record may impose minimal incremental costs on firms. We consulted on a requirement to make a written record of why payments made pursuant to the rule are reasonable estimates of the risks they address and that the money so paid will be client money. The prudent segregation record expands on this by requiring firms to keep a more detailed, separate record. Please refer to Annex 1 for an estimate of the costs associated with creating and retaining this record.

Alternative approach

Q27: Do you agree with our proposals in relation to the use of the alternative approach to client money segregation? If not, please provide reasons.

- 7.158** In 2012 the CASS Unit undertook research into firms' uses of the alternative approach to client money segregation (the '**alternative approach**') which has informed our final rules in this area.

Firms' use of the alternative approach

- 7.159** We consulted on requiring firms, prior to adopting the alternative approach to client money segregation, to:
- a.** establish and document its reasons for using the alternative approach on a per-business line basis prior to first adopting the alternative approach for a particular business line;
 - b.** notify the FCA three months in advance of its intention to adopt the alternative approach; and
 - c.** obtain a report from an independent auditor in respect of the firm's proposed use of the alternative approach.
- 7.160** We also consulted on requiring firms to review at least annually its reasons for continuing to operate the alternative approach. Once firms have carried out this annual review, where firms determine that their reasons for using the alternative approach for a particular business line are no longer valid, we consulted on requiring firms to stop using the alternative approach for that business line within three months.
- 7.161** A few respondents commented that the use of the alternative approach should not be limited to large investment banks.
- 7.162** A few respondents commented on the per-business line basis of these proposals. For example, a respondent queried whether our intention was for firms to carry out this assessment on a per-business line basis; others asked for a definition of business line and another suggested that the per-business line approach would add complexity where firms were using the alternative approach for some business lines and not others. We also received feedback that if an annual review revealed that a firm's reasons for using the alternative approach were no longer valid, given the changes to firms systems and controls that would be required to transition from the alternative approach to the normal approach, three months would be insufficient to make those changes.

- 7.163** One respondent commented that it was not clear from the CBA published in the CP what costs a firm might incur as a result of being required to move from the alternative approach to the normal approach as a result of this proposal. In carrying out the costs survey to feed into the cost benefit analysis, none of the respondents fed back that they anticipated having to move from using the alternative approach to the normal approach as a result of the proposal or cited costs associated with this. Similarly, no respondents to the CP stated that they considered that they would move to the normal approach as a result of the proposal.

Our response

- 7.164** Under the final rules, both those firms already using the alternative approach and any firms wishing to use it in the future will need to establish and document their reasons (as set out in the final rules) for using the alternative approach for a particular business line. The rationale for this is that while the use of the alternative approach may be appropriate for one business line, it may not be appropriate across the whole business. Under the current rules firms are permitted to operate the alternative approach for some types of business and the normal approach for others as long as they can demonstrate that their systems and controls are adequate. This rule change is an extension of this. We have not provided a definition of 'business line' as what constitutes a business line will differ from firm to firm and in some cases the approach may be suitable for the whole of the firm's business.
- 7.165** In the final rules, as consulted, a firm will be required to review at least annually its reasons for continuing to operate the alternative approach for each business line. In response to feedback, we have amended the final rules so that once a firm has carried out this annual review, we allow firms a maximum of six months (rather than three months) following the review to stop using the alternative approach if that is what the firm's own review determines to be appropriate (for example if the risks associated with the business line have changed). We expect the process for a firm to stop using the alternative approach and instead use the normal approach will involve a firm making a number of changes including changes to systems and processes to ensure that client money is received directly into client bank account, communications with clients and third parties to ensure that payments are made into the correct account, changes to the internal client money reconciliation process and ceasing calculating and maintaining an alternative approach mandatory prudent segregation amount. This increase in time from three to six months recognises that for some firms this will be a more lengthy process than for others so we are allowing all firms a maximum of six months.
- 7.166** We have not provided an estimate of the costs to firms of transitioning from the alternative to normal approach given that the costs depend on a number of factors that make it difficult to provide a reliable per firm cost estimate. For example, costs of transitioning will vary depending on the type of firm, their business model, whether they operate a normal approach for other business lines and the size of their client money holdings. However, when engaging with firms to understand the cost of this rule change, no firm indicated that it would stop using the alternative approach and as such we expect the estimated incremental costs from this rule change outlined in the original CBA to still apply. To minimise the costs to firms of moving to the normal approach, where they have decided that it is appropriate, we have (as noted above) increased the time that firms are given to transition from the alternative approach to the normal approach reducing the regulatory burden on affected firms. We expect the benefits to clients to be only minimally reduced as the client money will continue to be protected but will take six months rather than three to transition to a different approach to client money segregation that the firm has concluded is preferable under this rule.

7.167 In response to feedback, we will not be limiting the use of the alternative approach to large investment banks. We agree that there may be smaller firms that can justify using the alternative approach for particular business lines in accordance with the rules, however we would not generally expect this.

Auditor assurances – alternative approach

7.168 In relation to an auditor's report for a firm intending to operate the alternative approach to client money segregation, we consulted on requiring the report to be prepared on the basis of a reasonable assurance engagement, with the auditor opining on two matters:

- i. whether the firm's systems and controls are adequately designed to enable the firm to use the alternative approach effectively; and
- ii. whether the firm's proposed method of calculating and maintaining the 'cash buffer' is adequately designed to enable the firm to comply with the rules relating to the cash buffer. We received feedback on these proposals from both firms and auditors.

7.169 As with our proposals for auditor assurances around non-standard methods of internal client money reconciliation discussed below¹⁴⁰, we have continued to work with a group of industry representatives in finalising our requirements in this area.

7.170 From audit professionals, the main comments we received related to whether an auditor would be able to prepare the proposed reports on the basis of a 'reasonable assurance engagement'. Some auditors expressed concern that without seeing a firm's use of the alternative approach in operation they may not be able to provide the level of assurance proposed. These same respondents suggested that an opinion on design effectiveness should be restricted to a limited assurance engagement or an 'expert view' that is not an assurance engagement.

7.171 Others provided feedback on the drafting of the auditor's opinions set out in the CP. This included suggestions that the opinions given be reworded to refer to design 'suitability' instead of design 'adequacy'. A few respondents already operating the alternative approach remarked that in their view the existing annual CASS audit requirements should be sufficient, while others felt that any new audit report requirements should be 'rolled into' the work conducted as part of the work carried out on the firm's first annual CASS audit following implementation of the rules.

Our response

7.172 First of all, the terminology in the final rules has changed and the rules now refer to a 'mandatory prudent segregation amount ('MPSA')' rather than a 'cash buffer'.

7.173 Both those firms currently using the alternative approach and those wishing to use it for a business line in the future will be required to obtain a report from their auditor before operating the alternative approach to client money segregation. For those firms already using the alternative approach the reasons for this stem from the fact that the amended rules impose new requirements on these firms.

¹⁴⁰ At para. 7.233.

- 7.174** These firms will now be required to assess whether the use of the alternative approach for each business line is appropriate. Each firm will also be required to calculate and maintain a MPSA in relation to each business line for which it uses the alternative approach. As a result of the new requirements, a firm may need to change its existing systems and controls around the use of the alternative approach, including around the maintenance of the MPSA, which will necessitate a new auditor's report prepared in accordance with these rules.
- 7.175** This report will be prepared on the basis of a reasonable assurance engagement.¹⁴¹ We understand this is achievable under the FRC's definition of a reasonable assurance engagement. Nothing in these rules stipulates what steps an auditor must take to be able to provide firms with the report on the basis of a reasonable assurance engagement. We understand it is likely that many firms will need to have designed their processes and to have built test systems before an auditor feels able to provide the report. However, the specific steps an auditor may need to follow, and the matters which a firm may need to address before the auditor a reasonable assurance report, are matters for the auditor's professional judgment as governed by the requirements and standards imposed on the auditor by its regulator.
- 7.176** We will expect an auditor to have regard, where relevant, to standards and guidance issued by the FRC that specifically address these types of report. To this end, we will continue to work with the FRC and with auditors in respect of the further development of such standards and guidance.
- 7.177** An auditor's report prepared as an 'expert view' or on the basis of a 'limited assurance engagement' does not provide us with the level of assurance necessary. As with our new requirements for non-standard methods of internal client money reconciliation¹⁴², we are requiring this report to ensure each firm's proposed approach to operating the alternative approach, and in particular their development and maintenance of a cash buffer, is independently reviewed.
- 7.178** Based on feedback, we have also amended our rules to more closely reflect the drafting of the specific opinions we expect auditors to provide. This includes revisions to clarify that the auditor will be opining on whether a firms' proposed use of the alternative approach, including its proposed calculation and maintenance of a MPSA, is 'suitably designed' to achieve compliance with our requirements.
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Obtaining revised auditor reports

- 7.179** We consulted on requiring a firm to obtain a revised auditor's report if it changes the way it uses the alternative approach.
- 7.180** Some respondents asked for clarification of the types of changes that would trigger a requirement to obtain a new auditor report.

¹⁴¹ Similar to our new requirements for an auditor's report before a firm operates a non-standard method of internal client money reconciliation, discussed below at paras. 7.236 to 7.240.

¹⁴² Discussed below at para. 7.239.

7.181 In the final rules, we only require a firm to obtain a new auditor's report in the circumstances in which it changes the way that it calculates and maintains its MPSA. There are two parts to the auditor report under this rule:

- i. one part covering whether the firm's systems and controls are suitably designed to enable the firm to comply with the alternative approach rules (including the rules relating to the MPSA); and
- ii. the second part covering whether MPSA the firm will calculate and maintain is suitably designed to enable the firm to comply with the rules relating to the MPSA.

7.182 The proposal to require a firm to obtain a revised auditor opinion as a result of a change in the way it uses the alternative approach was intended to protect against the risk that if a firm were to alter the way it uses the alternative approach, the assurance from the auditor that the firm's systems and controls and its MPSA proposal were suitable to comply with the relevant rules would no longer be valid and so client money could be at risk. We take on board the feedback that the proposed rule applied to any change rather than purely 'material' changes.

7.183 The final rules state that a firm must not materially change how it will calculate and maintain its MPSA unless it has first obtained a revised auditor's report in accordance with the rules, narrowing the scope of the requirement to obtain a revised opinion from that consulted on. If a firm wanted to use the alternative approach for an additional business line it would be required under the final rules to obtain an auditor's opinion covering that business line. Given the fact that for business lines in relation to which a firm is already using the alternative approach the firm must assess for itself at least each year that it has adequate systems and controls to enable it to operate the alternative approach, we have agreed that firms will not be required to obtain a revised opinion for each change to its use of the alternative approach. However, the principal risks involved in firms' use of the alternative approach are those risks to client money that the rules address by requiring firms using this approach to maintain a MPSA. Given the importance of this MPSA to protecting client money, if a firm materially changes how it will calculate and maintain its MPSA, it will be required to obtain a revised report stating whether in the auditor's opinion the MPSA the firm will calculate and maintain is suitably designed to enable it to comply with the relevant rules.

7.184 Given our view that the risk that we aimed to address through requiring firms to obtain a revised systems and controls opinion are addressed through the other requirements under the rule, while the ongoing costs to firms of the proposal may be reduced, the benefits remain the same.

Calculation and maintenance of a mandatory prudent segregation amount

7.185 We consulted on requiring firms using the alternative approach to maintain a MPSA sufficient to address the following two risks:

1. the intra-day risk of client money being held in a firm's own account; and
2. the risk of the firm failing to identify for a period of time that money received into its own account is in fact client money ('**unidentified credits**').

Under the proposed rules, firms would be required to use the previous three months' trading records to calculate the MPSA and to review the MPSA amount at least quarterly.

- 7.186** We received feedback from firms, industry associations and auditors requesting more guidance on how this mandatory MPSA should be calculated and clarification on how and when firms should review their MPSAs.

Our response

- 7.187** Under the final rules, firms using the alternative approach for a particular business line will be required to calculate and maintain a MPSA for the forthcoming three months. In response to feedback, we have included some further detail on the information that firms should use to calculate a MPSA. A firm must take into account the client money requirement, the daily adjustment payments that the firm makes into, or removes from, its client bank account and the unidentified credits over at least the previous three months as shown in its internal client money records. Also a firm must take into account the impact of any particular events, the seasonal nature of a business line or any other aspect of a business line on the client money requirement, the daily adjustment payments that the firm makes into its client bank account and the unidentified credits over the forthcoming three months.
- 7.188** In the final rules, firms will be required to review the MPSA that they hold at least quarterly. This means that firms will be required to repeat and complete the process of determining the MPSA and paying any additional amounts of its own money into the client bank account as part of an amended MPSA (or removing any excess, as the case may be) at least on a quarterly basis. We have clarified that firms will have a period of ten business days to carry out each review and complete any adjustments to the MPSA in the client bank account. The final rules will not prevent firms from carrying out this review more frequently.
- 7.189** Finally, to ensure that the MPSA is segregated effectively such that it legally becomes part of the client money trust, we have amended firms' record keeping requirements under this rule to require them to create and maintain an 'alternative approach record'. This record will record the dates on which the firm determines each MPSA amount, the dates and amounts of payments into and withdrawals from client bank accounts to adjust the MPSA and the fact that the payment or withdrawal was made in accordance with the MPSA rules. We expect that the creation, maintenance and retention of this record will impose minimal incremental costs on firms compared to what we consulted on (we are only expanding on the record keeping requirements we already consulted on). As set out in Annex 1 we expect the incremental compliance costs of creating, maintaining and retaining records to be minimal.

Intra-day adjustments

- 7.190** We consulted on permitting firms using the alternative approach to adjust the balance of client money they hold in client bank accounts before completion of a client money reconciliation.
- 7.191** There was mixed feedback on this aspect of the proposal with some respondents welcoming it and others noting that permitting intra-day adjustments in this way may lead to firms withdrawing money and thereby putting clients at risk.

Our response

- 7.192** We are implementing the proposal largely as proposed in the CP but adding some clarifications to the relevant rules. During the course of carrying out its internal client money reconciliation (on T0) the rules will permit a firm to increase the balance held in its client bank accounts if

(and only if) the firm reasonably expects the client money requirement for the previous business day (T-1) will increase above the client money resource currently (at T0) held in the client bank accounts. The firm may only form such expectations on the basis of the internal client money reconciliation calculation that it is in the process of carrying out (relating to T-1).

- 7.193** Similarly, if on the basis of the internal client money reconciliation calculation that the firm is in the process of carrying out on T0 (relating to T-1), the firm reasonably expects the client money requirement for the previous business day (T-1) to decrease below the client money resource currently (at T0) held in the client bank accounts, the firm may make intra-day transfers out of the client bank accounts. However, in doing so, the firm must act prudently and manage the risk of not having segregated sufficient client money resource that reflects its actual client money requirement.
- 7.194** If a firm chooses to make intra-day transfers under this rule, the transfers must be linked to the internal client money reconciliation calculation that it is in the process of carrying out.
- 7.195** As set out in the rules, we would expect that, where used, such intra-day transfers will be used by firms that maintain client bank accounts in a number of different time zones and making adjustments to balances in client bank accounts in different time zones is dependent on meeting money transfer cut off times in those different time zones.

Transitional provisions

- 7.196** A number of respondents stated that a six month implementation timetable would be insufficient for firms to assess on a per-business line basis their use of the alternative approach and make any consequential systems and controls changes.

Our response

- 7.197** Please refer to the Table 2 in Chapter 2. All of our new rules relating to the alternative approach to client money segregation will enter into force from 1 December 2014. However, under a transitional provision, firms that are operating an alternative approach on for a particular business line on 30 November 2014 will be allowed to continue to comply with the existing requirements until 1 June 2015 in relation to those business lines. Firms that are not operating the alternative approach on the 30 June 2014 (or firms that wish to start using the alternative approach for a business line in relation to which they had not previously used the approach) will be subject to these new rules from 1 December 2014 and will need to be fully in compliance with them from this date. Firms will be permitted to provide us the notifications and auditor's report required under the changes being introduced in this PS before operating the alternative approach and we expect that by 1 June 2015 all firms that intend to continue after this date to operate the alternative approach to client money segregation will be in compliance with these new requirements (including their obligations to have provided us the requisite notifications and auditor's reports in advance of this deadline).

Client money held by third parties

Q28: *Do you agree with our proposal to clarify the requirements around how a firm should treat client money transferred to a third party? If not, please provide reasons.*

- 7.198** In the CP we proposed to clarify that, if a third party holds money for a client of the firm (rather than a client of the third party), that money remains client money of the firm and the firm should include the amount in its internal client money reconciliations. We also proposed re-emphasising guidance in CASS 7.5 that any client monies held at a third party should be held in a client transaction account and that the transactions for which the money has been transferred to the third party should be reasonably foreseeable.
- 7.199** The majority of respondents agreed with this proposal. However, a number of respondents had specific comments.
- 7.200** A few respondents commented that this rule¹⁴³ needs to recognise that client money may be held by third parties for transactions generally rather than for specific transactions.
- 7.201** A number of respondents also commented that the proposed rules did not appear to include any amendments to require firms to include amounts held in client transaction accounts at third parties in their internal client money reconciliations. Other respondents noted that this rule would require firms to obtain balance information from third parties intra-day or on a live basis.

Our response

- 7.202** We are introducing these rules with only minor changes to reflect feedback. For example, final guidance makes it clear that firms may allow another person to hold client money for both contingent liability investments and non-margined transactions for a client. The final guidance also clarifies that a firm may allow another person to hold client money under these provisions only for transactions that are likely to occur and for which that other person needs the client money to carry out the transaction or in relation to transactions which have recently settled such that the other person has recently received client money as settlement proceeds.
- 7.203** Firms will also continue to be required to include sums of client money that they allow another person to hold in a client transaction account when undertaking an internal client money reconciliation. Our revised rules for standard methods of internal client money reconciliations include guidance that confirms this approach, including a confirmation that a firm should be using the values contained in their internal records and ledgers to determine the balances of client money a firm has allowed a third party to hold in a client transaction account.¹⁴⁴ Firms will not be required, as a consequence of this rule, to obtain balance information from the relevant third parties on either an intra-day or on a live basis in order to carry out an internal client money reconciliation.

¹⁴³ See proposed CASS 7.5.2AG in the CP.

¹⁴⁴ At para. 7.221.

Client money relating to custody assets at custodians

Q29: Do you agree with our proposal to allow firms to hold client money in client transaction accounts at custodians? If not, please provide reason

- 7.204** In the CP we proposed that firms that hold custody assets and deposit these with third parties must recognise any money derived from these assets as client money (where appropriate). The money should therefore be held in a client bank account in the name of the firm. This could be at the custodian itself if the custodian is a bank. We proposed that as an alternative, the firm and the third party can establish their contractual agreement to cover the holding of client money by the third party in a client transaction account showing that it is holding the monies on behalf of the firm's clients. The proposals also noted our existing guidance that excess client money should not be held in a client transaction account.¹⁴⁵ Rather, the firm should arrange for such excess money to be transferred back to the firm when appropriate.
- 7.205** A number of firms asked for clarification that the policy intention was not to bring entities that use the banking exemption into the client money rules, for example, custodians that also have a banking licence.

Our response

- 7.206** The final rules makes it clear that if a firm has deposited custody assets with a third party under our custody rules¹⁴⁶ and money arises in connection with those assets the firm should treat that money as client money unless otherwise agreed. Where the third party custodian is also a bank, the firm may arrange for the client money to be held in a client bank account (from the perspective of the firm rather than the third party custodian) at the third party custodian itself or with another bank. Where the third party custodian is not a bank, the firm may arrange for the third party custodian to deposit the money in a client bank account (at a third party bank) or in a client transaction account. If firms are using the banking exemption they must have systems and controls to ensure they recognise this money as being held under the banking exemption, or if held by a third party, as client money.

¹⁴⁵ Existing CASS 7.5.3G.

¹⁴⁶ CASS 7.14.6R of Part 3 of the final rules in Appendix 1.

Client money recordkeeping and reconciliations

Q30: *Do you agree with our proposals in relation to internal and external client money reconciliations and notification and recordkeeping requirements? If not, please provide reasons.*

Overview

- 7.207** All investment firms that hold client money for clients are currently required to maintain their records in a way that ensures their accuracy and, in particular, their correspondence to the client money held for clients.¹⁴⁷ However, as noted in the CP¹⁴⁸, we continue to frequently identify instances of poor recordkeeping practices and firms with inadequate systems and controls in place to ensure the accuracy of their records. We observed that in many cases firms do not understand the current requirements around client money recordkeeping and reconciliations.
- 7.208** In this section, we discuss the changes and new requirements we are introducing to increase clarity around our requirements for recordkeeping, improve firms' practices and make certain that all firms have adequate systems and controls in place to ensure accuracy of their client money records.
- 7.209** The new rules in this PS will place additional recordkeeping obligations on all firms subject to our client money rules for investment firms. This includes a requirement for a firm to maintain its records in a way that allows it to promptly determine the total amount of client money it should be holding for each client. Under this rule, we expect that firms will need to ensure that they are able to determine the total amount of client money they should be holding for each client within two business days of having taken a decision to do so, or at the request of the FCA.
- 7.210** All firms will continue to be required to undertake each of the following processes, subject to certain changes set out in this PS, to ensure they comply with their recordkeeping obligations for client money (see also Diagram 3 below):

Internal client money reconciliations

- a reconciliation of a firm's internal records and accounts of the amount of client money the firm holds for each client with its internal records and accounts of the client money the firm should be holding in client bank accounts or has placed in client transaction accounts. A firm must use the internal reconciliation to either:
 - a. (when using the normal approach to client money segregation) check on a daily basis whether its client money resource, as at the close of business the previous business day, was equal to its client money requirement at the close of business on that previous day; or
 - b. (when using the alternative approach to client money segregation) ensure on a daily basis that its client money resource, as at the close of business on any day it carries out an internal client money reconciliation, is equal to its client money reconciliation at the close of business on the previous day.

¹⁴⁷ Existing CASS 7.6.1R and 7.6.2R and CASS 7.15.2R and 7.15.3R in Part 3 of the final rules in Appendix I.

¹⁴⁸ At paras. 4.108 and 4.109.

In either case, the:

- **'client money resource'** – being the aggregate balance on a firm's client bank accounts; and
- **'client money requirement'** – being the total amount of client money a firm is required to have segregated in client bank accounts under the client money rules.

The internal client money reconciliation may be performed by one of the standard methods or non-standard method:

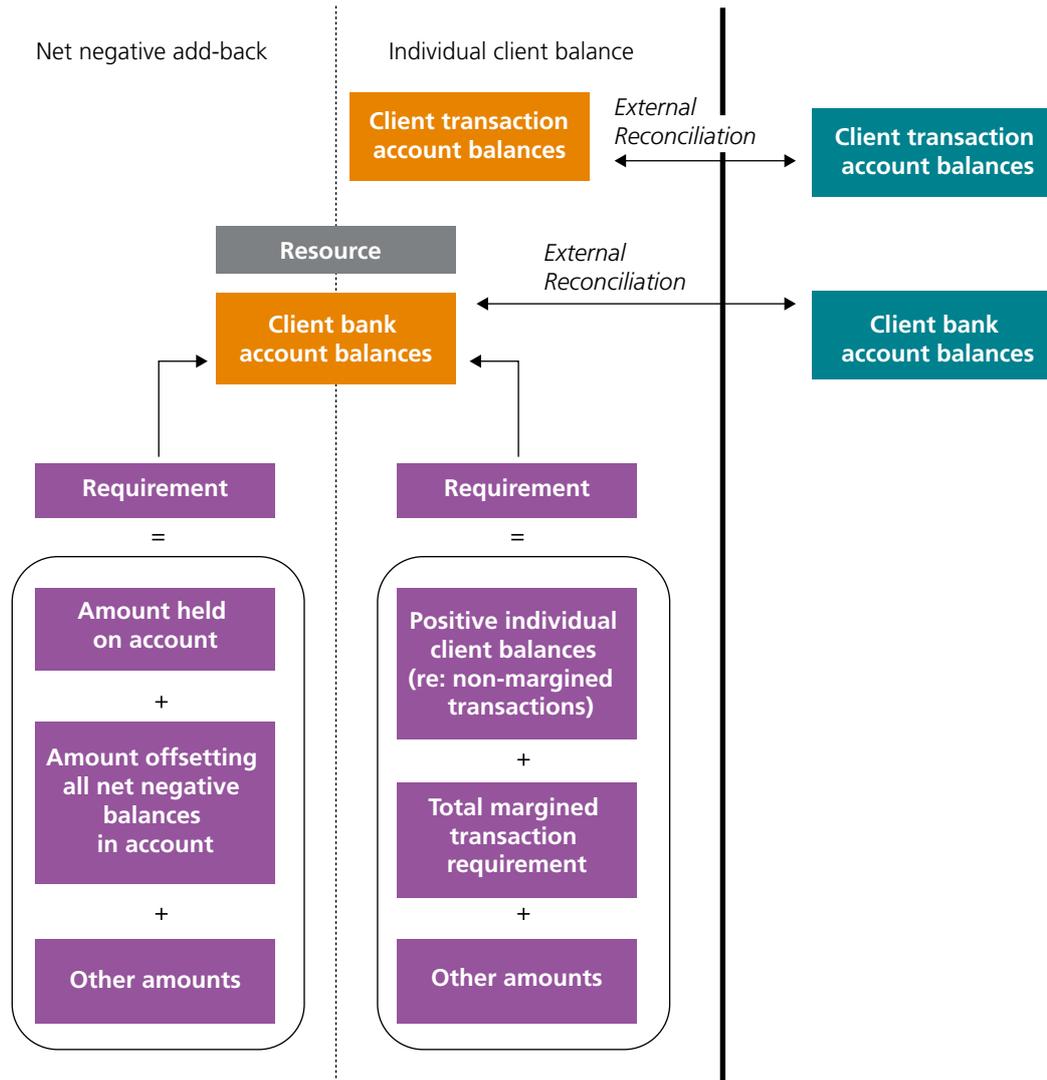
- **Standard methods of internal client money reconciliation** – the methods of reconciliation set out in our client money rules, which require a firm to calculate its client money requirement by one of two possible methods:
 - i. **Individual client balance** (available to all firms): requires a firm to calculate its client money requirement by reference to how much the firm should be holding in total for each of its individual clients with a positive balance in respect of non-margined transactions, margined transactions and certain other matters; or
 - ii. **Net negative add-back** (only available to CASS 7 asset management firms and CASS loan-based crowdfunding firms, and only when the firm does not engage in any margined transactions for clients): requires a firm to calculate its client money requirement by reference to the balances in each client bank account, adding any individual client's net position in a specific client bank account that is negative and certain other matters; or
- **Non-standard method of internal client money reconciliation** – this is a method of reconciliation that does not meet the requirements placed on firms undertaking one of the standard methods of internal client money reconciliation¹⁴⁹;

External client money reconciliations

- **External client money reconciliation:** this is a comparison of the balance, currency by currency, on each client bank account and client transaction account as recorded by the firm, with the balance on that account as set out in the most recent statement or other form of confirmation issued by the bank or person with whom the account is held.

¹⁴⁹ Existing CASS 7 Annex 1G and CASS 7.16 in Part 3 of the final rules in Appendix I.

7.211 Diagram 3 – illustrative example of the client money reconciliations a firm operating one of the standard methods of internal client money reconciliation may undertake:



- 7.212** Firms will be required to undertake internal client money reconciliations on a daily basis and external client money reconciliations whenever necessary but on at least a monthly basis. Both of these also require a firm to:
- a.** determine the reason for any discrepancy which arises between its client money requirement and client money resource which it identifies as a result of its internal client money reconciliation and address any associated shortfall or excess the same day it undertakes the internal reconciliation; and
 - b.** without undue delay investigate and take all reasonable steps to correct any discrepancy which it identifies as a result of its external client money reconciliation (segregating in the interim an amount of client money or approved collateral based on whichever record, or set of records, indicates a greater amount should be held by the firm).
- 7.213** We note separately that before a firm carries out a non-standard method of internal client money reconciliation it must first establish and document in writing specific matters, notifying us of its intentions and obtain and provide us with a copy of a written report opining on specific matters which has been prepared by an independent auditor of the firm.
- 7.214** We received feedback from approximately 60 respondents on our proposals for client money recordkeeping and reconciliations. Most respondents were broadly supportive of our proposals in this area and many stated that the revised rules represented best practice. Specific comments on the drafting of the proposed rules or requests for clarifications are summarised in the following sections.
- Internal client money reconciliations**
- 7.215** We consulted on rules requiring all firms to undertake an internal client money reconciliation on a daily basis. We proposed to define an internal client money reconciliation as a reconciliation between a firm's internal records and accounts of the amount of client money held for each client with its internal records and accounts of the client money that the firm should be holding in client bank accounts or have placed in client transaction accounts. We also introduced guidance on the purposes of an internal client money reconciliation.
- 7.216** Most respondents agreed that firms should undertake an internal client money reconciliation on at least a daily basis. A small number of asset management and private equity firms stated that a daily internal reconciliation would be unduly burdensome, arguing that the costs would not be justified in circumstances in which a firm may only hold client money or undertake transactions in client money on an infrequent basis. Respondents did not challenge the costs provided in the CBA. As such, we have not revised the costs set out in the CP.
- 7.217** One respondent disagreed with an internal client money reconciliation being characterised as a check that a firm operating the normal approach to client money segregation has segregated the correct amount of client money, noting that many firms will find that on any given day they need to top-up or reduce the balance in their client bank accounts as a result of having carried out the reconciliation.
- 7.218** Another respondent stated that the proposed rules for internal client money reconciliations should recognise that a firm's internal records for transactions in client money may be derived from information obtained from statements, electronic feeds or other forms of records from the bank with whom that money is deposited.

Our response

- 7.219** We are introducing these rules largely as proposed in the CP, requiring all firms to undertake an internal client money reconciliation on a daily basis. This requirement forms an important part of the steps a firm should be taking to ensure the accuracy of its client money records and that it has adequate arrangements in place for the protection of client money.
- 7.220** An internal client money reconciliation is also the means by which we expect a firm to check whether the amount of client money that it has recorded as being segregated in client bank accounts meets its obligations to clients, or, if the firm is operating the alternative approach to client money segregation, to calculate the amount of client money it should segregate in client bank accounts by the close of business on the day of the reconciliation. We recognise that there is a correlation between the number of transactions a firm undertakes and the likelihood that the firm will not have the correct amount of client money segregated at all times. However, whereas with the alternative approach to client money segregation the internal client money reconciliation is one of the ways by which a firm will determine how to comply with its segregation requirements (by calculating how much client money to segregate), a firm operating the normal approach to client money segregation should not rely on its internal reconciliation to achieve compliance with the client money segregation requirements (i.e. to determine whether or how much client money it should segregate). Instead, when operating the normal approach, the internal reconciliation should be used as an internal control to verify or otherwise determine whether the amount of client money the firm has segregated meets its obligations to clients under our rules. Where a firm determines that as a result of its internal client money reconciliation it has either too much or too little in its client bank accounts, a firm should identify the reason for that discrepancy and take measures as necessary to avoid that discrepancy from arising again.
- 7.221** In response to feedback, we are also clarifying that when a firm undertakes an internal client money reconciliation, it is required to use the values contained in its internal records and ledgers: a firm should not use values obtained directly from an external/third party's records. Consistent with this approach, we are also providing guidance to confirm that our rules require firms to keep internal records and accounts of the client money they hold. As a result, these records should be maintained by the firm and additional to any external records they might have access to or have otherwise obtained (discussed below¹⁵⁰).

Non-standard method of internal client money reconciliation

- 7.222** We consulted on continuing to allow firms to undertake a non-standard method of internal client money reconciliation, and clarifying that this method of internal client money reconciliation is one that does not follow the same process that would apply when undertaking one of the standard methods of internal client money reconciliation. This included proposals to maintain our existing requirements for firms to document the method of reconciliation they undertake, to carry out an assessment of the equivalency of the protections afforded to client money under that method in comparison with one of the standard methods and to obtain a report from an independent auditor before implementing the method¹⁵¹. We also proposed to clarify that any change in that firm's non-standard method would require the firm to repeat these steps before that change was implemented and to evidence that its amended non-standard method will provide an equivalent degree of protection as the standard methods.

¹⁵⁰ At paras. 7.259 to 7.266.

¹⁵¹ At paras. 4.114 to 4.115 of the CP.

- 7.223** Most respondents agreed that we should continue to allow firms to deviate from the standard methods of internal client money reconciliation. Some firms raised the point that although consistent with our current requirements, it was not entirely clear how a firm was expected to determine whether its non-standard method of internal client money reconciliation provided an equivalent degree of protection to the standard methods. A few of these same respondents suggested that it would be better if we clearly articulated the outcome we expected from a firm's use of a non-standard method.
- 7.224** Others questioned more generally how a firm was expected to determine whether a material change had or was going to occur to its non-standard method (triggering an obligation to complete a revised assessment of its proposed use of the method, obtain a new auditor's report on that method and notify us).
- 7.225** A number of respondents disagreed that an auditor needed to be involved in independently reviewing a firm's proposed processes for operating a non-standard method and suggested that any auditors' review of a non-standard method of internal client money reconciliation should be restricted to the auditor's work to prepare the annual auditor's client assets report for that firm.
- 7.226** Some questioned generally whether firms currently operating a non-standard method of internal client money reconciliation would be grandfathered for the purposes of the revised rules.

Our response

- 7.227** We are making the rules as proposed in the CP, but with two key changes.
- 7.228** First, when firms are assessing their current or proposed use of a non-standard method, we have clarified that a firm need not specifically opine on whether its non-standard method provides or will provide an equivalent degree of protection, rather the firm should consider whether the method achieves the same specified outcome as if the firm had used one of the standard methods. This includes considering whether the method will:
1. check whether the amount of client money recorded in the firm's records as being segregated in client bank accounts meets the firm's obligation to its clients under the client money rules on a daily basis (when using the normal approach to client money segregation); or
 2. calculate, on a daily basis, the amount of client money to be segregated in a client bank account which meets a firm's obligations to its clients under the client money rules (when using the alternative approach to client money segregation).
- 7.229** Second, we are also clarifying that only material changes (rather than any changes) to a firm's non-standard method of internal client money reconciliation will oblige the firm to repeat the steps required under our rules to use that method (i.e. carry out a new assessment and obtain and provide a new auditor's report to us). However, we are not providing any additional guidance on what change would be material, as this needs to be determined by the firm on a case-by-case basis and depends on different factors such as the firm's business model and how it operates its non-standard method.

- 7.230** We consulted on and are requiring firms to obtain an auditor's report which covers the firm's proposed use of a non-standard method before the firm makes use of that method. The purpose of this report is to ensure a firm's proposed method of internal reconciliation is independently reviewed to ensure it is able to operate the method in a way which will comply with our rules. The required annual auditor's client assets report¹⁵² is not a suitable alternative to this requirement, as this annual report would review a firm's non-standard method only after it has been implemented. Given the timing of the annual auditor's client assets report, there would also be the potential that the first independent review of the firm's new or amended method of internal client money reconciliation might not be undertaken for up to 16 months after the firm has started using that method. We do not expect the amendments to this proposal to have any CBA implications.
- 7.231** Finally, these new requirements for firms operating a non-standard method of internal client money reconciliation will come into force on 1 December 2014.¹⁵³ However, firms operating a non-standard method of internal client money reconciliation as of 30 November 2014 will have until 1 June 2015, or the date they materially alter their method of internal client money reconciliation, whichever is earlier, to comply with these new requirements (continuing to apply the existing requirements in the interim). All firms will also be permitted to comply with these new requirements for non-standard methods of internal client money reconciliation (including their obligations to provide us the requisite notifications and auditor's report) before the relevant rules coming into force, so long as when the relevant rules become mandatory for a firm, that firm is in compliance.

Auditor assurances – non-standard methods

- 7.232** Regarding an auditor's report for a firm intending to undertake a non-standard method of internal client money reconciliation, we consulted on requiring the report to be prepared on the basis of a reasonable assurance engagement. We also proposed in the CP to require the auditor to opine on whether:
- 1.** the firm's proposals for a non-standard method of internal client money reconciliation was adequately designed to provide an equivalent degree of protection to one of the standard methods of internal client money reconciliation; and
 - 2.** the firm's systems and controls were adequately designed to enable it to operate effectively the non-standard method the firm proposes to use.
- 7.233** In addition to the feedback we have received to the CP, we have also continued to work with a group of auditing professionals we convened to discuss our proposals generally around auditor assurances within CASS.¹⁵⁴
- 7.234** From the audit profession, we note the feedback was mixed as to whether an auditor would be able to prepare the proposed reports on the basis of a reasonable assurance engagement. Some auditors expressed concern that without seeing a method of reconciliation in operation they may not be able to provide the level of assurance proposed. These same respondents suggested that an opinion on design effectiveness should be restricted to a limited assurance engagement or an 'expert view' that is not an assurance engagement.

¹⁵² See SUP 3.10.

¹⁵³ At para. 2.9.

¹⁵⁴ Including our proposals for an auditor's report when a firm operates the alternative approach to client money segregation, discussed above at paras. 7.168 to 7.178. This advisory group represented the overwhelming majority of audit firms that currently report to us under the requirements in SUP 3.10 for an auditor's client assets report as well as representatives of the FRC.

- 7.235** Others provided feedback on the drafting of the auditor opinions set out in the CP. This included raising that it could be problematic for an auditor to opine on whether a method of reconciliation provides an 'equivalent degree of protection' to one of the standard methods of reconciliation, arguing that this was a legal question. Other respondents suggested the opinion should be reworded to refer to design 'suitability' instead of design 'adequacy'.

Our response

- 7.236** We are making rules that will require a firm to obtain a report from its auditor before engaging in a non-standard method of internal client money reconciliation. This report must be prepared on the basis of a reasonable assurance engagement. We understand this is achievable under the FRC's definition of a reasonable assurance engagement.
- 7.237** We also note that nothing in these rules stipulate what steps an auditor must take to be able to provide firms with these reports on the basis of a reasonable assurance engagement. We understand it is likely that many firms will need to have designed their processes and to have built test systems before an auditor feels able to provide us with the report. However, the specific steps an auditor may need to follow, and the matters that a firm may need to address before the auditor can provide a reasonable assurance report, are matters for the auditor's professional judgment as governed by the requirements and standards placed on the auditor by its regulator.
- 7.238** We also expect an auditor to have regard, where relevant, to standards and guidance issued by the FRC that specifically address these types of report. To this end, we will continue to work with the FRC and with auditors on the development of such standards and guidance.
- 7.239** We note that an auditor's report prepared as an 'expert view' or on the basis of 'limited assurance engagement' does not provide us with the level of assurance necessary. As discussed above¹⁵⁵, we are requiring this report to ensure firms are obtaining adequate professional advice in developing their reconciliation methods and so far as possible to ensure a firm's reconciliation method achieves the desired outcomes.
- 7.240** We have also amended our rules to more closely reflect the drafting of the specific opinions we expect auditors to provide. This includes revisions to clarify that the auditor will be opining on whether a firm's proposed non-standard method is 'suitably designed' and whether it would achieve a particular outcome (as set out in the rule) as opposed to a general opinion on whether the method is 'adequately designed' to provide an equivalency of protection. Nothing in the proposed rules was intended to imply that we expect auditors to provide a view on a legal question.

Standard methods of internal client money reconciliation

- 7.241** We consulted on restricting the availability of the '**net negative add-back method**'¹⁵⁶ for calculating a firm's client money requirement as part of one of the standard methods of internal client money reconciliation. These proposals were intended to ensure that only asset managers (i.e. those firms for whom the method was intended to accommodate when introduced into the FSA's Handbook in 2002¹⁵⁷) were allowed to use the net negative add-back method and

¹⁵⁵ At paras. 7.177.

¹⁵⁶ See existing para. 6(2) of CASS 7 Annex 1 G and CASS 7.16.17R in Part 3 of the final rules in Appendix I.

¹⁵⁷ CP130 Miscellaneous amendments to the Handbook (No. 1)(March 2002)(para. 4.92 *et al.*), available at www.fsa.gov.uk/pubs/cp/cp130.pdf.

that firms undertaking margined transactions (i.e. derivative transactions) were prohibited from using the method as part of the standard methods of internal client money reconciliation.

- 7.242** We also consulted on replacing all of our existing guidance around the standard methods of internal client reconciliation with new rules and guidance. This included the creation of a new sub-chapter, CASS 7.16¹⁵⁸, and a number of revisions to the existing provisions to improve clarity and address potential inconsistencies.

Restrictions on the use of the net negative add-back method

- 7.243** A large number of respondents (mostly representing asset management firms) provided feedback on our proposals to restrict the availability of the net negative add-back method of calculating a firm's client money requirement as part of standard method of internal client money reconciliation. The feedback was generally focused on whether the proposed rules achieved the intended policy, including drafting comments and questions on whether specific types of asset management firms would continue to be allowed to use the net negative add-back method¹⁵⁹. A small number of respondents noted our proposals meant that firms which were previously regulated by IMRO would continue to be allowed to use the method, but questioned whether firms that came into existence after IMRO ceased to exist would also be allowed to use the net negative add-back method as one of the standard methods.

- 7.244** A small number of respondents disagreed with the proposals stating it was unfair that other types of firms may not be allowed to use the method, including banks or other firms which may have one business line that provides asset management services. Others argued that instead of limiting the availability of the method, we should provide guidance on the 'correct' application of the method.

- 7.245** One respondent suggested we should abolish the net negative add-back method in its entirety, noting that the method presupposes that the balance on each client bank account is an accurate and reasonable starting point for an internal reconciliation without separately obliging the firm to prove that the balance is appropriate by reference to client entitlements (in the way that the individual client balance method would otherwise necessitate). Another respondent highlighted that one of the perceived benefits of the net negative add-back method was the ability for a firm to calculate its client money requirement on an account-by-account basis, and suggested that if the net negative add-back method were ever removed from the client money rules, we should consider allowing firms using the individual client balance method to calculate their client money requirement on an account-by-account basis.

- 7.246** We also note the proposal in CP13/13¹⁶⁰ and final rules in PS14/4¹⁶¹ and Handbook Notice 10¹⁶² which prevent firms from using the individual client balance method as part of the standard methods of internal client money reconciliation for loan-based crowdfunding business.

¹⁵⁸ See proposed CASS 7.6A in the the CP.

¹⁵⁹ This includes questions raised in respect of ISA managers, platform providers, Unit Trust/CIS/UCITS operators or firms conducting other variations on traditional asset management activities (such as investment managers in the share registry industry).

¹⁶⁰ See CP13/13, proposed rule CASS 7.6A.14BR, available at www.fca.org.uk/static/documents/consultation-papers/cp13-13.pdf.

¹⁶¹ See PS14/4, p.24, available at: www.fca.org.uk/static/documents/policy-statements/ps14-04.pdf.

¹⁶² See Handbook Notice 10, paras 2.23-2.25, available at: www.fca.org.uk/static/documents/handbook-notices/fca-handbook-notice-10.pdf.

Our response

- 7.247** We are prohibiting an investment firm from using the net negative add-back method to calculate its client money requirement as part of the standard methods of internal client money when that firm undertakes derivatives business for clients (i.e. margined transactions) or where that firm is neither an asset management firm nor a loan-based crowdfunding firm.¹⁶³ We reiterate that the net negative add-back method is not suited to any other type of firm or business model. It would not be appropriate for a firm's internal client money records and business practices to be designed on a bank account by bank account, rather than client by client, basis.
- 7.248** We have redrafted the rules proposed in the CP to achieve this outcome. For this purpose, we have created a new defined term 'CASS 7 asset management firm' to define the population of firms (other than loan-based crowdfunding firms)¹⁶⁴ which are permitted (unless also undertaking margined transactions) to use the net negative add-back method as a standard method of internal client money reconciliation. We have worked with the trade associations who provided us feedback on this point in the CP in developing this definition. To clarify, any firm that was previously a member of IMRO or would have been an IMRO member had it been authorised at that time, unless it undertakes any derivatives business for clients, will be permitted to continue to use the net negative add-back method of calculating its client money requirement. This represents no change to the position we consulted on in the CP.¹⁶⁵
- 7.249** We intend to continue to keep firms' use of the net negative add-back method under review. We are aware that the use of this method, as it presupposes that the balance recorded in a firm's internal records as being held in a client bank account to be accurate, will not on its own ensure the accuracy of a firm's internal records and accounts as they correspond to client money. Firms that use the net negative add-back method are reminded that they, as all firms, remain under a general obligation to maintain their records and accounts for client money in a way that ensures their accuracy.¹⁶⁶ In this context, although we are not introducing in this PS a blanket prohibition on the use of the net negative add-back method (as part of the standard methods of internal client money reconciliation), we may consult on doing so at a later stage.

New CASS 7.16

- 7.250** Most respondents welcomed the revised requirements and guidance proposed in the CP for a new sub-chapter on the standard methods of internal client money reconciliations. One respondent noted that these proposals increase clarity and remove many of the ambiguities which are otherwise found in our existing reconciliation requirements.
- 7.251** However, we did receive a number of comments on the drafting of the proposed rules and guidance. This included questions on how firms should treat physical receipts of client money and monies held in a client transaction account in respect of non-margined transactions within their internal client money reconciliation. Others stated that even more guidance around

¹⁶³ As stated in PS14/4, after considering feedback, we decided to maintain the policy on which we consulted in CP13/13, to prevent firms from using the individual client balance method as part of one of the standard methods of internal reconciliation for loan-based crowdfunding business, as the terminology used in the drafting does not relate to this type of business. Instead of the new provision as originally foreseen in CP13/13, we integrated the change into existing CASS 7 Annex 1, which meant that we needed more time to redraft the proposals, and this change that was signposted in PS14/4 (February 2014) was made in Handbook Notice 10 (March 2014). See PS14/4 pp. 24 and 25, 'our response', and FCA Handbook Notice 10, paras. 2.24 to 2.27, p.11.

¹⁶⁴ To ensure clarity we are further introducing a new defined term to identify loan-based crowdfunding firms which are subject to our client money rules in CASS 7 (a '**CASS loan-based crowdfunding firm**').

¹⁶⁵ With the caveat of the new approach being taking for CASS loan-based crowdfunding firms as a result of PS14/4, see footnote 161 above.

¹⁶⁶ See existing CASS 7.6.2R and CASS 7.15.3R in Part 3 of the final rules in Appendix I.

reconciliations was desired, including more statements around the purpose of particular requirements and defined terms. One respondent asked for clarification of the terms on which a firm would be expected to hold its approved collateral before it could use this collateral to reduce its margin transaction requirement.¹⁶⁷

- 7.252** A few respondents also questioned whether when using an individual client account maintained at a CCP for a client in respect of which the CCP has agreed with the firm to provide individual client segregation in accordance with EMIR (an 'ICA') we would expect sums held in the ICA to be included in the firm's internal client money reconciliation.

Our response

- 7.253** We are introducing a new sub-chapter in our client money rules¹⁶⁸ containing our rules and guidance around the standard methods of internal client money reconciliation¹⁶⁹. However, based on feedback, we have made a number of amendments to the rules proposed in the CP to ensure clarity and remove any inconsistencies between our rules for client money reconciliations and other recordkeeping and segregation requirements. For example, firms will be allowed to choose whether to include physical receipts of client money not yet deposited into a client bank account within its internal client money reconciliation, so long as they continue to comply with the underlying obligation to keep a record of all physical receipts of client money before those receipts being deposited into a client bank account. We have also provided guidance on the likely consequences for a firm's internal client money reconciliations depending on whether the firm includes or excludes such physical receipts in its internal client money reconciliation.¹⁷⁰
- 7.254** We expect all client money that may be placed in a client transaction account to be included in a firm's internal client money reconciliation. For margined transactions (i.e. derivatives business), where the firm is undertaking one of the standard methods of internal client money reconciliation, these sums must currently be included in the firm's calculation of its margined transactions requirement (one element of the firm's overall client money requirement). Nothing in the final rules changes this position. This will include any client money passed to an exchange, clearinghouse, intermediate broker, OTC counterparty or other person for a margined transaction (whether then placed in ICA, OCA or other account structure). This client money must be held in client transaction account with that person and should not be treated any differently in a firm's internal client money reconciliation than any other sums held in any other client transaction account for a margined transaction.
- 7.255** For non-margined transactions (e.g. securities business), we are also introducing guidance to confirm that firms should already be including monies held in a client transaction account in respect of non-margined transactions within their internal client money reconciliations. A firm, when allowing another person to hold its client money in connection with a client's non-margined transaction, will need to use the individual client balance method to calculate its client money requirement for the purposes of the standard methods of internal client money reconciliation. Under this approach, the firm will include balances placed with another person when calculating each individual client's balance with the firm. However, our revised guidance clarifies that before a firm finalises its client money requirement calculation, it will need to

¹⁶⁷ See existing CASS 7 Annex 1 G, para. 15, CASS 7.6A.31R as proposed in the CP and CASS 7.16.33R in Part 3 of the final rules in Appendix I.

¹⁶⁸ See CASS 7.16 in Part 3 of the final rules in Appendix I.

¹⁶⁹ Replacing the existing guidance at CASS 7 Annex 1 G.

¹⁷⁰ See CASS 7.16.7G in Part 3 of the final rules in Appendix I.

deduct the balances placed with another person in a client transaction account so as to ensure they do not give rise to a discrepancy between a firm's client money requirement and client money resource.

- 7.256** The final rules further clarify the way in which a firm must appropriate and hold its own approved collateral, and the records it will need to maintain, before it may use that collateral to meet and in effect reduce, its margin transaction requirement. This includes the firm ensuring the collateral is clearly identifiable as separate from the firm's own property, is recorded as being held for the client and will be liquidated on occurrence of a primary pooling event and paid into a client bank account. The firm will also need to keep a record of the actions it takes under the relevant rules¹⁷¹. We have also ensured that the client money distribution rules¹⁷² contemplate that this approved collateral will be available for liquidation and payment into a client bank account for the benefit of clients following the failure of the firm.
- 7.257** Finally, we have revised the requirements for a firm calculating its client money requirement in accordance with the individual client balance method¹⁷³ to allow firms to, instead of calculating each individual client balance based on the entire firm's holdings for an individual client, calculate each individual client balance on a product-by-product or business line basis. In these circumstances, this could lead to a firm segregating more client money than would be required if it had calculated each client's individual client balance across the whole of the firm (in effect netting out a client's negative and positive positions across all products and accounts in respect of non-margined transactions). So long as the firm has clearly documented how it undertakes internal client money reconciliations and its reasons for operating this way, this should prevent any additional risk to client money if the firm were to fail.
- 7.258** As set out above the amendments we have made in the final rules are clarifications to remove ambiguities raised in feedback and we do not expect these to have any CBA implications.

External client money reconciliations

- 7.259** We consulted on making it clear in our rules that firms are required to undertake an external client money reconciliation (i.e. a reconciliation between a firm's internal records and accounts and those of any third party with whom client money is deposited or otherwise placed) as regularly as necessary but no less often than at least once a month¹⁷⁴ and requiring firms to take into account specific factors when determining the appropriate frequency and to periodically review its determination. We also proposed guidance to clarify our view that firms that undertake transactions on a daily basis are likely to need to undertake daily external reconciliations.
- 7.260** Most respondents agreed with these proposals and a number highlighted that they represented best practices, in particular that external reconciliations should happen no less often than once a month. A few respondents thought external reconciliations need not happen on a monthly basis in all circumstances (e.g. where transactions occur infrequently on an account) and that management should be free to decide what is appropriate without limitation. On the other hand, one respondent argued we should set a minimum for external reconciliations to occur no less often than once every ten days. Others suggested that our guidance on circumstances in which firms should have to undertake external reconciliations on a daily basis was too prescriptive.

¹⁷¹ The estimate costs of keep this type of record are set out in Annex 1.

¹⁷² Discussed above at para. 3.1.

¹⁷³ See existing CASS 7 Annex 1 G at para. 6(1) and CASS 7.16.16R in Part 3 of the final rules in Appendix I.

¹⁷⁴ Consistent with the requirement in place prior to the implementation of MiFID, see CASS 2.6.2R.

- 7.261** A few respondents suggested the factors a firm should be required to consider in determining the appropriate frequency for external reconciliations should be consistent with our requirements for custody reconciliations and that those reviews should occur on at least an annual basis. A number of respondents also argued that firms should not be required to review the appropriateness of the frequency at which they undertake custody reconciliations if they already undertake daily external reconciliations.

Our response

- 7.262** We are implementing requirements for external client money reconciliations as proposed in the CP, except for two changes:

1. most firms will be required to undertake a review of the frequency at which they undertake external reconciliations on at least an annual basis; and
2. firms that already undertake an external client money reconciliation on a daily basis will not be required to separately review this decision unless they chose to change this frequency.

- 7.263** We also reiterate that firms that undertake daily transactions in client money should be undertaking external client money reconciliations on a daily basis. An external client money reconciliation is an important control for preventing loss, misappropriation and fraud. Also, the greater the frequency of transactions on a client bank account or client transaction account, the greater the risk to client money in that account and the increased importance of daily external reconciliations.

- 7.264** Taken together, we believe that none of the changes to the requirements we proposed for external client money reconciliations will require us to revisit the CBA published in the CP. For example, we expect the costs of annually reviewing the frequency of external reconciliations to be similar to the costs of the proposal in the CP to review the frequency of external reconciliations on a periodic basis, as we expect that firms would have interpreted 'periodic' in the proposed rules as 'annual'. Also, for firms that already undertake daily external reconciliations there will be a reduction in regulatory burden as they will not be required to annually review this frequency.

Resolving discrepancies

- 7.265** We consulted on minor changes in our rules for resolving discrepancies that come to light as a result of undertaking either an internal client money reconciliation or an external client money reconciliation.

- 7.266** We received a few comments on these proposals, each supportive of the approach we have taken. One respondent queried whether our rules required a firm to take any action after identifying a discrepancy between their client money resource and client money requirement and addressing any shortfall or excess to which it gave rise in a client bank account.

Our response

- 7.267** We are implementing the rules largely as proposed in the CP and, we are clarifying that where a firm identifies a discrepancy in their internal client money reconciliation as a result of a breach of a client money segregation requirement, that firm should not only address any excess or shortfall arising from that breach but, consistent with other requirements, take steps sufficient to avoid a reoccurrence of that breach.

Recordkeeping and notifications

- 7.268** We consulted on introducing a number of additional recordkeeping obligations and clarifications on the details firms need to ensure are recorded in their internal accounts and the manner in which certain records should be maintained. We also proposed more prescriptive notification requirements.
- 7.269** Respondents were generally supportive of these proposals. Some noted that our proposal that all firms be able to determine, at any time and without delay, the total amount of client money they are holding for each client¹⁷⁵, could require significant system changes for some firms. However, none of these respondents suggested firms would incur costs beyond those identified in the CBA published in the CP. A few of these respondents suggested that the phrase 'at any time and without delay' was unclear and that we instead should mandate a minimum timeframe in which firms' systems must be able to determine a client's total holdings of money with the firm. Some of these same respondents suggested that 48 hours seemed appropriate given the similar time period allowed firms to compile up-to-date documents and figures for their CASS RP.¹⁷⁶ Others stated that if a firm uses multiple databases to record client money holdings, that firm may need to, at a minimum, process overnight batches of transaction data before it could accurately determine how much client money it is holding for each client.
- 7.270** A number of respondents asked us to confirm that the records that would be required for receipts of client money and payments out of client bank accounts will remain consistent with firm's existing practices. Others queried whether the proposed rules for how firms should be recording receipts of client money were intended to change the basis on which firms prepare their accounts.
- 7.271** For our proposed notification requirements, a few respondents queried what the different situations were in which a firm 'will be unable' to comply with a requirement or 'materially fails' to comply. Some others requested additional guidance on in what circumstances a breach would be considered to be material.

Our response

- 7.272** We are introducing each recordkeeping requirement we proposed in the CP. Records a firm will be required to make and retain include copies of each internal and external client money reconciliation the firm undertakes, each review it conducts of these arrangements and its policies and procedures for complying with our requirements, including those around recordkeeping and reconciliations.
- 7.273** We are amending our proposal to clarify that every firm must maintain its records in a way that allows the firm at any time to be able to promptly determine the total amount of client money it should be holding for each client. We are also clarifying that 'promptly' under this rule means that, unless required sooner by another requirement, a firm should be able to make this determination within no later than two business days of having taken a decision to do so or at the request of the FCA. This change will, in effect, allow some firms up to two business days (instead of on demand, as proposed in the CP) to accurately determine the total amount of client money it should be holding for each client. This approach is also consistent with the amount of time firms are allowed to produce documentation and accurate information for its CASS resolution pack under CASS 10.¹⁷⁷ Moreover, by allowing firms slightly longer to determine total client money per client than under the proposal in the CP, we have reduced the regulatory burden on firms.

¹⁷⁵ See proposed CASS 7.6.3AR in the CP.

¹⁷⁶ CASS 10.1.7R.

¹⁷⁷ CASS 10.1.7R.

- 7.274** We also highlight that this rule will not require a firm to determine the total amount of client money it is holding for each client on an ongoing basis, rather it will only require that the firm ensure it has the ability to do so within the requisite timeframe whenever required.
- 7.275** Nothing in these proposals states how a firm must record a physical receipt of client money (i.e. cheque or cash) not received directly into a client bank account. However, we will continue to require that firms maintain appropriate records which account for all receipts of client money. Based on feedback, we are also providing guidance as to how firms undertaking the standard methods of internal client money reconciliation may choose to either include or exclude these balances when calculating their client money requirement. This is to reflect the different practices we understand firms may follow when accounting for client money.
- 7.276** We have also made minor amendments to the proposed notification requirements and have ensured they are consistent with similar requirements found in our custody rules. A firm will have to notify us whenever it will be unable to comply with a specified requirement (i.e. a firm has not yet breached the relevant rule but becomes aware that it will, in future, either continuously or for a specified period, be unable to comply with that rule) and whenever it materially fails to comply with a rule (a breach of the rule having occurred). A materiality threshold applies to actual breaches, meaning not all breaches need to be notified to us specifically; although we expect all breaches to be reported in a firm's annual client assets report. We are providing no additional guidance on when a firm's failure to comply with a specific requirement is material. What is material will depend on the circumstances and firms will need to consider on a case-by-case basis. If in doubt, a firm should discuss any concerns with its normal FCA supervisory contact.

Transitional provisions

- 7.277** A number of respondents stated that a six-month implementation timetable would be insufficient to allow them to make the necessary changes to their system and processes to implement our proposals generally around recordkeeping, notification and reconciliations for client money. The responses cited anywhere between nine and 24 months as a more achievable timetable.

Our response

- 7.278** Please refer to Table 2 in Chapter 2. In general, most firms will have approximately 12 months to bring their current systems and practices into line with these new requirements for client money recordkeeping and reconciliations. Nevertheless, any firm may choose to comply with these new requirements sooner and this should not lead to a breach of our current requirements. For this purpose, we are amending the Glossary definition of the 'standard method of internal client money reconciliation' to clarify that until 1 June 2015, a firm which follows either CASS 7 Annex 1 G or the new CASS 7.16 in the final rules (in Appendix I) when carrying out an internal client money reconciliation will be undertaking one of the standard methods of internal client money reconciliation.
- 7.279** Separately, the requirements being introduced in this PS for firms operating a non-standard method of internal client money reconciliation will come into force on 1 December 2014. However, firms operating a non-standard method of internal client money reconciliation as of 30 November 2014 will have until 1 June 2015, or the date they materially alter their method of internal client money reconciliation, whichever is earlier, to comply with these new requirements (continuing to apply the existing requirements in the interim). All firms will be

permitted to comply with these new requirements for non-standard methods of internal client money reconciliation (including their obligations to provide us the requisite notifications and auditor's report) before the relevant rules coming into force, so long as when the relevant rules become mandatory for a firm, that firm is in compliance.

Acknowledgment letters

Q31: Do you agree with our proposals for the exchange of acknowledgment letters? If not, please provide reasons.

- 7.280** We consulted on requiring all firms to complete and exchange standard template acknowledgment letters when arranging to deposit or place client money with a bank or other third party (e.g. in a client bank account or a client transaction account). This was in response to the mistakes and poor practices we consistently observe across the industry in respect of the use of acknowledgment letters.
- 7.281** These rules are important for ensuring that the segregation of client money placed with third parties is appropriately secure. Deficient notification and acknowledgment letters create uncertainty about the protections afforded client money and, in our experience, can lead to disputes which can delay or prevent the release of client money following the failure of a firm.
- 7.282** We received feedback on our proposals for acknowledgment letters from over 90 respondents. The overwhelming majority of responses were broadly supportive of these proposals. Respondents highlighted that, in particular, the proposed templates and additional guidance should simplify and clarify the process for firms. Others noted that a standardised approach would increase industry awareness and certainty over the obligations incurred and protections afforded when client money is deposited or placed with a third party.
- 7.283** A few respondents raised concern that our proposals were, on the whole, too prescriptive and that a mandated template might be too inflexible to accommodate specific business models or arrangements. Others queried whether mandating the use of a template acknowledgment letter was the right approach and suggested we consider other alternatives, such as:
1. changes to primary legislation through which client bank accounts would be automatically protected at law;¹⁷⁸
 2. directly requiring banks and other third parties which accept client money from a firm to agree to the required terms (discussed further below¹⁷⁹);
 3. the introduction of an account registration scheme in which a third party bank may separately agree to register and operate a client bank account with and under the terms of a voluntary scheme providing similar protections to those provided by an acknowledgment letter (negating the necessity for a letter to be exchanged and executed for accounts subject to the scheme); and

¹⁷⁸ For example, where a solicitor keeps a client bank account (under the rules applicable to it), the Solicitors Act 1974 provides that the relevant bank 'shall not have any recourse or right against money standing to the credit of the account in respect of any liability of the solicitor to the bank, other than a liability in connection with the account'. See Sections 32 and 85, available at: www.legislation.gov.uk/ukpga/1974/47.

¹⁷⁹ At para. 7.286.

4. requiring a firm to include the relevant notifications/matters for agreement in the underlying agreement between the parties (rather than in a stand-alone acknowledgment letter).

Our response

- 7.284** All firms holding client money under CASS 7 will be required to use the relevant templates and follow a set process for completing and exchanging acknowledgment letters¹⁸⁰. This standardisation should simplify the process of providing notification of and agreeing the obligations the parties are expected to incur when accepting client money from an investment firm. It should also reduce the likelihood of firms making errors with these letters and minimise the risks associated with a flawed letter.
- 7.285** These requirements should reduce negotiation costs and create efficiencies for firms when arranging the execution of an acknowledgment letter, reducing the amount of time and resources necessary to comply with these requirements. We separately believe a stand-alone acknowledgment letter will ensure that greater certainty over the matters covered by the letter and that the rights and obligations of the parties involved when client money is held are clearly established and understood. Furthermore, the template letters have been drafted with the aim of clarifying that the terms of the acknowledgment letter may not be varied or overridden through any other arrangement between the parties.
- 7.286** We have also considered alternatives to the process of exchanging acknowledgment letters. We are introducing rules and guidance which will apply uniformly regardless of the jurisdiction in which an account is located or a relevant counterparty might be established. Some alternatives to a letter-based process would not be suitable to a firm operating abroad or with overseas counterparties. We will keep the requirements we are introducing for acknowledgment letters under review and will remain alert to any appropriate alternatives to the process of exchanging acknowledgment letters.
- 7.287** We note separately that the use of a stand-alone and standardised acknowledgment letter is consistent with the approach recently adopted in the United States by the Commodities Futures Trading Commission ('CFTC').¹⁸¹

Template acknowledgment letters

- 7.288** We consulted on requiring a firm to prepare an acknowledgment letter on its own letterhead, signing it and then sending it to the relevant third party for their countersignature. The draft rules contemplated that firms would not be allowed to alter fixed text and that firms would need to remove or include certain variable text, as appropriate. The intention was to ensure that the terms of the template letter were non-negotiable, in that the firm is prohibited from agreeing to any request to vary or otherwise change the text set out in the template.
- 7.289** The template was also drafted to:
1. ensure consistency in use, where appropriate, between the type of client account being opened;

¹⁸⁰ We recently introduced a similar set of requirements and template acknowledgment letters for CASS debt management firms. See CASS 11.8 and PS14/4, see footnote 175, and Handbook Notice 10 (March 2014), see footnote 176.

¹⁸¹ See *Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations: Final Rule*, 17 CFR Parts 1, 3, 22, et al., 78 Federal Register 220 (14 November 2013), available at: www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-26665a.pdf.

2. clarify which matters require an acknowledgment of notice and which matters require the parties' agreement;
3. ensure client money is protected from third party claims which may delay or prevent the release of client money following the failure of the firm (establishing that a third party should have no right or recourse to money deposited or placed in the relevant account and, in respect of client bank accounts, should be released on demand); and
4. introduce provisions to strengthen the terms of the letter, including governing law, forum, variation and merger/integration clauses.

7.290 A large number of respondents did not agree with the acknowledgment letter being drafted on firm letterhead. Many argued that it was current practice for the third party with whom client money is deposited or placed to provide the requisite acknowledgments on its own letterhead as part of the account opening process. These respondents suggested that using their own letterhead would introduce an additional and unnecessary cost into the process. Others suggested, discussed further below¹⁸², that if the acknowledgment letter was issued on the relevant third party's letterhead, this would provide an additional degree of assurance to the firm that whoever was countersigning the acknowledgment letter was authorised to do so.

7.291 Some queried whether account details such as the title and unique identifiers (e.g. account numbers) need to be agreed and included in the acknowledgment letter before it is sent to the relevant counterparty for their review and countersignature. Many of these respondents noted that the proposed rules would require the acknowledgment to be put in place before or at the same time that an account is opened when these details may not yet be available. A few respondents were also unclear whether we were mandating that a certain quantity or type of unique identifiers be in use and reflected in the acknowledgment letter for each client account.

7.292 A small number of respondents also raised concerns that an acknowledgment letter would not be able to cover multiple accounts. In particular, some argued that where many accounts are involved, a firm should be able to identify the accounts in an annex attached to the letter. These respondents suggested it may be operationally easier to separate the process of arranging a counterparty's agreement to the terms of an acknowledgment letter and their agreement to which accounts those terms are intended to relate, especially in a situation in which a firm is frequently opening and closing a high number of client accounts.

7.293 We received a number of further comments on the specific drafting of the template letters, including that:

- terms within the template acknowledgment letter may conflict with terms otherwise set out in an underlying agreement (e.g. a banking or custody services agreement which may grant the relevant third party a general right of set-off across both a firm's own and client accounts);
- the letter should clearly override any terms to the contrary in an underlying agreement;
- firms should be allowed to vary the terms of the letter to comply with the mandatory rules of a jurisdiction from which the parties cannot derogate;
- a counterparty should be allowed to incorporate additional terms into the letter to clarify its own legal and regulatory responsibilities (e.g. allowing a bank to clarify in the letter it will hold the funds it receives from the firm as banker);

¹⁸² At para 7.295.

- a bank may be unwilling to agree to release on demand amounts deposited in a client bank account where an outstanding liability is owed to the bank on that same account; and
- where different currencies are held within the same client bank account, the terms of the acknowledgment letter should clearly state that set-off between such currencies is permitted.

Our response

- 7.294** We have finalised the drafting of the template acknowledgment letters based on feedback and following extensive engagement with the industry, including those banks, clearing houses and intermediate brokers with whom we understand a significant proportion of client money is placed both within the UK and overseas.
- 7.295** The template letters will need to be drafted on firm letterhead and the firm will not be allowed to alter any of the fixed text within the letter. The responsibility to carry out this process will remain with the firm subject to our client money rules and not on any third party with whom client money may be deposited or placed. As a result, the firm will be unable to agree to any alteration to the substantive matters covered by the acknowledgment letter. We believe this approach will minimise the opportunity for errors to arise in the drafting of the acknowledgment letters and should limit the scope for the parties to disagree as to the content and effect of these arrangements at a later stage. Also, as using these templates will become commonplace, banks and other third parties should become accustomed to the process, which should increase its efficiency.
- 7.296** The template acknowledgment letters and accompanying guidance envision that, in order to appropriately identify the accounts to which a letter relates, firms will need to include at least one unique identifier per account. The templates have also been drafted so that a firm can accommodate their counterparty's account titling and identification conventions (to the extent this is consistent with the naming conventions set out in our rules). Firms are reminded that, as proposed in the CP, all client bank accounts and client transaction accounts will need to include the term 'client' in their title and certain types of client bank accounts will need additional terms.¹⁸³ Nevertheless, we contemplate that there will be circumstances in which account titles may need to be abbreviated¹⁸⁴ and with this in mind we are providing that firms should include both the full account title and any abbreviated version of an account in the body of an acknowledgment letter. We are also not limiting the form or type of unique identifier that must be associated with an account (which may come in various forms such as a sort code and account number, a reference code, pool ID, etc.). However, we expect that in all circumstances at least one unique identifier would be associated with each client bank account or client transaction account (money market deposits being an exception discussed below¹⁸⁵).
- 7.297** The template acknowledgment letters have been drafted to accommodate multiple accounts and we are introducing the guidance we consulted on to this effect, without change. We appreciate there may be efficiencies for some firms if they were permitted to incorporate account details into a separate annex from the body of an acknowledgment letter. We do not judge these efficiencies to be significant so as best practice, firms will need to ensure that

¹⁸³ For example, designated client bank accounts and designated client fund accounts required the terms 'designated' and 'designated fund', respectively.

¹⁸⁴ Where the systems constraints of the firm's counterparty or the firm that holds the account (or both) make it impracticable to include the full title of the account, an abbreviation of the title may be used. For example, terms such as 'designated', 'designated fund' or 'segregated' may be abbreviated as 'des', 'des fnd' or 'seg'.

¹⁸⁵ At para. 7.343.

where a letter is intended to cover multiple accounts, each of these accounts is identified in the body of the letter as opposed to a separate annex. We have observed situations in which an annex or other side letter containing account details has become separated, or otherwise misplaced, from the relevant acknowledgement letter. This can lead to confusion and disputes over the status and treatment of an account following the failure of a firm.

- 7.298** We are also aware that, as some respondents stated, the obligations that a counterparty will incur through the acknowledgment letter process (such as their agreement to relinquish any right or recourse over monies in a client account for sums owed to the counterparty on another account) may be inconsistent with the rights that a counterparty might seek in their underlying agreement with the firm (such as a general set-off provision in a banking or custody services agreement). Firms should not be granting a right or security interest to a counterparty with whom they deposit or place client money which would otherwise be prohibited under the terms of the template acknowledgment letter. This is important to ensure the segregation of client money remains appropriately secure. Nevertheless, the template acknowledgment letters include terms which endeavour to ensure such protections remain in place in spite of any provision to the contrary in any underlying agreement.
- 7.299** Nothing in the template letters is intended to prejudice the application of provisions of law of that cannot be derogated from by agreement. On this basis, it is unlikely that the template letters would need to be redrafted to accommodate any applicable mandatory rule of law. However, to the extent the provision of a mandatory rule of law would mean that an overseas counterparty would be unable to execute the template letters without modification (see also below¹⁸⁶), a firm should discuss this situation with its normal FCA supervisory contact.
- 7.300** Finally, we note that nothing in the template acknowledgment letters prevents a counterparty, such as a bank, from exercising a right of set-off between currencies held in the same account, by effecting a currency conversion of one currency to cover an overdraft arising in another currency.
- 7.301** We have also made a number of technical changes to the template letters to more precisely articulate the intended scope of the parties' obligations and responsibilities under these letters; this includes changes to ensure the substantive obligations incurred through these letters remain consistent with European legislation.¹⁸⁷ Additionally, we have made some other minor grammatical and stylistic changes to clarify meaning and provide consistency across the template letters, where appropriate.
- 7.302** The original CBA provided an estimate of the incremental compliance costs to firms from using the template acknowledgement letter. This cost included the cost of using a firm's letterhead. We acknowledge that firm compliance costs from this requirement could be reduced if we do not require firms to use letter-headed paper. However, letterheads are necessary to achieve our policy objective because this is part of the requirement to use a template which will minimise the opportunity for errors to arise in the drafting of the acknowledgment letters and should limit the scope for the parties to disagree as to the content and effect of these arrangements at a later stage.

¹⁸⁶ At paras. 7.319 to 7.321.

¹⁸⁷ Such as EMIR.

Removal of 20-business day 'grace period'

- 7.303** We consulted on removing the 20 business day grace period in which firms are allowed to use a client bank account or client transaction account without obtaining a duly countersigned acknowledgment letter in respect of that account.¹⁸⁸
- 7.304** A number of respondents were concerned that this proposal might unnecessarily restrict an IP's ability to open and make use of client bank accounts following the failure of the firm. Others suggested that this proposal could lead to client detriment in circumstances in which a firm might need to swiftly open an account to hold client money on a contingency basis – for example, when responding to volatile market conditions or the occurrence of an IT systems failure.
- 7.305** A few noted that removing the grace period could also reduce the leverage a firm might otherwise have in seeking the agreement of the relevant third party to the terms of the acknowledgment letter. These respondents noted that once a firm has opened and placed money in a client account it is then easier to negotiate the terms of the acknowledgment letter than in circumstances in which the account has not yet been opened and no money has been placed with the third party.
- 7.306** A number of respondents also argued that we should require the relevant banks and third parties to agree to the terms of the required acknowledgment letters and/or at least respond to such as request within a specified time period.

Our response

- 7.307** All firms will be prohibited from depositing client money in a client bank account or allowing a third party to hold client money on a client transaction account until the firm has completed and obtained a duly countersigned acknowledgment letter from the relevant bank or third party (except where the third party is an authorised central counterparty, as discussed below¹⁸⁹). We see no reason for client money to be provided a different degree of protection because the account in which it is deposited or placed is new.
- 7.308** However, to facilitate the requirements following a primary pooling event, we have amended the requirements in the context of a firm failure, so as to allow a firm (or any relevant IP) to open and begin using new client bank accounts, for the purposes of our client money distribution rules after sending a completed acknowledgment letter to the relevant third party, but before having had any reply from that third party. Nevertheless, consistent with our existing requirements, where the firm (or IP) is unable to obtain the agreement and countersignature of the relevant person to the template acknowledgment letters within 20 business days of dispatch of the letter, the firm (or IP) will be expected to withdraw all money standing to the credit of the account and deposit it in a client bank account with another bank as soon as possible.

¹⁸⁸ See existing CASS 7.8.1R(2) and CASS 7.8.2R(2).

¹⁸⁹ See paras. 7.325 to 7.327 below.

- 7.309** Firms should separately have in place adequate organisation arrangements to minimise the risk of the loss or diminution of client money.¹⁹⁰ This type of risk can arise in a variety of circumstances, including volatile market conditions and/or after the occurrence of an IT failure. Restricting the ability of firms to make use of a client bank account or client transaction account without having received a duly countersigned acknowledgment letter is not inconsistent with, and does not negate, the responsibility placed on firms to ensure they have adequate organisation arrangements in place when holding client money.
- 7.310** We do not intend to require a bank or other third party to accept on deposit or otherwise hold client money on behalf of a firm subject to CASS – this remains a commercial decision for that counterparty. However, we recognise that the consequence of a bank or other third party refusing to accept the terms of the acknowledgment letter in respect of a given account under these requirements will be that the firm is prohibited from using the relevant account to deposit or place client money with that counterparty.¹⁹¹ However, we note that given the acknowledgment letter sets out the terms according to which we expect third parties to currently be operating client money bank accounts, we would not therefore expect third parties who already hold client money on deposit to refuse the terms of the acknowledgment letters.

Overseas counterparties

- 7.311** We consulted on requiring firms to obtain an acknowledgment letter for all client bank accounts, not just those located in the UK, and client transaction accounts. This proposal contemplated that firms would use the same template acknowledgment letters regardless of the location of the relevant account.
- 7.312** A number of respondents suggested that overseas counterparties may be unwilling to agree to the terms of the template letters and asked us to clarify what was expected of firms in this situation. Respondents suggested that, if firms were unable to use client accounts with certain overseas counterparties in specific jurisdictions, this could put FCA authorised firms at a competitive disadvantage or could frustrate a firm's ability to carry out transactions for customers in specific jurisdiction. Some of the reasons cited for why an overseas counterparty may be unwilling to agree to the terms of the acknowledgment letter included:
- the letter not being governed by the counterparty's local law;
 - the letter granting exclusive jurisdiction to a court within the UK;
 - references in the letter to the firm's role as trustee; and
 - a lack of understanding around our client money rules or the operation of the statutory trust created over client money.
- 7.313** However, we note no overseas persons provided feedback stating they would be unable to agree to the terms set out in the proposed acknowledgment letters and, in developing these proposals, we engaged with a wide-range of overseas institutions with whom we understand a significant portion of client money is deposited or placed.

¹⁹⁰ CASS 7.3.2R.

¹⁹¹ See also the discussion below on overseas counterparties' potential unwillingness to refuse to acknowledge receipt and agree to the terms of the template acknowledgment letter, at paras. 7.312 to 7.314.

- 7.314** A few respondents stated generally that we should confirm whether the drafting of this letter will be effective in any jurisdiction. One respondent argued that we should require all firms to obtain a legal opinion on the validity and enforceability of template acknowledgment letter before the firm is allowed to rely on the letter for compliance with the rules.

Our response

- 7.315** Firms will be required to obtain an acknowledgment letter for all client bank accounts, not just those located in the UK, and client transaction accounts (except for those held with a CCP, as discussed below¹⁹²). We intend to make no distinction in our rules for acknowledgment letters based on whether the relevant account or counterparty is located overseas. This is because client money should not be provided a different degree of protection under our rules because the relevant account is held with a bank or other third party outside of the UK.
- 7.316** We appreciate the concerns firms have shared with us about the potential unwillingness of overseas counterparties to agree to the terms of the template acknowledgment letters proposed in the CP. However, the concerns raised have been of a generalised nature and we have not been provided with any specific examples of a jurisdiction in which the changes we are introducing for acknowledgment letters would be unworkable. We are also aware that the CFTC received similar feedback when consulting on the template acknowledgment letter which it now requires US firms to use with both US and non-US counterparties with whom those firms deposit or place client money.¹⁹³
- 7.317** However, based on feedback, we have altered the template acknowledgment letters so that firms are able to agree a governing law and choice of competent jurisdiction which are not restricted or exclusive to a jurisdiction within the UK, so long as the laws of at least one jurisdiction will govern the terms of the acknowledgment letter and that same jurisdiction will retain the ability to settle any disputes arising out of, or in connection with, the acknowledgment letter, its subject matter or formation. Following the failure of a firm, it is important that the parties to an acknowledgment letter are limited in their ability to dispute the jurisdiction or body of law which govern this arrangement. However, we recognise that many overseas counterparties may be unwilling to agree to a governing law or an exclusive choice of competent jurisdiction which differs from either the laws of the place under which the firm or the relevant counterparty is organised or as is found in any underlying agreements between the parties. Nevertheless, consistent with a firm's obligation to exercise all due skill, care and diligence in the selection and appointment of a bank to hold its client money¹⁹⁴, firms should take care that, when choosing the law of a particular jurisdiction (outside of the UK) to govern the letter, this choice will not alter the meaning of the fixed text within the template letter.
- 7.318** Also, in some cases, we note that when agreeing to governing law, some firms may need to ensure that the acknowledgment letter clarifies that the parties' choice of governing law is intended to reflect only the application of the substantive rules of law in force in that jurisdiction and not that jurisdiction's rules of private international law¹⁹⁵ that could lead to the

¹⁹² At para. 7.325 to 7.327.

¹⁹³ See *Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations: Proposed Rule* CFTC 17 CFR Parts 1, 3, 22 *et al.*, 77 Federal Register 220 (14 November 2012), available at www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-26435a.pdf. See also footnote 196 above.

¹⁹⁴ See existing CASS 7.4.7R and CASS 7.13.8R in Part 3 of the final rules in Appendix I.

¹⁹⁵ For example, conflicts of law provisions or general principles of choice of law.

application of the substantive laws of another jurisdiction.¹⁹⁶ As a result, the relevant template acknowledgment letters have been drafted to provide firms the ability to clarify this position in the letter where necessary.

- 7.319** We are not aware of any reasons why an overseas counterparty would be unable to execute the proposed template letters on the basis that it makes reference to an investment firm's role and obligations as a trustee. Similarly, we are not aware of any jurisdiction in which it will be impossible for firms to obtain the required acknowledgment letters. We also specifically disagree that the introduction and mandated use of the template acknowledgment letters will put FCA-authorized firms at a competitive disadvantage. Any counterparty that refuses to acknowledge and agree to the terms of the template acknowledgment letter is likely to be the same counterparty that would have refused to participate in the acknowledgement letter process under our existing requirements. Our requirements in this are an important part of the protections afforded client money, namely that the segregation of client money remains appropriately secure. The exchange of the template acknowledgment letters ensures that the key rights and obligations of each party involved and arrangements concerning the segregation of client money are clearly established and understood.
- 7.320** As a result, where for a given account an overseas counterparty refuses to countersign and return the applicable acknowledgment letter, firms will be prohibited from depositing or otherwise placing client money in that account. However, we note that given the acknowledgement letter sets out the same substantive terms as under the current rules, we would not expect third parties who already hold client money on deposit to refuse the terms of these new acknowledgment letters. Nevertheless, we recognise that, for some overseas counterparties, there might exist valid reasons for why the counterparty would be unable to execute the template letters without modification.¹⁹⁷ In such circumstances, a firm should discuss the situation with its normal FCA supervisory contact.
- 7.321** Some respondents were concerned that the terms of an acknowledgment letter may not be enforceable in some overseas jurisdictions. As mentioned above¹⁹⁸, firms should be considering these issues when they choose and agree the laws of which jurisdiction (if outside the UK) will govern the agreement and, more generally, when they consider with whom and in what jurisdictions they will deposit client money in a client bank account.¹⁹⁹

Authorised central counterparties

- 7.322** We consulted on requiring firms to use the same acknowledgment letter with CCPs as in any other circumstance in which a firm passes client money to a third party to be held in a client transaction account. This proposal would have required firms to seek the CCP's written agreement to the matters covered by the acknowledgment letter. In developing this proposal, we engaged with a number of clearing houses, with whom collectively we understand the majority of client money in client transaction accounts is placed.

¹⁹⁶ We note that, where applicable, Article 20 of Regulation (EC) No 593/2008 provides that 'the application of the law of any country specified by this Regulation means the application of the rules of law in force in that country other than its rules of private international law, unless provided otherwise in this Regulation'. Available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32008R0593&qid=1397139898753&from=EN>.

¹⁹⁷ At para. 7.317 to 7.318.

¹⁹⁸ At para. 7.317.

¹⁹⁹ Existing CASS 7.4.7R and CASS 7.13.8R in Part 3 of the final rules in Appendix I. See also discussion above at paras. 7.312 to 7.314.

- 7.323** A number of respondents queried whether it was necessary to obtain the written agreement of a CCP to the terms of an acknowledgement letter when the substantive obligations to which the counterparty was expected to agree should already be covered by the requirements of EMIR. A few also expressed concerns that CCPs might be unwilling to agree to the terms of the template letter and queried what would happen if a CCP refused to provide the required acknowledgments.
- 7.324** Some CCPs stated that under their existing agreements and/or default rules, they already incur the same obligations as those provided for in the template acknowledgement letter. A few suggested it was burdensome for them to respond to acknowledgment letter requests. However, no CCP suggested it would be wholly unable to participate in a two-way acknowledgment letter process as required under the existing rules or as proposed in the CP.

Our response

- 7.325** We have amended our proposals so that a firm, when placing client money with a CCP, must write to the CCP to notify it of specific matters using a template acknowledgement letter specially drafted for these purposes. This template gives the CCP the option of countersigning and returning the acknowledgement letter, however this is not a requirement. Firms will be able to use a client transaction account with that CCP at any time after providing the CCP with the relevant acknowledgement letter, whether or not the CCP has countersigned and returned the letter to the firm.
- 7.326** The matters to be notified in the template acknowledgement letter for use with CCPs are consistent with the obligations placed on CCPs under EMIR.
- 7.327** We note this change represents a reduction in the existing requirements, which include an obligation for CCPs to participation in a two-way acknowledgment letter process. This change is also consistent with the proposals we consulted on in CP12/22.²⁰⁰ By reducing this process to a one-way notification, there should be no impact on the protections afforded client money placed with a CCP. The protections which would otherwise be safeguarded through a two-way acknowledgment letter process are achieved directly by the requirements placed on CCPs under EMIR, although enhanced by the provision of a one-way notification. This notification remains important to ensure the relevant CCP is on notice of a firm's clients' interest in client money that the CCP has been allowed to hold and to ensure that the relevant accounts have been opened in the correct form.

Recordkeeping and periodic reviews

- 7.328** We consulted on requiring all firms to periodically, at least on an annual basis, review their acknowledgement letters and, in addition, whenever they become aware of an inaccuracy to promptly organise a replacement acknowledgment letter. We further consulted on rules to require firms to obtain a new acknowledgment letter whenever a client bank account or client transaction account is transferred to a new entity. We had proposed also to require firms to retain copies of every acknowledgment letter for five years following the closure of the account or accounts to which the letter relates.

²⁰⁰ See footnote 28.

- 7.329** A number of respondents expressed concern that these proposals were too onerous. Some suggested that a firm should only be required to review the contents of an acknowledgment letter when it becomes aware of circumstances which may merit a change to the letter, such as a notification from its counterparty that it has renamed its business. Others suggested a five-yearly review would be more proportionate. A few respondents requested clarification that an annual review of the letters would not mean firms would be required to repaper their acknowledgment letters on an annual basis.
- 7.330** Others argued that repapering an acknowledgment letter to reflect the change in name or address of a counterparty was unnecessary. While some commented that it was not clear what inaccuracies in an acknowledgment letter would require repapering and requested further guidance.

Our response

- 7.331** We intend to implement the proposals in the CP with only minor changes to the drafting of the rules to ensure clarity; for example to confirm that these proposals will not require firms to repaper their acknowledgement letters on an annual basis. However, we do not think requiring firms to annually review their acknowledgement letters and to promptly arrange for a replacement acknowledgement letter whenever they uncover an inaccuracy or an account is transferred to a new entity is unduly burdensome. An acknowledgement letter must be current in order to maintain certainty over the status conferred on the relevant accounts and the obligations incurred by each party. This will reduce the scope for disputes and better protect client money in the event of a firm's failure.

Establishing signatory authority

- 7.332** We consulted on requiring firms to use reasonable endeavours to ensure that any individual that has countersigned an acknowledgment letter was authorised to do so on behalf the relevant third party. This included guidance clarifying that where a firm does not receive sufficient evidence from an individual who countersigns an acknowledgment of their authority to do so, then the firm should make appropriate enquiries to satisfy itself of that individual's authority to do so. The guidance went on to provide a non-exhaustive list of examples of the types of evidence of an individual's authority which a firm might obtain.
- 7.333** Several respondents suggested that this rule would require all firms to obtain from their counterparties a list of their authorised signatories and raised concern that this may not always be possible. Others highlighted that there could be data protection concerns or issues with fraud if firms were always required to obtain an authorised signatory list.
- 7.334** A few respondents argued that if the acknowledgment letter were set out on letterhead belonging to the bank or other third party, then there would be no need for a firm to take any additional steps to verify the authority of the individual who has countersigned the letter. Others suggested that it would be sufficient if the letter required the individual countersigning to represent that it was authorised to do so.
- 7.335** Some commented that a rule requiring firms to undertake reasonable endeavours was either too subjective or too burdensome. Some small firms thought that it was 'absurd' that when depositing client money with a large bank, the firm would have to take steps to assure themselves

that the individual who has countersigned the acknowledgment letter was authorised to do so, remarking that we should instead be placing obligations on the banks to ensure only authorised individuals are countersigning an acknowledgment letter.

Our response

- 7.336** We are introducing this requirement and the associated guidance as proposed in the CP with no change. Firms need to ensure they are obtaining at least the same level of assurance over the authority of an individual to countersign an acknowledgment letter as the firm would seek when managing its own commercial arrangements. An acknowledgment letter signed by an individual who has no authority to act on behalf of the relevant counterparty provides limited, if any, protections to the client money deposited or placed with that counterparty.
- 7.337** The list of examples set out in the guidance of the type of evidence a firm might obtain to establish the authority of an individual is not exhaustive. There might be other means not set out in our guidance by which a firm may satisfy itself of the authority of an individual countersigning an acknowledgment letter. In particular, we are not requiring firms to obtain a copy of a counterparty's list of authorised signatories (this will not always be possible) and nor do we believe that this guidance will require firms to obtain legal advice to the steps necessary to verify a signatory's authority in every overseas jurisdiction in which they may hold client money. Firms need to consider what evidence would be appropriate or necessary for them to obtain in their specific circumstances. A firm should be able to demonstrate how it has concluded that a particular individual who has countersigned an acknowledgment letter was authorised to do so and should expect us to challenge it when it is unable to reasonably justify its conclusions.

Electronic signatures

- 7.338** We consulted on guidance clarifying that an acknowledgment letter may be signed or countersigned electronically, so long as the electronic signature would be admissible as evidence in a legal proceeding. An electronic signature that cannot be relied on to enforce the terms of the acknowledgment letter is of limited benefit to the firm and could increase the likelihood of a dispute over the content and effect of an acknowledgment letter following the failure of a firm.
- 7.339** A number of responses suggested that this guidance would require firms in all circumstances to obtain a legal opinion as to the validity of any specific acknowledgment letter which is signed or countersigned electronically. In these circumstances, respondents suggested the entire industry would revert to only accepting 'wet' signatures.

Our response

- 7.340** We have made some minor amendments to this guidance to clarify that an acknowledgment letter signed or countersigned electronically should not, for that reason alone, result in a breach of our rules. We often receive queries as to whether firms are or are not allowed to accept electronic signatures. Firms need to consider whether, in their specific circumstances, an electronic signature on an acknowledgment letter could be relied upon as evidence in a relevant legal proceeding (for example, if the firm needed to take action to enforce the terms

of the letter). In the UK, we note that the Electronic Communications Act 2000²⁰¹ sets out the requirement for the admissibility of electronic signatures and related certifications in courts. We understand there are similar requirements in other jurisdictions which may be relevant. If firms are uncertain about what these requirements include, they should consider seeking legal advice. However, our guidance should not be read to suggest that a legal opinion is required each time a firm receives an acknowledgment letter which has been countersigned electronically.

Overnight money market deposits

- 7.341** We consulted on guidance clarifying how a firm may make use of the template acknowledgment letters when arranging the deposit of client money in overnight money market deposits.
- 7.342** Most respondents supported this proposal but some argued it would be unworkable, because at the time that a money market deposit is made, neither the firm nor the bank with whom the money is being deposited will have an account number, reference code or other unique identifier by which to identify the deposit. One respondent noted that a firm might have no idea with whom they will be placing client money on overnight deposit until shortly before the deposit is made, leaving insufficient time to arrange the execution of an acknowledgment letter.

Our response

- 7.343** We are implementing the guidance proposed in the CP for the use of template acknowledgment letters with client money placed in overnight money market deposits. This guidance is consistent with the existing requirements for firms to ensure any client money placed in a money market deposits is appropriately identified as being client money. Firms will also be required to ensure they have an acknowledgment letter in place to cover any client money placed into an overnight money market deposit before that deposit is made. As a practical matter, a firm may be unable to incorporate into an acknowledgment letter any unique identifier to be associated with an overnight deposit, as in many cases those identifiers (often limited to a reference code or confirmation number) are issued to the firm only after the overnight deposit is made. In these circumstances, a firm may complete and execute an acknowledgment letter with a bank before it places client money into overnight money market deposits by setting out in the body of the letter:
1. the title and other account information for the client bank account from which the deposits will be placed; and
 2. how the firm will notify the bank that the money market deposit being placed with it consists of client money (e.g. by inclusion of the words 'client money deposit' in its instructions to the bank).

This will of course necessitate that a firm establish a relationship with a bank under the terms of the template acknowledgment letter before the firm will be able to use that bank to place client money in overnight money market deposits.

²⁰¹ Electronic Communications Act 2000, Part 2, Section 7, as amended, original version available at: www.legislation.gov.uk/ukpga/2000/7/contents.

Transitional provisions and repapering

- 7.344** We consulted on requiring all firms to repaper each existing trust notification and/or acknowledgment letter they hold under the current rules²⁰² within six months and allowing firms the choice to comply with either the current rules or the proposed rules for acknowledgment letters during this period.
- 7.345** A large number of responses expressed concern that six months would be insufficient time for the entire industry to repaper their existing acknowledgment letters. Some banks, in particular, highlighted that whereas an individual firm may only need to repaper a few letters, each bank may need to respond to a large number of requests at the same time. Some respondents suggested 12-18 months would be more a practical timetable. Others suggested that firms should not be required to repaper existing acknowledgment letters with the proposed templates.

Our response

- 7.346** All firms will be required to repaper their existing acknowledgment letters with the template acknowledgment letters being introduced in this PS. This is important to ensure consistency and that client money, wherever deposited or placed, will benefit from the same level of protection under our rules.
- 7.347** Please refer to Table 2 in Chapter 2. Firms will have until 1 June 2015 (i.e. approximately 12 months, instead of six) to repaper their existing client bank accounts and client transaction accounts. We expect that allowing firms this additional time to bring the use of their existing accounts into compliance should also reduce the overall cost impact of these changes for some firms, allowing these letters to be updated as part of many firms' business as usual processes.
- 7.348** However, firms will be required to have one of the template acknowledgment letters in place for any client bank accounts or client transaction accounts opened after 30 November 2014. Firms will also have the choice to comply with either the current rules or the rules being introduced in this PS until these rules come into force on 1 December 2014.

Commodity Futures Trading Commission Part 30 Exemption Order

Q32: Do you agree with our proposed guidance on the Part 30 Exemption Order and LME Bond Arrangements? If not, please provide reasons.

- 7.349** We consulted on revised guidance for firms that trade on behalf of customers resident in the US on non-US futures and options exchanges under the Part 30 Exemption Order issued by the US CFTC (the '**Part 30 Exemption Regime**').
- 7.350** Approximately 20 respondents commented on this proposal, all but one supportive of the additional guidance. A few suggested that we issue more detailed guidance around the CFTC's Part 30 Exemption Regime and, in particular, the operation of any alternative segregation arrangements a firm may have in place when holding money on behalf of US customers for transactions undertaken on the London Metal Exchange ('**LME Bond Arrangements**'), and

²⁰² See existing CASS 7.8 and CASS 7.18 in Part 3 of the final rules in Appendix I.

the requisite format of letters of credit. Some respondents suggested revised drafting for the guidance based on the wording in the Part 30 Exemption Order and others made suggestions based on the historic guidance issued by the FCA's predecessors (such as the FSA and SFA). Another also requested we clarify our approach to supervising firms operating under the Part 30 Exemption Regime.

- 7.351** One respondent disagreed with the proposed guidance, stating it would have the effect of preventing a bank from utilising the CASS 7 'banking exemption'²⁰³ for monies from US customers when engaged in trading on non-US futures and options exchanges.
- 7.352** A number of respondents questioned more generally whether the entire Part 30 Exemption Regime should be reviewed, and highlighted the importance of continued FCA engagement with the industry on this topic.

Our response

- 7.353** We intend to introduce the revised guidance largely as proposed in the CP. As a result of feedback, we are moving the guidance to its own chapter in CASS and have ensured the drafting corresponds to the Part 30 Exemption Order. This guidance is based on our understanding of the requirements placed on firms by the CFTC under the terms of the Part 30 Exemption Order and, for LME Bond Arrangements, certain no-action letters. On a business as usual basis, we remain available to provide individual guidance to firms on FCA Handbook requirements relevant to the Part 30 Exemption Regime.
- 7.354** We supervise firms conducting business pursuant to the Part 30 Exemption Order for compliance with the FCA Handbook and undertake to notify the CFTC of any change in status of a firm that would affect its continued eligibility to operate under the Part 30 Exemption Regime.²⁰⁴ Notifications to the CFTC are made pursuant to a Financial Information Sharing Memorandum of Understanding and other related information sharing arrangements in place between the FCA and the CFTC.²⁰⁵ Some of the supervisory tools we use include the data we collect on both a regular²⁰⁶ and ad-hoc basis from firms which operate subject to the Part 30 Exemption Order. In particular, we note that firms which operate an LME Bond Arrangement are required to report to us on a quarterly basis in respect of those arrangements.²⁰⁷
- 7.355** We will continue to engage with all relevant trade bodies and associations and, in particular, the London Metal Exchange, on matters relating to the operation of the CFTC's Part 30 Exemption Regime within the UK.

²⁰³ See generally, discussion above at paras. 7.4 to 7.19.

²⁰⁴ Condition 1(b) of the Part 30 Exemption Order, 68 Federal Register 197 (October 10, 2003), available at: www.cftc.gov/files/foia/fedreg03/foi031010a.pdf.

²⁰⁵ Financial Information Sharing Memorandum of Understanding, (September 1, 1988) available at: <http://www.fca.org.uk/your-fca/documents/mou/mou-fsa-united-states-commodity-futures-trading-commission>.

²⁰⁶ SUP 16.14.1R requires that CASS large and CASS medium firms submit a monthly Client Money and Asset Return, see data field 5, available at: http://media.fshandbook.info/Forms/sup/sup_chapter16_annex29R_20130401.pdf.

²⁰⁷ See SUP 16.12.11R, FSA040 form, available at: http://media.fshandbook.info/Forms/sup/sup_chapter16_annex24r_20140401.pdf.

8. Mandates (CASS 8)

- 8.1** In this chapter we discuss changes to the mandate rules, which will affect firms holding mandates.

Non-written mandates

Q47: *Do you agree with our proposal to bring 'non-written' mandates into the scope of CASS 8? If not, please provide reasons.*

- 8.2** We consulted on extending the definition of a mandate to include mandates received by a firm that are not in written form. This would have required a firm to treat any means that would give the firm the ability to control a client's assets or liabilities as a mandate, regardless of the form in which the relevant information was received.
- 8.3** We received feedback from firms requesting clarification of what would constitute a non-written mandate, and how these should be recorded and retained. A number of firms expressed the view that all non-written mandates should be rendered into a written document for evidential purposes, and that there should be further clarification of the systems and controls that should surround the protection of these documents.

Our response

- 8.4** We are implementing the rules as proposed in the CP with minor changes in response to feedback. A mandate is information that gives the firm the ability to control a client's assets or liabilities and however it is received from the client, be it in a written or non-written form, it is important that there are controls around the recording and use of this data. We are clarifying that the same information received in multiple forms (for example by a recorded phone conversation and a follow-up letter) represents a single mandate.
- 8.5** We are not requiring firms to separately document non-written mandates. However, specific information about each non-written mandate will need to be recorded in the firm's list of mandates and the firm will need to establish systems and controls to ensure that all such information is captured. The firm's list of mandates must be kept up to date by the firm and retained for a defined period after the mandate ends.
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9. Client reporting and information (CASS 9)

Introduction

- 9.1** At present most of the client information and reporting requirements in relation to client assets held by investment firms are derived from MiFID and found in the conduct of business sourcebook ('**COBS**').²⁰⁸ One key exception is the disclosure and reporting requirements specific to prime brokerage firms in CASS 9.
- 9.2** In our experience of recent firm failures, we observed that clients of all types often have misconceptions around the protections afforded to client assets, and may fail to understand the protections available under the client assets rules and the impact contractual terms have on these protections.
- 9.3** In response, we consulted on introducing a package of proposals concerning the frequency of reporting to clients²⁰⁹, the information that should be provided to clients before the provision of investment services²¹⁰ and the creation of a standalone disclosure document to summarise key provisions within client agreements which may affect rights or protections under CASS.²¹¹ The purpose of these proposals was to increase market transparency and improve market awareness of the operation of our regime for the protection of client assets in the UK. We also suggested these proposals could improve outcomes for clients following a firm failure by reducing the number of disputes and queries before and during the distribution process.
- 9.4** We note that existing requirements together with these proposals are consistent with the client asset recommendations recently published by the International Organization of Securities Commissions ('**IOSCO**').²¹² We refer in particular to IOSCO Principle 2 on statements to clients, IOSCO Principle 5 on risk disclosures and IOSCO Principle 6 on agreements and disclosures to clients regarding rights to protections.
- 9.5** We received feedback from over 70 respondents on some or all of our proposals for additional CASS client reporting and information requirements.

208 See COBS 6.1.7R and COBS 16.

209 Proposed CASS 9.4 in the CP.

210 Proposed CASS 9.5 in the CP.

211 Proposed CASS 9.6 in the CP.

212 Recommendations Regarding the Protection of Client Assets, IOSCO, January 2014, recommendations 2, 5 and 6, pp. 3 – 7, available at www.iosco.org/library/pubdocs/pdf/IOSCOPD401.pdf.

Application of CASS 9

- 9.6** These new requirements in CASS 9 will only apply to firms holding custody assets under the custody rules or client money under the client money rules. These requirements will not apply for any client money an insurance intermediary may hold under the client money rules for insurance mediation activity²¹³ or a debt management firm may hold under the debt management client money chapter.²¹⁴
- 9.7** A few respondents questioned why these requirements were being introduced in CASS instead of COBS.

Our response

- 9.8** The additional requirements we are bringing into CASS 9 will only apply to firms that are otherwise subject to CASS. This means that firms that have passported into the UK under MiFID will not be subject to these new requirements²¹⁵ to the extent that they already fall within the relevant general application exclusion in CASS 1²¹⁶, although these firms passporting into the UK will remain subject to our existing information and reporting requirements in COBS.

Regular reporting to clients

Q44: *Do you agree with our proposed requirements on reporting to clients on their holdings of client assets? If not, please provide reasons.*

- 9.9** In the CP, we consulted on introducing guidance in CASS to remind investment firms of their client reporting obligations in relation to client assets under both the conduct of business rules²¹⁷ and the client assets rules.²¹⁸ In line with firms' existing obligations to be fair, clear and not misleading in their communications with clients²¹⁹, we suggested clarifying that firms should ensure that in any report to a client it is clear when assets or monies that the firm reports as holding for the client are, or are not, protected under either or both of the custody rules and the client money rules.
- 9.10** We also consulted on requiring firms to report to clients on their holdings of client assets more frequently than is otherwise required if a client so requests. The requisite frequency of reporting to clients is either at least annually²²⁰, or between monthly and six-monthly.²²¹ We stated that where such requests were received, any charges for providing the information to the client must reasonably correspond with the firm's actual costs for providing the information requested.

²¹³ See CASS 5.

²¹⁴ See CASS 11.

²¹⁵ Being introduced in this PS.

²¹⁶ See CASS 1.2.3R(2).

²¹⁷ See CASS 16.

²¹⁸ See CASS 9.

²¹⁹ See CASS 4.2.

²²⁰ See COBS 16.4.

²²¹ See COBS 16.3

- 9.11** The majority of respondents agreed with this proposal. A few supported the approach as proposed but stated that they did not think the FCA should be requiring firms to provide clients with information at whatever frequency the client so desired. A small minority, mostly representatives of the fund management industry, disagreed with the proposals in their entirety. Of those in disagreement, it was noted that ad-hoc client requests for statements were more difficult for firms to respond to than if we introduced an increased minimum frequency.
- 9.12** Others argued that the benefits to some clients of providing statements more frequently may be limited, especially when the firm only holds assets or monies on a temporary basis (e.g. in-between subscriptions and redemptions in units).
- 9.13** A number of respondents suggested that the costs associated with this proposal could be significant, many of whom said their costs would be significantly reduced if we either or both:
- a.** allowed firms up to 12 months to build new systems to comply with these requirements; or
 - b.** introduced a cap on the number of requests a firm was required to honour per year.

Others appreciated that the proposal would allow firms to recoup from a client the firm's reasonable costs of honouring the client's requests. None of the feedback we received on potential costs specifically disagreed with the costs we estimate in the CP or suggested the costs some firms would incur would be higher than those estimated.

Our response

- 9.14** We are introducing this proposal as set out in the CP with some changes to the drafting of the proposed rules to reflect feedback. These include highlighting that the underlying obligation being placed on firms is to honour client requests for information on their holdings of client assets. This includes requests for ad-hoc or more frequent statements and requests for copies of previously provided statements (in the latter case, firms being obliged to provide the copy to the client within one week). However, in both cases, firms will, as proposed, be allowed to charge a client the firm's reasonable costs in meeting the request.
- 9.15** We appreciate the feedback that we should place a cap on the number of requests a firm is obliged to honour to reduce the costs placed on firms. However, since these new requirements will require all firms to honour client requests, and the rules allow firms to charge a client the firm's reasonable costs in doing so, we see no reason to restrict the number of requests that a client may make for information.
- 9.16** However, we have provided additional guidance to clarify that where a firm provides a report to a client containing information on its holdings of client assets, a firm should ensure that it is clear from the report when assets or monies are, or are not, protected under either or both of our custody rules and client money rules.
- 9.17** We also note that, under this requirement, any information that the firm provides to the client may, although it is not required to, be in the same form as the statements that the firm is required to provide to the client under our conduct of business rules.²²²

²²² For example, under the existing rules this is COBS 16.4, or, if appropriate, COBS 16.3.

- 9.18** More generally, firms are reminded that they must report to their client²²³ in a 'durable medium'. This includes paper statements, and can include forms of electronic communications such as email and certain types of websites.

Transitional arrangements

- 9.19** Please see Table 2 in Chapter 2.²²⁴ Based on feedback, firms will be allowed until 1 June 2015 to bring their existing arrangements into compliance with these new requirements. We understand from feedback that this additional time (from the six month period proposed in the CP) should reduce the cost impact of these proposals allowing some firms to develop the systems they will need to handle these types of requests from clients as part of their business as usual processes.

Information to clients on client assets protection arrangements

Q45: *Do you agree with our proposals around the information that firms should be required to provide to clients about their holdings of client assets? If not, please provide reasons.*

- 9.20** We highlighted in the CP that the majority of the disclosure requirements in COBS which arise when a firm holds client designated investments or client money, currently only apply in respect of retail clients.²²⁵
- 9.21** We consulted on introducing guidance in CASS reminding investment firms of the information they are required to give clients about their holdings of client assets before they provide an investment service. We proposed to widen the scope of assets that could give rise to an obligation to give clients information²²⁶ to match the scope of assets that a firm might hold under the custody rules. We also proposed to remove the distinction made between types of clients in the disclosure requirements in COBS which arise when a firm holds client designated investments or client money²²⁷, with the effect that a firm subject to the custody rules and/or the client money rules would be required to provide the same information to all its clients. We stated that we see no logical reason for allowing the information on client assets provided to clients to vary based on the classification of a client or the type of asset held for the client.
- 9.22** The majority of respondents agreed with this proposal and many suggested they already provide the same level of information to all clients, irrespective of type, on their client asset arrangements. Some respondents, generally those who stated they do not have any retail clients, disagreed with this proposal, suggesting it would be burdensome and arguing that professional clients should be sophisticated enough to undertake their own due diligence to determine a firm's client asset arrangements and its consequences without the firm having to report separately. No one suggested they would incur costs inconsistent with those we consulted on in the CP, but a few did indicate that their costs could be significantly reduced

²²³ Whether under the existing requirements in COBS 16 or the new rules in CASS 9.5 on reporting to clients being introduced in this PS.

²²⁴ At para. 2.17.

²²⁵ See existing COBS 6.1.7R.

²²⁶ *Ibid.*

²²⁷ *Ibid.*

if they were allowed a longer transitional period to incorporate the required information into their existing client documentation. Others suggested an alternative would be to only require a firm to provide the information to a professional client if requested.

- 9.23** A few respondents requested clarification of the scope and application of these proposals and provided other drafting comments.

Our response

- 9.24** We are introducing this proposal with only minor changes to the rules we consulted on to clarify their intended scope and to ensure clarity. All investment firms subject to our custody rules or client money rules will be required to provide all of the information concerning safeguarding client assets that firms are required to provide to clients before the provision of investment services under the requirements in COBS²²⁸ to all clients. This will be irrespective of client type (i.e. not just retail clients) and asset type (e.g. not just designated investments, but any custody asset a firm may hold that is subject to our custody rules).
- 9.25** We see no reason for a firm to provide a client a different level of information on the arrangements in place for the client's assets and monies based on the client's classification or the type of asset placed with the firm. Recent experience with firm failures demonstrates that clients of all types are often unaware of the arrangements in place for the protection of their assets. Also, if a greater level of information is available to clients, it is less likely that queries or disputes may arise, even if from only a few clients, that could delay or reduce the distribution of client assets for all clients.

Transitional arrangements

- 9.26** Please see Table 2 in Chapter 2.²²⁹ These rules will come into force on 1 December 2014. This will mean that any new clients of the firm from 1 December 2014 should receive all of the information which is required under this rule before the provision of investment services. However, in respect of the client relationships that firms already have in place as at 30 November 2014, those firms will have until 1 June 2015 to comply with these new requirements.

Client assets disclosure document

Q46: *Do you agree with our proposals for the introduction of a Client Assets Disclosure Document? If not, please provide reasons.*

- 9.27** In the CP we proposed introducing a requirement for all firms subject to either the custody rules or the client money rules to have in place a Client Assets Disclosure Document ('**CADD**'). This was intended to highlight to clients, in the form of a stand-alone disclosure document, a summary of the key provisions within their client agreements which modified rights or protections that would otherwise be available to the client under the custody rules or the client money rules. We suggested this document would have to be reviewed and provided to clients at least annually, and before the provision of services or whenever the terms of any underlying agreement were amended such that a representation in the document was no longer accurate.

²²⁸ COBS 6.1.7R.

²²⁹ At para. 2.17.

- 9.28** The CADD was intended to be a tool by which clients would be reminded of the arrangements in place for the protection of client assets and a single-source record of the contractual arrangements a firm may have in place which could affect a client's rights to or interest in client assets.
- 9.29** A considerable number of respondents disagreed with the proposal to introduce the CADD, arguing that the costs of producing such a document would be disproportionate to the benefits that clients would gain from receiving the information in this form. Respondents argued that the information could be provided within other documentation that firms already have in place, and that, in the case of retail investors, receiving a standalone document could cause confusion rather than clarity due to the complexities of a firm's arrangements. Others argued that for this proposal to work, a considerable amount of additional guidance would be required as to the form and contents of the CADD. One trade association suggested that if we were to proceed with this proposal it would commission a template for its member firms to use when putting together their document.
- 9.30** Some respondents supported the standardisation of information disclosed to clients as an effective way of increasing client awareness of CASS protections. However, the general consensus was that providing this information to clients in the form of a separate disclosure document would not be the most efficient method of ensuring that clients understood the level of protection surrounding their money and assets.

Our response

- 9.31** We have decided not to proceed with our proposal for a CADD at this time. We are aware that the package of changes we are introducing in this PS will represent a significant change for some firms in how they report and provide information to their clients on client assets. This includes:
- Banking Exemption: where a bank holding a client's money is not going to be treated as subject to the banking exemption, that bank must notify its client accordingly;²³⁰
 - DvP windows: where a firm makes use of, or intends to make use of, the delivery versus payment window in relation to a client's money passing through a commercial settlement system or in relation to a regulated collective investment scheme, it must obtain the agreement of or otherwise notify its client before doing so;²³¹
 - TTCA: a firm must have a written agreement in place with the client for each of the title transfer collateral arrangements they are operating;²³²
 - CASS 9 – honouring client information requests: a firm is required to honour clients' requests for ad hoc or more frequent statements on client assets, and copies of previously issued statements;²³³ and
 - CASS 9 – information concerning safeguarding of client assets: a firm is required to provide the information set out in COBS 6.1.7R to all clients and in relation to all asset types before the provision of investment services.²³⁴

²³⁰ At paras. 7.4 to 7.19.

²³¹ At paras. 7.36 to 7.53 and 6.16 to 6.32.

²³² At paras. 6.2 to 6.15.

²³³ At paras. 9.9 to 9.19.

²³⁴ At paras. 9.20 to 9.26.

- 9.32** In addition to our existing client reporting and information requirements, we believe these new requirements should serve together to achieve our policy objectives of increasing client awareness of client asset protections, and importantly, the impact certain arrangements may have on client protections. Based on feedback, we understand not proceeding with the proposal for a separate disclosure document will reduce the perceived burden on firms compared to what we proposed in the CP.
- 9.33** We will keep the topic of reporting and providing information to clients on client assets under review and may, at a later stage, consult on revised proposals for a CADD.
-

10.

Consequential changes

- 10.1** In the CP we noted that in the final rules we intended to include amendments to CASS that are a consequence of the changes that we are making to the client money rules or the custody rules (as the case may be). For example, we noted that we would make any necessary consequential amendments to the rules relating to the CASS RP and the CMAR.
- 10.2** In the CP we also noted that we would aim to make the final rules simpler and easier to follow.
- 10.3** This chapter of the PS addresses the consequential changes and the restructuring of the rules.

Consequential changes

CASS 1

- 10.4** In the CP we consulted on inserting guidance in CASS 1 to ensure that the application of the CASS sourcebook is clear in particular circumstances. For example, we consulted on including guidance on the application of the CASS sourcebook to firms' affiliates in the context of MiFID business and non-MiFID business and including guidance on when the CASS sourcebook is applicable to trustee firms.
- 10.5** We did not receive any feedback on these proposals.
- 10.6** In light of this, we intend to implement these amendments as proposed. We are including one further amendment to clarify how firms subject to more than one client money chapter in the CASS sourcebook, such as the investment firm client money chapter, the insurance client money chapter or the debt management client money chapter, should apply these rules simultaneously.

CASS 3

- 10.7** As proposed in the CP, we are introducing additional guidance to remind firms of their obligations under the client's best interest rule²³⁵ when agreeing to a collateral arrangement.

CMAR

- 10.8** We are updating the CMAR and the CMAR guidance to reflect the wording and terminology and rule references that are used within the final rules being introduced in this PS. For example, Section 8E of the CMAR is currently titled 'Total number of trust status letters and/or acknowledgement letters in place that cover these and from the 1 June 2015 will be titled 'Total number of accounts at the end of the reporting period covered by an acknowledgement letter' in order to reflect the changes to the acknowledgement letter rules being introduced in this PS.

²³⁵ See COBS 2.1.1R.

CASS resolution pack

- 10.9** We are updating the CASS RP to reflect to reflect the wording and terminology that has been used within the final rules and any changes that have been made to rule references. For example reference to 'internal reconciliations relating to safe custody assets'²³⁶ has been changed to 'internal custody records checks' to reflect changes in the terminology used in relation to the custody records, accounts and reconciliation rules.

Structure of draft rules

Q49: Do you agree with the approach of replacing the existing client assets sourcebook with a new sourcebook? If not, please provide reasons.

- 10.10** We proposed in the CP to alter the structure of CASS and arrange the final rules so they would be simpler and easier to follow. We also noted that we were considering whether to replace the existing CASS sourcebook with a new sourcebook.
- 10.11** Over half of the respondents agreed that replacing the current CASS source book with a new sourcebook would be useful given the level of revision to the rules that we proposed in the CP. A number of respondents raised that creating a new sourcebook could lead to confusion due to the change to rule references. The majority of respondents supported our proposal to arrange the final rules in a manner that ensures they are simpler and easier to follow than the current rules.

Our response

- 10.12** As a result of the feedback and the changes to our rules we have decided to alter the structure of the current client assets sourcebook to make the rules simpler and easier to follow, but not to create a new sourcebook. The changes to the structure of the sourcebook are as follows:
- CASS 6.5 will be deleted in its entirety and replaced by CASS 6.6 Records, accounts and reconciliations;
 - CASS 7 will be renumbered to begin with CASS 7.11 Application and purpose;
 - CASS 7 Annex 1 will be deleted and replaced by a new chapter, CASS 7.17 The standard methods of internal client money reconciliation, which has been inserted before the CASS 7.18 Statutory trust rules;
 - CASS 7.8 will be renumbered and renamed to form the new chapter CASS 7.19 Acknowledgement letters;
 - A new chapter CASS 7.20 Multiple pools will be created;

²³⁶ See CASS 10.1.9E(1)(d).

- Four new annexes will be added to the CASS 7 client money rules, Annex 7 Annex 2R Client bank account acknowledgment letter template, 7 Annex 3R Client transaction account acknowledgment letter template, 7 Annex 4R Authorised central counterparty acknowledgment letter template and 7 Annex 5G Guidance notes for acknowledgement Letters (CASS 7.19); and
 - CASS 9 Prime brokerage will be renamed to CASS 9 Information to clients.
-

Annex 1

Cost benefit analysis

1. This annex provides:
 - (A) our views on the impact on the cost benefit analysis published in the CP (**'the CBA'**) from not proceeding with the CASS 7A client money distribution rules proposals at this stage;
 - (B) our views on the impact on the CBA from the other amendments being made in this PS to the policy proposals in the CP; and
 - (C) an overview of our response to the feedback we received to Q50 of the CP.
2. We explained in the CP that we expect the package of proposals would deliver benefits through the following three outcomes:
 - faster return of money and assets to clients;
 - lower shortfalls in the overall amount of money and assets returned to clients; and
 - greater market stability in the event of the failure of a firm.
3. The CBA set out an explanation of how we thought each of these outcomes might be positively impacted through the proposals in the CP, and where possible, an estimate of the value of those benefits to firms, clients and the wider market. The CBA also provided an estimate of the costs some firms would incur as a result of specific proposals if they were implemented.
4. In summary, and as described in more detail below, we have revised some of the cost estimates provided in the CBA in response to firm feedback. In some cases, this has prompted us to amend the proposal set out in the CP to reduce the burden on firms (for example, in the case of the UTDs proposal). These revisions and our conclusions are summarised below. We expect that each of the amendments we have made in this PS to the policy proposals in the CP (including decoupling the CASS 7A distribution rules) do not significantly increase the compliance costs to firms. In most instances these changes should reduce the regulatory burden on firms (see table below). Taking all these amendments together, we expect that the costs and benefits overall remain in line with those set out in the CBA published in the CP.
5. PS14/4 published final rules relating to 'crowdfunding' which entered into force on 1 April 2014, subject to certain transitional arrangements. Under these rules, firms carrying out the designated investment business of 'operating an electronic system in relation to lending' (i.e. operating a loan-based crowdfunding platform) will become subject to the client money rules and the client money distribution rules. We note that CASS 7 rule changes set out in this PS will apply to loan based crowdfunding firms. We expect the incremental compliance costs of these changes to these firms will be in line with the per firm cost estimates for other CASS 7 firms that were set out in the CP and this PS.

6. We consider that the compatibility statement set out in the CP still applies. We did not receive any feedback that requires us to revise the compatibility statement. Also, we consider the amendments being introduced in this PS do not require it to be revised.

(A) Impact of decoupling the CASS 7A proposals (including the Speed Proposal) on the CBA

7. As set out above²³⁷, we are not proceeding at this time with the CASS 7A distribution proposals (including the speed proposal). These proposals included:
- the speed proposal which required an insolvency practitioner ('IP') appointed on a firm's failure to promptly distribute client money on the basis of firm records;
 - a proposal to permit an IP to use allocated but unclaimed client money entitlements to cover shortfalls in the client money pool ('CMP'); and
 - a proposal to apply 'hindsight' to the valuation of clients' open positions with the aim of ensuring that clients' entitlements in respect of those positions to the CMP 'match' the value in the CMP.

not proceeding with the CASS 7A distribution proposals at this time does not require us to revise our CBA, as this will not change the regulatory burden on firms compared to what we consulted on. We also expect the remaining package of proposals to still achieve the estimated benefits (related to a faster return of client money and a reduction in shortfalls in the CMP) in line with those set out in the CP - as explained below.

8. In the CBA the two benefits relevant to the CASS 7A distribution rules proposals (along with the other proposals we consulted on that will improve client money segregation and record keeping) are achieving a faster return of client money²³⁸ and reducing client money shortfalls in the CMP in the event of firm failure. On this basis, the CBA provided an estimate of:
- a. the possible opportunity cost savings (for consumers); and
 - b. the possible reduction in client shortfalls,

that could have been achieved in the context of recent firm insolvencies if the proposals (including the CASS 7A distribution rules proposals) we consulted on had been in place at the time of these firm failures.

9. We recognise that by not proceeding with the CASS 7A distribution rules proposals some of the benefits we estimated might not be realised. However, we expect the segregation, recordkeeping, information and system proposals in this PS will improve firms' operations, organisational arrangements, records and practices and make it quicker, easier and therefore cheaper for an IP to determine the client money and custody assets estate of a failed firm, and thereby facilitate a faster return of client money and custody assets and lower client shortfalls than under our current regime.

²³⁷ At para. 3.7.

²³⁸ See outcome 1 above and para. 1.12 of the CP.

10. We will consider the impact of any CASS 7A distribution rules proposals on the CBA published in the CP in the context of any new proposals in the CASS 7A consultation later this year.

(B) Impact of other policy amendments on the CBA

11. We do not expect any of the other amendments to the individual policy proposals consulted on in the CP to require revisions of the CBA as the effect of these changes is to either reduce the regulatory burden on firms or minimally increase incremental costs (as such the legal threshold for revising the CBA have not been met²³⁹). Commentary on this can be seen in the relevant sections of this PS. The table below provides a summary of the amendments we have made grouping them depending on whether they reduce the cost burden on firms or minimally increase costs to firms. Overall we expect the regulatory burden on firms, compared to what we proposed in the CP, to likely remain the same.
12. In terms of the benefits, each of the amendments to individual proposals in the CP will have either no impact (for example they are already achieved through the other changes) or only a minimal impact on the benefits associated with the package of changes being introduced in this PS. Therefore, the estimated benefits from the overall package of new and revised rules being introduced in this PS (in terms of faster return of client money, lower shortfalls and greater market stability) remain in line with those estimated in the CP. As set out above, while decoupling the majority of our proposals for CASS 7A distribution rules from this PS (and in particular the speed proposal), we expect the other changes being introduced in this PS to still achieve a faster return of client money and lower client shortfalls on a firm failure (compared to the current regime). We will revisit these observations when considering any subsequent changes to our client money distribution rules.

Table 3 Summary of changes to costs or benefits estimated in CP13/5

Location in this PS	Policy changes – likely reduced costs to firms	Expected impact on benefits of proposal
Para 2.17	Transitional provisions – where appropriate, extended the proposed transitional provisions to allow firms 12 months (instead of six) to bring the arrangements into compliance with this PS.	Minimal impact to expected benefits.
Para 5.17	Registration of firm assets – continuing to allow firms to register their own assets in same name as client assets in limited circumstances.	Minimal impact to expected benefits.
Para 5.61	Internal system evaluation method; Physical custody reconciliations – removal of obligation to obtain an auditor's report.	Minimal impact to expected benefits.

²³⁹ We note that we have revised the CBA for the UTD proposal. We received feedback that we had not accounted for the loss of income that some firms would experience if we were to implement the CP proposal. As a result, we revised our initial cost estimates (section C), and amended the CP proposal to reduce the burden on firms.

Para 6.58	Unclaimed custody assets; unclaimed client money – reduction in number of steps which must be taken before paying away an asset or money, including removal of requirement to use media adverts.	Removing expensive and/or ineffective requirements should mean firms are not put off from using this optional mechanism. We expect that firms will still be effectively able to reach clients through the other specified means.
Para 5.52	Review of frequency of record checks and reconciliations – under both our custody rules and client money firms will not be separately be required to review the frequency at which a record check or reconciliation is carried out if the process is carried out daily.	No impact to expected benefits.
Para 7.50	DvP window relating to a regulated collective investment scheme – instead of removing this window entirely, we are clarifying it is a one-day window and requiring notification to clients.	Minimal impact to expected benefits.
Para 7.101	Unbreakable term deposits (UTD) – changed approach to permit UTDs up to duration of 30 days following revised cost benefit analysis to reflect the potential impact of the proposal in the CP on firm and client income. By carving out trustee firms and allowing firms to use UTDs of up to 30 days, we have reduced the regulatory burden on firms compared to what we initially proposed in the CP.	Only a small proportion of firms use UTDs. Although it means firms are likely to have to wait until the UTD matures before responding to market information or before distributing client money in the event of firm failure (longer than under our initial proposal), firms can be more responsive to market information and clients will get money back more quickly than in the absence of this rule (e.g. if firms were using 60 day or longer UTDs).
Para 7.112	Immediate segregation of client money – introducing carve out from the immediate segregation requirements for members of CCPs in certain circumstances. Where used, such firms will be required to maintain a prudent segregation to cover risks relating to the receipt of mixed remittances into a house account.	This change gives clearing firms more flexibility while still ensuring the risk of client shortfalls are minimised as much as possible.

Para 9.32	Client assets disclosure document – no longer proceeding with this proposal.	We expect the benefits of this proposal are already being achieved by our other proposals. For example, the additional disclosure and reporting requirements we are introducing around the banking exemption, TTCAs, the DvP windows and other changes to CASS 9.
	Policy changes – possible increased costs to firms	Expected significance of increase in costs
Para 6.29	Resolving custody shortfalls with a firm's own assets or money – additional requirement to create and retain a record describing the shortfall, identifying the affected client(s), and specifying the applicable assets appropriated to cover the shortfall. This record must then be updated when the discrepancy is resolved.	Minimal impact on costs (staff hours) associated with creation and retention of additional record.
Para 6.31	DvP window relating to commercial settlement systems – to allow to segregate their own money instead of custody asset until a delivery versus payment transaction settles so long as the firm keeps and retains a record describing the custody asset in question, identifying the affected client(s) and specifying the amount of money that the firm appropriates to cover the value of the custody asset.	Minimal impact on costs (staff hours) associated with creation and retention of additional record.
Para 5.22	Due diligence on third parties holding custody assets – additional recordkeeping obligation to retain record of periodic assessment.	Minimal impact on costs associated with longer record retention period (data storage).
Para 7.86	Due diligence on third parties holding client money – additional recordkeeping obligation to retain record of periodic assessment.	Minimal impact on costs associated with longer record retention period (data storage).
Para 7.34	Diversification of client money – additional recordkeeping obligation to create and retain a record of the firm's periodic assessment of whether it is appropriately diversified.	Minimal impact on costs associated with creation and retention of additional record.
Para 7.57	Prudent segregation – additional obligation to create and retain a 'prudent segregation record' wherever a firm chooses to prudently segregate in a client bank account.	Minimal impact on costs (staff hours) associated with creation and retention of an expanded record.

Para 7.184	Alternative approach mandatory prudent segregation amount – additional obligation to create and retain a ‘mandatory prudent segregation amount record’ in respect of the mandatory prudent segregation amount which firms who operate the alternative approach to client money segregation will be required to maintain.	Minimal impact on costs (staff hours) associated with creation and retention of additional record.
Para 7.122	Clearing arrangement mandatory prudent segregation amount – additional obligation to ‘create and retain a clearing arrangement mandatory prudent segregation amount record’ in certain situations.	Minimal impact on costs (staff hours) associated with creation and retention of additional record.
Para 5.82	Internal client money reconciliations and approved collateral – additional obligation to create and retain a record in respect of any of a firm’s own approved collateral which it holds to meet part of its margin transaction requirement.	Minimal impact on costs (staff hours) associated with creation and retention of additional record.
Para 5.68	Frequency of external client money reconciliations – clarification that review should occur on an at least an annual basis. This change will impact some firms which other would have undertaken the review on a less than annual basis.	Minimal impact on costs associated with carrying out review of frequency of external reconciliations more frequently.

13. We made two additional changes that are relevant for a number of the proposals highlighted above.
14. Firstly, we included additional requirement for **firms to retain records** of due diligence that they carry out on third party banks and custodians, and their periodic diversification assessments, for a period of five years. We expect firms will incur only minimal incremental costs as a result of having to retain these records (for example, we expect incremental costs of no more than £0.05 per firm annually for each proposal²⁴⁰). Also we expect that, as firms are already required to produce some of these records under the current rules, they will already retain these records and, as a result, they will incur no incremental compliance costs by the introduction of a specific rule to retain records.
15. Secondly, we have also included additional **record keeping requirements** for firms in relation to:
1. prudent segregation;
 2. covering custody shortfalls with the firm’s own money or assets;
 3. allowing a firm to segregate its own money instead of a custody asset held in connection with the DvP commercial settlement window;
 4. diversification of client money;
 5. alternative approach mandatory prudent segregation amount;

²⁴⁰ See NERA report, *Estimated compliance costs of conduct of business regulation for general insurance*, 2003 (figures adjusted for inflation), p.28, available at www.fsa.gov.uk/pubs/cp/187/nera.pdf.

6. clearing arrangement mandatory prudent segregation amount; and
7. using own approved collateral to meet a margin transaction requirement. Again, we expect the incremental compliance costs to firms will be minimal.

For example, if a firm were to comply with the record-keeping for seven of the requirements listed above we would expect the total costs to be around £1,200 per firm per year.²⁴¹ We expect this is an overestimate given that: many firms will not be affected by all seven proposals, and many firms will already be partially recording this information and so the incremental cost is likely to be negligible.

(C) Summary and response to firm feedback on Q50

Q50: *What are your views on the benefits and costs of the proposals? Please provide explanations and qualitative evidence to support your response where appropriate.*

16. The feedback we received to this question generally agreed with the benefits set out in the CBA. However, a number of respondents commented that we may have underestimated the incremental compliance costs to firms in relation to certain proposals.

Our response:

17. Where the comments we received on the CBA relate to specific proposals we have addressed them on an individual basis in the body of this PS. In particular, where we agree that in relation to a specific proposal there was a need to revise the CBA we have done so. We have summarised the most significant revisions below.
18. The most significant revision to the CBA was in relation to our proposal to prohibit firms from placing client money in unbreakable term deposits. As explained in the main body of this PS²⁴² we estimate that the loss of income for firms with the largest client money holdings in UTDs could be between £150mn and £225mn (representing around 1.5% of total turnover) and for firms with the smallest reported client money holdings in UTDs could be between £3,000 and £5000 (representing around 3.5% of total turnover). We note that this proposal affects very few firms. However, given the size of this loss of income we have revised the proposal down – to reduce the burden on firms.²⁴³ For example, we have carved out trustee firms and allowed other firms to use UTDs for up to 30 days. We acknowledge that if a firm with client money in an UTD fails, the firm will not be able to distribute that client money until it receives it when the UTD has matured. Similarly, the firm will not be able to withdraw that money in response to market information until that UTD has matured. However, firms will receive this client money more quickly than in the absence of this rule (e.g. for example, if firms were permitted to use 60 day or longer UTDs).

²⁴¹ This assumes that the record keeping requirements for each proposal takes four hours of a junior compliance officer on around £55,000 per year – see footnote 240 NERA report at p.48 (figures adjusted for earnings inflation).

²⁴² At para. 7.101.

²⁴³ At paras. 7.98 to 7.106.

19. Also, some respondents noted that there could be ‘repapering’ costs as a result of some of the proposals in the CP which were not accounted for in the CBA. By repapering we understand that these respondents meant having to revise client documentation and to recirculate that documentation with clients. Therefore we consider these costs in more detail below.
20. We estimate that most firms will incur some costs as a result of the changes being introduced in this PS from **repapering client agreements or other documentation**. However, we expect these costs will not exceed those a firm would have incurred if we were introducing the proposals in the CP for a CADD. The CADD would have necessitated the creation and distribution of a stand-alone disclosure document to all clients. This would have involved firms, having reconsidered existing contractual clauses and disclosures in light of this PS, extracting the relevant information from their existing documentation, redrafting some of these statements, compiling them into a standalone document and recirculating this new document to clients. As such, some of the costs associated with the CADD are similar to those we would generally expect in the context of any exercise which might require firms to redraft and distribute client documentation.
21. In the CBA we carried out for the CADD proposals, we reported that we expected most small and medium sized firms would incur one-off median costs of £1,000²⁴⁴. For the majority of the largest firms we estimated median upfront costs of £6,000²⁴⁵. We note that some firms estimated that they would incur considerably higher costs to implement the CADD proposal but we do not think that these are reflective of the costs that are likely for repapering.
22. The incremental costs incurred by firms from reviewing and updating their documentation in response to the proposed changes set out in this PS are likely to be significantly lower than the estimates we reported for the CADD because:
1. many firms will not have to review and repaper their client documentation for all the multiple changes being introduced in this PS²⁴⁶; and
 2. given that firms will have until 1 December 2014 to bring their current documentation into line with these new requirements and firms will have a further six months to repaper existing agreements and documentation²⁴⁷, firms will be able to repaper their existing arrangements with clients as part of their business as usual processes, further reducing the likely costs these requirements will impose on them.

244 Annex 1 in the CP at para 71.

245 *Ibid.*

246 For example, some firms may incur costs to repaper their client documentation to meet new notification, consent or information requirements which are **mandatory** in specific circumstances. This includes firms: (1) making use of the exemptions in our client money and custody rules for TTCAs; (2) making use of the DvP window for commercial settlement systems; (3) making use of the DvP window for regulated collective investment schemes; (4) taking client money on deposit as banker (the banking exemption); and (5) firms with non-retail clients may also incur costs from the additional information which they will now be obligated to provide those clients before the provision of investment services (new CASS 9.4). Others might only incur additional costs from having chosen to make use of an **optional** mechanism under our rules for the handling of client money and custody assets in specific circumstances. This includes firms which may choose to follow the procedures we are requiring for: (1) handling unclaimed client money and custody assets; (2) carrying out a transfer of business; (3) choosing to operate multiple client money pools (e.g. the sub-pool disclosure document); and (4) handling shortfalls in custody assets (certain credit institutions operating under the banking exemption may need to revise their client documentation in order to be able to segregate their own money as client money to cover a shortfall in custody assets instead of otherwise immediately making good that shortfall).

247 See para. 2.12.

Annex 2

List of non-confidential responses

Below is a list of the respondents to the CP who provided us their feedback on a non-confidential basis:

1. A J Bell Securities Ltd
2. Aberdeen Asset Management
3. Aberforth Partners LLP
4. Allied Irish Banks plc
5. Arbuthnot Latham & Co. Limited
6. Artemis Investment Management LLP
7. Association for Financial Markets in Europe (AFME)
8. Association of British Insurers (ABI)
9. AXA Investment Managers
10. AXA Wealth
11. Bank Of New York Mellon
12. BDO LLP
13. BlackRock, Inc.
14. Botts & Company
15. Brewin Dolphin Ltd
16. Brian Shearing and Partners Limited
17. British Bankers' Association
18. British Private Equity and Venture Capital Association's Regulatory Committee
19. Cambridge Fund Managers Ltd
20. Capita Life and Pensions Regulated Services Limited

21. Charles Stanley & Co Limited
22. City Asset Management
23. City of London Law Society
24. Close Brothers Asset Management
25. CMC Markets
26. CMS Cameron McKenna LLP
27. Compound Growth Limited
28. Computershare Investor Services plc
29. Deloitte LLP
30. Depository and Trustee Association (DATA)
31. Dewhurst Torevell & Co Ltd
32. E*TRADE Securities Limited
33. Equiniti Financial Services Limited (EFSL)
34. Ernst & Young LLP
35. Eurex Clearing AG
36. Euroclear SA/NV
37. Euroclear UK & Ireland
38. F&C Fund Management Limited
39. Family Investments (FEPL and FPML)
40. Fidelity Worldwide Investment
41. Financial Markets Law Committee
42. FNZ (UK) Ltd
43. Foresters Fund Management Limited
44. Forex Capital Markets Limited
45. Futures and Options Association
46. GLG Partners Investment Funds Limited

47. ICAEW
48. ICAP plc
49. Institute of Chartered Secretaries and Administrators Registrars Group
50. Integrated Financial Arrangements plc
51. International Financial Data Services
52. Invesco Perpetual
53. Investec Wealth & Investment Limited
54. Investment Management Association
55. Joanna Benjamin
56. Jupiter Asset Management
57. Kinetic Partners LLP
58. KPMG LLP
59. Liontrust Fund Partners LLP
60. Liverpool Victoria Friendly Society Limited
61. Lloyds Banking Group
62. London Metal Exchange
63. Martin Currie Investment Management Ltd
64. McInroy and Wood Ltd
65. Northern Trust
66. Novia Financial plc
67. NRS Regulatory Services Ltd
68. Nucleus Financial Services
69. Panmure Gordon
70. Parmenion
71. Pershing Limited
72. Pershing Securities Limited

73. PricewaterhouseCoopers LLP
74. Rathbone Investment management Limited
75. Reyker Securities plc
76. Royal Bank of Scotland plc
77. Sanford C. Bernstein Limited
78. Santander UK plc
79. Sarasin & Partners LLP
80. Schroder Unit Trusts Limited
81. Seedrs Limited
82. Share Centre Limited
83. Skandia MultiFUNDS Limited
84. Smith & Williamson
85. St. James's Place Wealth Management Group
86. Standard Life Investments (Mutual Funds) Limited
87. Standard Life Savings Ltd
88. State Street Global Services
89. Talos Securities Limited
90. Tax Incentivised Savings Association
91. The TA Forum
92. UBS AG
93. Walbrook Partners Limited
94. Wealth Management Association
95. WH Ireland Limited
96. Williams de Broe Asset Management Limited
97. Winterflood Securities Limited

In addition to the above, there were 21 respondents who provided us their feedback confidentially.

Appendix 1

Made rules (legal instrument)

CLIENT ASSETS SOURCEBOOK (AMENDMENT NO 5) INSTRUMENT 2014**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 powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force as specified within each Annex.

Amendments to the FCA Handbook

- D. The modules of the FCA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Conduct of Business sourcebook (COBS)	Annex B
Client Assets sourcebook (CASS)	Annex C
Supervision manual (SUP)	Annex D

Notes

- E. In Annex C to this instrument, the “notes” (indicated by “**Note:**”) are included for the convenience of readers but do not form part of the legislative text.

Citation

- F. This instrument may be cited as the Client Assets Sourcebook (Amendment No 5) Instrument 2014.

By order of the Board of the Financial Conduct Authority
5 June 2014

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 1 July 2014

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

<i>general pool</i>	the discrete pool of <i>client money</i> held for all <i>clients</i> of the <i>firm</i> for whom the <i>firm</i> receives or holds <i>client money</i> in accordance with CASS 7.1.1AR, other than <i>client money</i> received or held in accordance with CASS 7.1.1AR in respect of a <i>sub-pool</i> .
<i>gross-minus-net amount</i>	at any given time, in respect of an <i>omnibus client account</i> maintained by a <i>clearing member firm</i> and the positions recorded therein, an amount equal to the difference between: <ol style="list-style-type: none"> (a) the sum of the margin amounts received from each <i>client</i> in relation to positions held for such <i>client</i> in that <i>omnibus client account</i> and (b) the amount of margin calculated on a net basis in respect of all of the <i>client</i> positions recorded in that <i>omnibus client account</i> and paid by that <i>firm</i> to the <i>authorised central counterparty</i>.
<i>LME</i>	the London Metal Exchange Limited.
<i>LME bond arrangement</i>	an arrangement for the segregation of money held by <i>firms</i> on behalf of US customers for transactions undertaken on the exchange operated by the <i>LME</i> , which is an alternative to complying with condition 2(g) of the <i>Part 30 exemption order</i> , and which has been established in accordance with certain no-action letters issued by the Commodity Futures Trading Commission.
<i>net margined omnibus client account</i>	an <i>omnibus client account</i> maintained by a <i>clearing member firm</i> in respect of which the margining arrangements give rise to a <i>gross-minus-net amount</i> which is held by the <i>clearing member firm</i> as <i>client money</i> .
<i>pool</i>	either a <i>sub-pool</i> or a <i>general pool</i> , as the context requires.
<i>sub-pool</i>	a discrete <i>pool</i> of <i>client money</i> established under CASS 7.19.
<i>sub-pool disclosure</i>	a document prepared by a <i>firm</i> containing the information required by

document CASS 7.19.9R.

Amend the following as shown.

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

clearing house a clearing house through which transactions may be cleared and for the purposes of *CASS 7* and *CASS 7A*, includes an *authorised central counterparty* and a *CCP*.

client money ...

(2A) (in *FEES*, *CASS 6*, *CASS 7*, *CASS 7A* and *CASS 10* and, in so far as it relates to matters covered by *CASS 6*, *CASS 7*, *COBS*, *GENPRU* or *IPRU(INV)*) subject to the *client money rules*, *money* of any currency:

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

(b) which, in the course of carrying on *designated investment business* that is not *MiFID business*, a *firm* holds ~~in respect of any investment agreement entered into, or to be entered into, with or for a client, or which a firm treats as client money in accordance with the client money rules; or~~

(c) which a *firm* treats as *client money* in accordance with the *client money rules*.

...

client money rules ...

(3) (in *CASS 3*, *CASS 6*, *CASS 7*, *CASS 7A*, *UPRU*, *COBS* and *FEES*) *CASS 7.1 to 7.8* and *CASS 7.19*.

limited assurance engagement a 'limited assurance engagement' as described in the Glossary of terms in ~~the Auditing Practices Board Standards and Guidance for Auditors issued in 2010~~ Financial Reporting Council: Audit and Assurance: Standards and Guidance 2014.

Part 30 Exemption ~~an~~ the order under regulation 30.10 of the General Regulations under the US Commodity Exchange Act, issued by the Commodity Futures

<i>Order</i>	Trading Commission on 15 May 1989 <u>on 10 October 2003 (consolidating and updating relief granted to <i>firms</i> in prior orders)</u> , granting a <i>person authorised under the Act</i> exemption from the registration requirement <u>certain requirements</u> contained in Part 30 of those General Regulations.
<i>port</i>	means , in respect of the assets and positions recorded in a <i>client transaction account</i> that is an <i>individual client account</i> or an <i>omnibus client account</i> at an <i>authorised central counterparty</i> , action taken by that <i>authorised central counterparty</i> to transfer those assets and positions in accordance with article 48 of <i>EMIR</i> to another clearing member designated by the individual <i>client</i> (in the case of an <i>individual client account</i>) or designated by all of the <i>clients</i> for whom the account is held (in the case of an <i>omnibus client account</i>).
<i>reasonable assurance engagement</i>	a 'reasonable assurance engagement' as described in the Glossary of terms in the Auditing Practices Board Standards and Guidance for Auditors issued in 2010 <u>Financial Reporting Council: Audit and Assurance: Standards and Guidance 2014</u> .
<i>standard method of internal client money reconciliation</i>	(a) CASS 7 Annex 1G; <u>or</u> (b) <u>the methods of internal reconciliation of <i>client money</i> balances referred to in CASS 7.16 of the Client Assets Sourcebook (Amendment No 5) Instrument 2014.</u>
<i>trustee firm</i>	a <i>firm</i> which is not an <i>OPS firm</i> and which is acting as a: (a) <u>trustee (other than for a trust of <i>client money</i> arising only under CASS 5.3.2R, CASS 5.4 (Non-statutory client money trust), CASS 7.7.2R or CASS 11.6.1R); or</u> ...

Part 2: Comes into force on 1 December 2014

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

<i>acknowledgement letter</i>	(in CASS 7) a <i>client bank account acknowledgement letter</i> (a letter in the form of the template in CASS 7 Annex 2R), a <i>client transaction account acknowledgement letter</i> (a letter in the form of the template in CASS 7 Annex 3R) or an <i>authorised central counterparty acknowledgment letter</i> (a letter in the form of the template in CASS 7 Annex 4R).
<i>alternative approach mandatory prudent segregation</i>	the requirement under CASS 7.4.18BR on a <i>firm</i> using the alternative approach to segregate an amount of <i>money</i> as <i>client money</i> .

<i>alternative approach mandatory prudent segregation record</i>	the record created and maintained by a <i>firm</i> under CASS 7.4.19AR to CASS 7.4.19CR.
<i>authorised central counterparty acknowledgment letter</i>	a letter in the form of the template in CASS 7 Annex 4R.
<i>client transaction account acknowledgement letter</i>	a letter in the form of the template in CASS 7 Annex 3R.
<i>commercial settlement system</i>	a system commercially available to <i>firms</i> that are members or participants, a purpose of which is to facilitate the settlement of transactions using <i>money</i> and/or assets held on one or more <i>settlement accounts</i> .
<i>non-standard method of internal client money reconciliation</i>	a method of internal reconciliation of <i>client money</i> balances that is not a <i>standard method of internal client money reconciliation</i> .
<i>settlement account</i>	an account containing <i>money</i> and/or assets that is held with a <i>central bank</i> , central securities depository, <i>central counterparty</i> or any other institution acting as a <i>settlement agent</i> , which is used to settle transactions between participants or members of a <i>commercial settlement system</i> .

Amend the following definitions as shown.

<i>acknowledgement letter fixed text</i>	(in CASS 11) the text in the template acknowledgement letters in CASS 11 Annex 1R that is not in square brackets.
	(1) <u>(in CASS 7) the text in the template <i>acknowledgement letters</i> in CASS 7 Annex 2R, CASS 7 Annex 3R and CASS 7 Annex 4R that is not in square brackets.</u>
	(2) <u>(in CASS 11) the text in the <i>template acknowledgement letters</i> in CASS 11 Annex 1R that is not in square brackets.</u>
<i>acknowledgement letter variable text</i>	(in CASS 11) the text in the template acknowledgement letters in CASS 11 Annex 1R that is in square brackets.
	(1) <u>(in CASS 7) the text in the template <i>acknowledgement letters</i> in CASS 7 Annex 2R, CASS 7 Annex 3R, and CASS 7 Annex 4R that is in square brackets.</u>
	(2) <u>(in CASS 11) the text in the <i>template acknowledgement letters</i> in CASS 11 Annex 1R that is in square brackets.</u>

- client bank account acknowledgement letter* ~~(in CASS 11) a letter in the form of the template in CASS 11 Annex 1R.~~
- (1) (in CASS 7) a letter in the form of the template in CASS 7 Annex 2R.
- (2) (in CASS 11) a letter in the form of the template in CASS 11 Annex 1R.

Part 3: Comes into force on 1 June 2015

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

- aggregate safe custody asset record* a *firm's* internal record or account of all the *safe custody assets* that the *firm* holds for its *clients* (including those *safe custody assets* deposited by the *firm* with third parties under CASS 6.3 and any *physical safe custody assets* held by the *firm*).
- CASS 7 asset management firm* a *firm* subject to the *client money rules* and which falls within either (a) or (b), or both, but not (c):
- (a) a *firm* that was a member of *IMRO* immediately before *commencement*;
- (b) a *firm* for which the most substantial part of its gross income (including *commissions*) from its *MiFID business* or *designated investment business* that is not *MiFID business*, or both, is derived from one or more of the following activities:
- (i) *managing investments* other than *derivatives*;
- (ii) *OPS activity*;
- (iii) acting as the *manager* or *trustee* of an *AUT*;
- (iv) *managing an AIF*;
- (v) acting as the *ACD* or *depository* of an *ICVC*;
- (vi) acting as the *authorised contractual scheme manager* or *depository of an ACS*;
- (vii) *acting as trustee or depository of an AIF*;

- (viii) *acting as trustee or depositary of a UCITS;*
 - (ix) *establishing, operating or winding up a collective investment scheme (other than an AUT, ICVC or ACS);*
 - (x) *establishing, operating or winding up a personal pension scheme;*
 - (xi) *safeguarding and administering investments; and*
 - (xii) *the provision of platform services;*
- (c) a *firm* for which the most substantial part of its gross income is derived from its *safeguarding and administering investments* activities.

CASS 7 loan-based crowdfunding firm

a *firm*:

- (a) that is subject to the *client money rules* in CASS 7; and
- (b) whose *designated investment business* includes *operating an electronic system in relation to lending*.

clearing arrangement mandatory prudent segregation

the requirement under CASS 7.13.73R on a *firm* using the normal approach to segregate an amount of *money* as *client money*.

clearing arrangement mandatory prudent segregation record

the record created and maintained by a *firm* under CASS 7.13.74R and CASS 7.13.75R.

client money requirement

the total amount of *client money* a *firm* is required to have segregated in *client bank accounts* under the *client money rules* (see CASS 7.16.10R).

client money resource

the aggregate balance on the *firm's client bank accounts* (see CASS 7.16.8R).

client-specific safe custody asset record

a *firm's* internal record or account identifying each of the particular *safe custody assets* that the *firm* holds for each particular *client* (including those *safe custody assets* deposited by the *firm* with third parties under CASS 6.3 and any *physical safe custody assets* held by the *firm*).

external client money reconciliation

the *client money* reconciliation described in CASS 7.15.20R.

external custody reconciliation

the *safe custody asset* reconciliation described in CASS 6.6.34R.

<i>firm's equity balance</i>	the sum of <i>money</i> described in CASS 7.16.29R.
<i>individual client balance</i>	for each <i>client</i> , the total amount of all <i>money</i> the <i>firm</i> holds, has received or is obliged to have received or be holding as <i>client money</i> in a <i>client bank account</i> for that <i>client</i> in respect of <i>non-margined transactions</i> , calculated in accordance with CASS 7.16.21R.
<i>individual client balance method</i>	the method of calculating a <i>firm's client money requirement</i> described in CASS 7.16.16R.
<i>internal client money reconciliation</i>	the <i>client money</i> reconciliation described in CASS 7.15.12R.
<i>internal custody reconciliation method</i>	a method for performing an <i>internal custody record check</i> , described in CASS 6.6.17R.
<i>internal custody record check</i>	the <i>safe custody assets</i> record check described in CASS 6.6.10G(2) performed using either the <i>internal custody reconciliation method</i> or the <i>internal system evaluation method</i> .
<i>internal system evaluation method</i>	a method for performing an <i>internal custody record check</i> , described in CASS 6.6.19R.
<i>margined transaction requirement</i>	the total amount of <i>client money</i> a <i>firm</i> is required to segregate in <i>client bank accounts</i> for <i>margined transactions</i> under the <i>client money rules</i> , in accordance with CASS 7.16.32R.
<i>net negative add-back method</i>	the method of calculating a <i>firm's client money requirement</i> described in CASS 7.16.17R.
<i>non-margined transaction</i>	a transaction <i>executed</i> by a <i>firm</i> : <ul style="list-style-type: none"> (a) for, or on behalf of, a <i>client</i> in relation to <i>MiFID business</i> and/or <i>designated investment business</i>; and (b) which is not a <i>margined transaction</i>.
<i>physical asset reconciliation</i>	the <i>safe custody assets</i> reconciliation described in CASS 6.6.24R, using either the <i>total count method</i> or the <i>rolling stock method</i> .
<i>physical safe custody asset</i>	a <i>safe custody asset</i> (or tangible evidence of one) that is in a <i>firm's</i> physical custody and which may also be registered with the relevant issuer or agent of the issuer.
<i>prudent segregation</i>	a <i>firm's</i> segregation of an amount of <i>money</i> as <i>client money</i> under CASS 7.13.41R.
<i>prudent segregation record</i>	the records created and maintained by a <i>firm</i> under CASS 7.13.50R to CASS 7.13.53R.

rolling stock method a method for performing a *physical asset reconciliation*, as described in CASS 6.6.28R.

total count method a method for performing a *physical asset reconciliation*, as described in CASS 6.6.27R.

Amend the following definitions as shown:

alternative approach mandatory prudent segregation the requirement under ~~CASS 7.4.18B~~ 7.13.65R on a *firm* using the alternative approach to segregate an amount of *money* as *client money*.

alternative approach mandatory prudent segregation record the record created and maintained by a *firm* under ~~CASS 7.4.19A~~ 7.13.66R to ~~CASS 7.4.19C~~ 7.13.68R.

client bank account ...

(2) (in CASS 7 and CASS 7A):

(a) an account at a bank which:

(i) ~~holds the money of one or more clients;~~
[deleted]

(ii) is expressly held in the name of the *firm* that is subject to the requirement in CASS 7.13.3R; and

(iii) is a current or a deposit account; or

(b) a money market deposit account of *client money* which is identified as being *client money*; and

(c) in either case, which is a *general client bank account*, a *designated client bank account* or a *designated client fund account*.

client equity balance ~~the amount which a *firm* would be liable (ignoring any non-cash collateral held) to pay to a *client* (or the *client* to the *firm*) in respect of his *margin*ed transactions if each of his open positions was liquidated at the closing or settlement prices published by the relevant exchange or other appropriate pricing source and his account closed. This refers to cash values and does not include non-cash collateral or other *designated investments* held in respect of a *margin*ed transaction~~ the sum of *money* as described in CASS 7.16.28R.

client money rules ...

- (3) (in CASS 3, CASS 6, CASS 7, CASS 7A, COBS and FEES) CASS 7.1 to 7.8 and CASS 7.10 to 7.19.

client money segregation requirements

~~CASS 7.4.1R~~ 7.13.3R and ~~CASS 7.4.11R~~ 7.13.12R.

client transaction account

(in relation to a *firm* and ~~an exchange, clearing house, or intermediate broker~~ another person) an account maintained by ~~the that other person, such as an exchange, clearing house, or~~ intermediate broker or OTC counterparty, as the case may be, in respect of transactions in contingent liability investments undertaken by the firm with or for its clients who a firm allows to hold client money under CASS 7.14 (Client money held by a third party), which:

- (a) is in the name of the firm;
- (b) includes in its title the word “client” (or, if the system constraints of the relevant person or the firm that holds the account (or both) make this impracticable, an appropriate abbreviation of “client” that has the same meaning); and
- (c) is not a client bank account.

designated client bank account

a *client bank account* with the following characteristics:

...

- (b) the account includes in its title the ~~word~~ words "designated client" (or, if the systems constraints of the approved bank or the firm that holds the account (or both) make this impracticable, an appropriate abbreviation of those words that has the same meaning);

...

designated client fund account

a *client bank account* with the following characteristics:

...

- (b) the account includes in its title the ~~word~~ words "designated client fund" (or, if the systems constraints of the approved bank or the firm that holds the account (or both) make this impracticable, an appropriate abbreviation of those words that has the same meaning); and

...

<i>general pool</i>	the discrete pool of <i>client money</i> held for all <i>clients</i> of the <i>firm</i> for whom the <i>firm</i> receives or holds <i>client money</i> in accordance with CASS 7.1.1AR <u>7.10.1R</u> other than <i>client money</i> received or held in accordance with CASS 7.1.1AR <u>7.10.1R</u> in respect of a <i>sub-pool</i> .
<i>general client bank account</i>	a <i>client bank account</i> that holds <i>client money</i> of one or more <i>clients</i> , <u>which includes in its title the word “client” (or, if the systems constraints of the approved bank or the firm that holds the account (or both) make this impracticable, an appropriate abbreviation of the word “client” that has the same meaning), and which is not:</u> ...
<i>MiFID client money (minimum implementing) rules</i>	CASS 7.3.1R <u>7.12.1R</u> , CASS 7.3.2R <u>7.12.2R</u> , CASS 7.4.1R <u>7.13.3R</u> , CASS 7.4.5R , CASS 7.4.7R <u>7.13.8R</u> , CASS 7.4.8R <u>7.13.10R</u> , CASS 7.4.11R <u>7.13.12R</u> , CASS 7.13.28R , CASS 7.6.1R <u>7.15.2R</u> , CASS 7.6.2R <u>7.15.3R</u> and CASS 7.6.9R <u>7.15.20R</u> .
<i>non-standard method of internal client money reconciliation</i>	a <u>the method of internal reconciliation of <i>client money</i> balances</u> <i>internal client money reconciliation</i> that is not a standard method of internal client money reconciliation <u>described in CASS 7.15.17R.</u>
<i>segregated client</i>	a <i>client</i> whose money must be segregated by the <i>firm</i> under CASS 4.3.3R (Segregation). <u>[deleted]</u>
<i>shortfall</i>	... (3) <u>(in relation to <i>safe custody assets</i>) any amount by which the <i>safe custody assets</i> held by a <i>firm</i> under the <i>custody rules</i> fall short of the <i>firm’s</i> obligations to its <i>clients</i> to hold <i>safe custody assets</i>.</u> ...
<i>standard method of internal client money reconciliation</i>	(a) CASS 7 Annex 1G; <u>[deleted]</u> (b) the methods of internal reconciliation of <i>client money</i> balances <u><i>internal client money reconciliation</i> described referred to in CASS 7.16 of the Client Assets Sourcebook (Amendment No 5) Instrument 2014.</u>
<i>trustee firm</i>	a <i>firm</i> which is not an <i>OPS firm</i> and which is acting as a: (a) trustee (other than for a trust of <i>client money</i> arising only under CASS 5.3.2R, CASS 5.4 (Non-statutory client money trust), CASS 7.7.2R <u>7.17.2R</u> or CASS 11.6.1R); or ...

Annex B

Amendments to the Conduct of Business sourcebook (COBS)

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

Part 1: Comes into force on 1 December 2014

6 Information about the firm, its services and remuneration

6.1 Information about the firm and compensation information

...

6.1.7A G *Firms* subject to either or both the *custody rules* and the *client money rules* are reminded of the information requirements concerning *custody assets* and *client money* in *CASS 9.3* (Prime brokerage agreement disclosure annex) and *CASS 9.4* (Information to clients concerning custody assets and client money).

...

Part 2: Comes into force on 1 June 2015

16 Reporting information to clients

...

16.4 Statements of client designated investments or client money

...

16.4.6 G *Firms* subject to either or both the *custody chapter* and the *client money chapter* are reminded of the reporting obligations to *clients* in *CASS 9.2* (Prime broker's daily report to clients) and *CASS 9.5* (Reporting to clients on request).

...

Annex C

Amendments to the Client Assets sourcebook (CASS)

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

Part 1: Comes into force on 1 July 2014

1 Application and general provisions

...

1.2 General application: who? what?

...

- 1.2.7 G (1) ~~The approach in CASS is to ensure that the rules in a chapter are applied to firms in respect of particular regulated activities or unregulated activities. [deleted]~~
- (2) ~~The scope of the regulated activities to which CASS applies is determined by the description of the activity as it is set out in the Regulated Activities Order. Accordingly, a firm will not generally be subject to CASS in relation to any aspect of its business activities which fall within an exclusion found in the Regulated Activities Order. The definition of designated investment business includes, however, activities within the exclusion from dealing in investments as principal in article 15 of the Regulated Activities Order (Absence of holding out etc). [deleted]~~
- (3) ~~The custody chapter and the client money chapter apply in relation to regulated activities, conducted by firms, which fall within the definition of MiFID business and/or designated investment business. [deleted]~~
- (3A) ~~The collateral rules apply in relation to regulated activities, conducted by firms, which fall within the definition of designated investment business (including MiFID business). [deleted]~~
- (4) ~~The insurance client money chapter applies in relation to regulated activities, conducted by firms, which fall within the definition of insurance mediation activities. [deleted]~~
- ...
- (6) ~~The mandate rules apply in relation to regulated activities, conducted by firms, which fall within the definition of designated investment business (including MiFID business) and insurance mediation activity, except where it relates to a reinsurance contract.~~

[deleted]

...

1.2.8 G ...

(4) Each provision in the *collateral rules*, *custody chapter*, and the *client money chapter* and CASS 9 (Information to clients) makes it clear whether it applies to activities carried on for *retail clients*, *professional clients* or both. ~~There is no further modification of the rules in these chapters in relation to activities carried on for eligible counterparties. Such clients are treated in the same way as other professional clients for the purposes of these rules.~~

(4A) There is no further modification of the rules in the chapters referred to in (4) for activities carried on for eligible counterparties. Such clients are treated in the same way as other professional clients for the purposes of these rules.

...

...

Application for affiliates

1.2.9A G (1) The fact that a firm's client is an affiliated company for MiFID business does not affect the operation of CASS to the firm in relation to that client.

(2) For business that is not MiFID business, the operation of the custody chapter or the client money chapter may differ if a firm's client is an affiliated company and depending on certain other conditions (see, for example, CASS 6.1.10BR and CASS 7.1.12AR).

...

1.2.11 R ~~Where a firm is subject to two or more of the *client money chapter*, the *insurance client money chapter* and the *debt management client money chapter*, it must ensure segregation between money held under each chapter, including that money held under different chapters is held, in different, separately designated, *client bank accounts* or *client transaction accounts*.~~

(1) A firm must not keep money in respect of which any one of the following chapters applies in the same *client bank account* or *client transaction account* as money in respect of which another of the following chapters applies:

(a) the *client money chapter*;

(b) the *insurance client money chapter*;

(c) the *debt management client money chapter*.

- (2) In accordance with CASS 7.1.15HR, a firm which is subject to the client money chapter and holds money both (i) in its capacity as a trustee firm and (ii) other than in its capacity as a trustee firm must not keep money held in in its capacity as a trustee firm in the same client bank account or client transaction account as money held other than in its capacity as a trustee firm.
- (3) To the extent that the restriction under (1) or (2) applies to a firm, the client bank accounts and client transaction accounts that a firm holds in respect of different chapters or in its different capacities (as the case may be) must be separately designated.

...

- 1.2.13 G A firm may, where permitted by the relevant rules, opt to hold under a single chapter money that would otherwise be held under different chapters (see ~~CASS 5.1.1R(3)~~ and CASS 7.1.3R and CASS 7.1.15BAR). However, making such an election does not remove the requirement under CASS 1.2.11R(1).

1.4 Application: particular activities

...

- 1.4.8 R (1) ~~Other than the mandate rules, CASS does not apply to a trustee firm which is not a depositary, or the trustee of a personal pension scheme or stakeholder pension scheme, unless MiFID applies to it, in which case the custody chapter and the client money chapter do apply. [deleted]~~
- (2) ~~In the custody chapter, the client money chapter and the mandate rules, 'client' means 'trustee', 'trust', 'trust instrument' or 'beneficiary', as appropriate. [deleted]~~
- 1.4.8A R (1) The application of CASS for a trustee firm acting as a depositary is set out in CASS 1.4.6R and CASS 1.4.7R.
- (2) The application of CASS for a trustee firm that is not acting as a depositary is limited as follows:
- (a) the mandate rules apply;
- (b) for MiFID business, the custody chapter and the client money chapter apply; and
- (c) for business that is not MiFID business, the custody chapter and the client money chapter apply only to trustee firms acting as trustees of personal pension schemes or stakeholder pension schemes, including SIPPs.

- (3) To the extent that CASS applies to a trustee firm, it applies with the following general modification: 'client' means 'relevant trustee', 'trust', or 'beneficiary', as appropriate.

...

3 Collateral

3.1 Application and purpose

...

- 3.1.7A G Firms are reminded of the client's best interests rule which requires a firm to act honestly, fairly and professionally, in accordance with the best interests of its clients, when agreeing to, entering into, exercising its rights under and fulfilling its obligations under an arrangement covered by this chapter, and when structuring its business to include such arrangements.

...

6 Custody rules

6.1 Application

- 6.1.1 R This chapter (the *custody rules*) applies to a firm:

...

- (1C) when it is *acting as trustee or depositary of an AIF*; ~~and/or~~
- (1D) when it is *acting as trustee or depositary of a UCITS*; and
- (1E) in respect of any arrangement for a client to transfer full ownership of a safe custody asset to the firm which is:
- (a) in the course of, or in connection with, the firm's designated investment business; and
- (b) for the purpose of securing or otherwise covering present or future, actual or contingent or prospective obligations,

but the application of the custody rules to a firm under this paragraph is limited to the rules and guidance in CASS 6.1.6R to CASS 6.1.9G.

...

...

- 6.1.10A G ~~In respect of business which is not MiFID business, the custody rules do not apply to a firm when it safeguards and administers a designated investment on behalf of an affiliated company, unless:~~

- (1) ~~the firm has been notified that the *designated investment* belongs to a *client* of the *affiliated company*; or~~
- (2) ~~the *affiliated company* is a *client* dealt with at arm's length. [deleted]~~

6.1.10B R In respect of a firm's business falling under CASS 6.1.1R(1B), the custody rules do not apply to the firm when it is safeguarding and administering investments on behalf of an affiliated company, unless:

- (1) the firm has been notified that the *designated investment* belongs to a *client* of the *affiliated company*; or
- (2) the *affiliated company* is a *client* dealt with at arm's length.

...

6.1.16F R ...

Reference	Rule
...	
<u>CASS 6.3.1R to CASS 6.3.4R</u>	<u>Depositing safe custody assets with third parties</u>
...	..

...

6.1.16H R ~~When a *trustee firm* or *depository* within CASS 6.1.16FR arranges for, or delegates the provision of safe custody services by or to another *person*, the *trustee firm* or *depository* must also comply with CASS 6.3.1R (Depositing assets and arranging for assets to be deposited with third parties) in addition to the custody rules listed in the table in CASS 6.1.16FR. [deleted]~~

...

6.1.16IC G A firm (Firm A) to which another firm acting as trustee or depository of an AIF (Firm B) has delegated safekeeping functions in ~~line~~ accordance with ~~FUND 3.11.25R~~ 3.11.28R (Delegation: safekeeping) will not itself be acting as trustee or depository of an AIF for that AIF. CASS 6.1.16IAR will not apply to Firm A in respect of that AIF. However, Firm A may be safeguarding and administering investments in respect of that AIF.

6.1.16J R Only the custody rules in the table below apply to a firm when arranging safeguarding and administration of assets:

Reference	Rule
...	

CASS 6.1.16JR	Arrangers
<u>CASS 6.1.16KR</u>	<u>Records</u>
...	
CASS 6.1.16KR	Records

- 6.1.16K R When a *firm* arranges *safeguarding and administration of assets*, it must ensure that proper records of the ~~*custody assets which it arranges for another to hold or receive, on behalf of the client*~~, arrangements are made and retained for a period of 5 years after they are made.

...

6.4 Use of safe custody assets

...

- 6.4.1A G The FCA expects firms which enter into arrangements under CASS 6.4.1R with retail clients to only enter into securities financing transactions and not otherwise use retail client's safe custody assets.

- 6.4.2 G *Firms* are reminded of the *client's best interests rule*, which requires the *firm* to act honestly, fairly and professionally in accordance with the best interests of their *clients*. ~~An example of what is generally considered to be such conduct, in the context of stock lending activities involving retail clients is that~~ For any transactions involving retail clients carried out under this section the FCA expects that:

...

...

6.5 Records, accounts and reconciliations

...

- 6.5.3 R ~~A~~ Unless otherwise stated, a firm must ensure that the records any record made under this section are the custody rules is retained for a period of five years after they are made starting from the later of:

- (1) the date it was created; and
- (2) (if it has been modified since the date it was created), the date it was most recently modified.

...

- 6.5.5 R ~~A firm that uses an alternative reconciliation method must first send a written confirmation to the FCA from the firm's auditor that the firm has in place systems and controls which are adequate to enable it to use the method~~

effectively: ~~[deleted]~~

...

7 Client money rules

7.1 Application and purpose

7.1.1 R This chapter ~~(the *client money rules*)~~ applies to a *firm* that receives *money* from or holds *money* for, or on behalf of, a *client* in the course of, or in connection with:

- (1) ~~[deleted]~~
 - (a) ~~[deleted]~~
 - (b) ~~[deleted]~~
- (2) ~~[deleted]~~
- (3) *its MiFID business; and/or*
- (4) *its designated investment business, that is not MiFID business in respect of any investment agreement entered into, or to be entered into, with or for a client;*

~~unless otherwise specified in this section. [deleted]~~

7.1.1A R This chapter applies to a *firm* that receives *money* from or holds *money* for, or on behalf of, a *client* in the course of, or in connection with, its:

- (1) *MiFID business; and/or*
- (2) *designated investment business;*

unless otherwise specified in this section.

7.1.1B G A *firm* is reminded that when CASS 7.1.1AR applies it should treat *client money* in an appropriate manner so that, for example:

- (1) if it holds *client money* in a *client bank account*, that account is held in the *firm's* name in accordance with CASS 7.4.11AR;
- (2) if it allows another *person* to hold *client money* this is effected under CASS 7.5; and
- (3) its internal reconciliations of *client money* carried out in line with CASS 7.6.6G and CASS 7 Annex 1G take into account any *client equity balance* relating to its *margin*ed transaction requirements.

...

- 7.1.3R R ...
- (3) This rule is subject to CASS 1.2.11R.
- 7.1.3A G Firms are reminded that, under CASS 1.2.11R(1), they must not keep money in respect of which the client money chapter applies in the same client bank account or client transaction account as money in respect of which the insurance client money chapter applies.
- ...
- 7.1.15 R (1) An *authorised professional firm* regulated by the Law Society (of England and Wales), the Law Society of Scotland or the Law Society of Northern Ireland that, with respect to its *regulated activities*, is subject to the following rules of its *designated professional body*, must comply with those rules and, where relevant paragraph (3), and if it does so, it will be deemed to comply with the *client money rules*.
- (2) The relevant rules are:
- (a) if the *firm* is regulated by the Law Society (of England and Wales); the SRA Accounts Rules 2011;
- (i) ~~the Solicitors' Accounts Rules 1998; or~~
- (ii) ~~where applicable, the Solicitors Overseas Practice Rules 1990;~~
- (b) if the *firm* is regulated by the Law Society of Scotland, ~~the Solicitors' (Scotland) Accounts, Accounts Certificate, Professional Practice and Guarantee Fund Rules 2001~~ the Law Society of Scotland Practice Rules 2011; and
- (c) if the *firm* is regulated by the Law Society of Northern Ireland, the Solicitors' Accounts Regulations 1998.
- (3) If the *firm* in (1) is a *MiFID investment firm* that receives or holds *money* for, or on behalf of a ~~client~~ *client* in the course of, or in connection with its *MiFID business*, it must also comply with the *MiFID client money (minimum implementing) rules* in relation to that business.
- ...
- 7.1.15B R ~~This chapter does not apply to client money held by a firm which:~~
- (1) ~~receives or holds client money in relation to contracts of insurance; but which~~
- (2) ~~in relation to such client money elects to act in accordance with the insurance client money chapter. [deleted]~~

7.1.15B R A Provided it complies with CASS 1.2.11R, a firm that receives or holds client money in relation to contracts of insurance may elect to comply with the provisions of the insurance client money chapter, instead of this chapter, in respect of all such money.

7.1.15C R A firm ~~should~~ must make and retain a written record of any election which it makes under ~~CASS 7.1.15BR~~ 7.1.15BAR.

...

Trustee firms (other than trustees of unit trust schemes)

...

7.1.15F R Subject to CASS 7.1.15GR ~~Only~~ only the *client money rules* listed in the table below apply to a *trustee firm* in connection with *money* that the *firm* receives, or holds for or on behalf of a *client* in the course of or in connection with its *designated investment business* which is not *MiFID business*.

Reference	Rule
...	
CASS 7.1.15ER and CASS 7.1.15FR <u>to CASS 7.1.15LG</u>	Trustee firms (other than trustees of unit trust schemes)
...	
CASS 7.7.2R to CASS 7.7.4G	<u>Requirement</u>
...	
CASS 7.6.6G to CASS 7.6.16R	...
CASS 7.7.2R to CASS 7.7.4G	<u>Requirement</u>
<u>CASS 7 Annex 1G</u>	<u>The standard method of internal client money reconciliation</u>

7.1.15G R (1) A trustee firm to which CASS 7.1.15FR applies may, in addition to the client money rules set out at CASS 7.1.15FR, also elect to comply with:

- (a) all the client money rules in CASS 7.4 (Segregation of client money);
- (b) CASS 7.5 (Transfer of client money to a third party);
- (c) all the client money rules in CASS 7.6 (Records, accounts and reconciliations); or

- (d) CASS 7.8 (Notification and acknowledgement of trust).
- (2) A trustee firm must make a written record of any election it makes under this rule, including the date from which the election is to be effective. The firm must make the record on the date it makes the election and must keep it for a period of five years after ceasing to use it.
- (3) Where a trustee firm has made an election under (1) which it subsequently decides to cease to use, it must make a written record of this decision, including the date from which the decision is to be effective, and keep that record from the date the decision is made for a period of five years after the date it is to be effective.
- 7.1.15H R A trustee firm to which CASS 7.1.15FR applies and which is otherwise subject to the client money rules must ensure that any client money it holds other than in its capacity as trustee firm is segregated from client money it holds as a trustee firm.
- 7.1.15I G A trustee firm to which CASS 7.1.15FR applies and which is otherwise subject to the client money rules should ensure that in designing its systems and controls it:
- (1) takes into account that the client money distribution rules will only apply in relation to any client money that the firm holds other than in its capacity as trustee firm; and
- (2) has regard to other legislation that may be applicable.
- 7.1.15J R (1) A trustee firm to which CASS 7.1.15FR applies may elect that:
- (1) the applicable provisions of CASS 7.4 (Segregation of client money) and CASS 7.6 (Records, accounts and reconciliations) under CASS 7.1.15FR; and
- (2) and any further provisions it elects to comply with under CASS 7.1.15GR(1);
- will apply separately and concurrently for each distinct trust that the trustee firm acts for.
- (2) A trustee firm must make a written record of any election it makes under this rule, including the date from which the election is to be effective. The firm must make the record on the date it makes the election and must keep it for a period of five years after ceasing to use it.
- (3) Where a trustee firm has made an election under (1) which it subsequently decides to cease to use, it must make a written record of this decision, including the date from which the decision is to be effective, and must keep that record from the date the decision is

made for a period of five years after the date it is to be effective.

7.1.15K G A trustee firm may wish to make an election under CASS 7.1.15JR if, for example, it acts for a number of distinct trusts which it wishes, or is required, to keep operationally separate. If a firm makes such an election then it should:

(1) establish and maintain adequate internal systems and controls to effectively segregate client money held for one trust from client money held for another trust; and

(2) conduct internal client money reconciliations as set out in CASS 7 Annex 1G and external client money reconciliations under CASS 7.6.9R for each trust.

7.1.15L G The provisions in CASS 7.1.15ER to CASS 7.1.15KG do not affect the general application of the client money rules regarding money that is held by a firm other than in its capacity as a trustee firm.

...

7.2 **Definition Treatment of client money**

...

Interest

7.2.14 R Unless a firm notifies a retail client in writing whether or not interest is to be paid on client money and, if so, on what terms and at what frequency, it must pay that client all interest earned on that client money. Any interest due to a client will be client money. [deleted]

7.2.14A R A firm must pay a retail client any interest earned on client money held for that client unless it has otherwise notified him in writing.

7.2.14B G (1) The firm may, under the terms of its agreement with the client, pay some, none, or all interest earned to the relevant client.

(2) Where interest is payable on client money by a firm to clients:

(a) such sums are client money and so, if not paid to, or to the order of the clients, are required to be segregated in accordance with CASS 7.4 (Segregation of client money);

(b) the interest should be paid to clients in accordance with the firm's agreement with each client; and

(c) if the firm's agreement with the client is silent as to when interest should be paid to the client the firm should follow CASS 7.4.28G (Allocation of client money receipts);

irrespective of whether the client is a retail client or otherwise.

Discharge of fiduciary duty

- 7.2.15 R *Money ceases to be client money (having regard to CASS 7.2.17R where applicable) if:*
- ...
- (2) ~~it is paid to a third party on the instruction of the client, unless it is transferred to a third party in the course of effecting a transaction, in accordance with CASS 7.5.2 R (Transfer of client money to a third party); or:~~
- (a) paid to a third party on the instruction of, or with the specific consent of, the client unless it is transferred to a third party in the course of effecting a transaction under CASS 7.5.2R (Transfer of client money to a third party); or
- (b) paid to a third party pursuant to an obligation on the firm where:
- (i) that obligation arises under an enactment; and
- (ii) the obligation under that enactment is applicable to the firm as a result of the nature of the business being undertaken by the firm for its client; or
- (3) subject to CASS 7.2.16AR, it is paid into a bank account of the client (not being an account which is also in the name of the firm); or
- ...
- (9) it is transferred by the firm to a clearing member in connection with a regulated clearing arrangement and the clearing member remits payment directly to the indirect clients of the firm ~~firm~~ in accordance with CASS 7.2.15CR(2).
- ...
- 7.2.15D R Client money received or held by the firm for a sub-pool ceases to be client money for that firm to the extent that such client money is transferred by the firm to an authorised central counterparty or a clearing member as a result of porting.
- ...
- 7.2.16 G ~~When a firm wishes to transfer client money balances to a third party in the course of transferring its business to another firm, it should do so in a way which it discharges its fiduciary duty to the client under this section. [deleted]~~
- 7.2.16A R A firm must not pay client money into a bank account of the client that has

been opened without the consent of that *client*.

.....

7.4 Segregation of client money

...

- 7.4.-1 **R** Where a *firm* establishes one or more *sub-pools*, the provisions of CASS 7.4 (Segregation of client money) shall be read as applying separately to the *firm's general pool* and each *sub-pool* in line with CASS 7.19.3R and CASS 7.19.12R.

...

Qualifying money market funds

- 7.4.3 **G** ~~Where a *firm* deposits *client money* with a *qualifying money market fund*, the units in that fund should be held in accordance with CASS 6.~~
~~[Note: recital 23 to the *MiFID implementing Directive*] [deleted]~~
- 7.4.3A **R** Where a *firm* deposits *client money* with a *qualifying money market fund*, the *firm's* holding of those units in that fund will be subject to any applicable requirements of the *custody rules*.

[Note: recital 23 to the *MiFID implementing Directive*]

...

- 7.4.6 **G** If a *firm* that intends to place *client money* in a *qualifying money market fund* is subject to the requirement to disclose information before providing services, it should, in compliance with that obligation, notify the *client* that:
- (1) *money* held for that *client* will be held in a *qualifying money market fund*; and
 - (2) as a result, the *money* will not be held in accordance with the *client money rules* ~~but in accordance with the *custody rules*.~~; and
 - (3) if it is the case, that the *units* will be held as the *client's safe custody assets* in accordance with the *custody rules*.

...

- 7.4.9B **R** For the purposes of CASS 7.4.9AR an entity is a relevant group entity if it is:
- (1) a *CRD credit institution*; ~~or a bank authorised in a third country, a *qualifying money market fund*, or the entity operating or managing a *qualifying money market fund*~~; and

(2) ...

Client bank accounts

...

- 7.4.11A R (1) An account which the *firm* uses to deposit *client money* under CASS 7.4.1R(1) to (3) must be a *client bank account*.
- (2) Each *client bank account* used by a *firm* must be held on terms under which:
- (a) the relevant bank's contractual counterparty is the *firm* that is subject to the requirement under CASS 7.4.1R; and
- (b) unless the *firm* has agreed terms that comply with CASS 7.4.11AR(3), the *firm* is able to make withdrawals of *client money* promptly and, in any event, within one *business day* of a request for withdrawal.

Transitional provision CASS TP 1.1.10AR applies to (2).

- (3) *Firms* may use *client bank accounts* held on terms under which withdrawals are, without exception, prohibited until the expiry of a fixed term or a notice period of a maximum of 30 days.
- (4) Paragraphs (2)(b) and (3) do not apply in respect of *client money* received by a *firm* in its capacity as a *trustee firm*.
- 7.4.11B G CASS 7.4.11AR(2)(b) and (3) do not prevent a *firm* from depositing *client money* on terms under which a withdrawal may be made before the expiry of a fixed term or a notice period (whatever the duration), including where such withdrawal would incur a penalty charge to the *firm*.
- 7.4.11C G CASS 7.4.11AR does not prevent a *firm* from depositing *client money* in overnight money market deposits which are clearly identified as being *client money* (for example, in the *client bank account* acknowledgment letter).
- 7.4.11D G *Firms* are reminded of their obligations under CASS 7.8 (Notification and acknowledgement of trust) for *client bank accounts*. *Firms* should also ensure that *client bank accounts* meet the requirements in the relevant *Glossary* definitions, including regarding the titles given to the accounts.
- 7.4.12 G A *firm* may open one or more *client bank accounts* in the form of a *general client bank account*, a *designated client bank account* or a *designated client fund account* (see CASS 7A.2.1G (Failure of the authorised firm: primary pooling event)). The requirements of CASS 7.4.11AR(2) and (3) apply for each type of *client bank account*.

...

Commodity Futures Trading Commission Part 30 exemption order

- 7.4.32 G ~~United States (US) legislation restricts the ability of non-US firms to trade on behalf of US customers on non-US futures and options exchanges. The relevant US regulator (the CFTC) operates an exemption system for firms authorised under the Act. The FCA or the PRA sponsors the application from a firm for exemption from Part 30 of the General Regulations under the US Commodity Exchange Act in line with this system. [deleted]~~
- 7.4.33 G ~~A firm with a Part 30 exemption order undertakes to the CFTC that it will refuse to allow any US customer to opt not to have his money treated as client money if it is held or received in respect of transactions on non-US exchanges, unless that US customer is an “eligible contract participant” as defined in section 1a(12) of the Commodity Exchange Act, 7 U.S.C. In doing so, the firm is representing that if available to it, it will not make use of the opt-out arrangements in CASS 7.1.7BR to CASS 7.1.7FR in relation to that business. [deleted]~~
- 7.4.34 R ~~A firm must not reduce the amount of, or cancel a letter of credit issued under, an LME bond arrangement where this will cause the firm to be in breach of its Part 30 exemption order. [deleted]~~
- 7.4.35 R ~~A firm must notify the FCA immediately it arranges the issue of an individual letter of credit under an LME bond arrangement. [deleted]~~
- 7.4.36 G CASS 12 contains provisions which are relevant to a firm conducting business pursuant to the Part 30 exemption order.

...

7.5 Transfer of client money to a third party

- 7.5.1 G ~~This section sets out the requirements a firm must comply with when it transfers~~ allows another person to hold client money, to another person other than under CASS 7.4.1R, without discharging its fiduciary duty owed to that client. Such circumstances arise when, for example, a firm passes client money to a clearing house in the form of margin for the firm's obligations to the clearing house that are referable to transactions undertaken by the firm for the relevant clients. They may also arise when a firm passes client money to an intermediate broker for contingent liability investments in the form of initial or variation margin on behalf of a client. Similarly, this section applies where a firm allows a broker to hold client money in respect of the firm's client's non-margined transactions, again without the firm discharging its fiduciary duty to that client. ~~In these circumstances~~ In all cases, the firm remains responsible for that client's client equity balance held at the intermediate broker until the contract is terminated and all of that client's positions at that broker closed. If a firm wishes to discharge itself from its fiduciary duty, it should do so in accordance with the rule regarding the discharge of a firm's fiduciary duty to the client (CASS 7.2.15R).
- 7.5.2 R A firm may allow another person, such as an exchange, a clearing house or

an *intermediate broker*, to hold or control *client money*, but only if:

- (1) the *firm* ~~transfers~~ allows that *person* to hold the *client money*:
 - (a) for the purpose of ~~a transaction~~ one or more transactions for a *client* though or with that *person*; or

...
- (2) in the case of a *retail client*, that *client* has been notified that the ~~*client money* may be transferred to *firm*~~ *firm* may allow the other *person* to hold its *client money*.

7.5.2A G *Client money* that a *firm* allows another person to hold under CASS 7.5.2R:

- (1) should only be held for transactions which are likely to occur (and for which the other *person* needs to receive *client money*) or have recently settled (and such that the other *person* has received *client money*); and
- (2) should be recorded in *client transaction accounts* by that other *person*.

7.5.3 G ~~A~~ Apart from *client money* held by a *firm* in an *individual client account* or an *omnibus client account* at an *authorised central counterparty*, a *firm* should not hold excess *client money* in its *client transaction accounts*, ~~with *intermediate brokers*, *settlement agents* and *OTC counterparties*~~; it should be held in a *client bank account*. ~~This guidance does not apply to *client money* provided by a *firm* to an *authorised central counterparty* in connection with a *contingent liability investment* undertaken for a *client* and recorded in a *client transaction account* that is an *individual client account* or an *omnibus client account* at that *authorised central counterparty*.~~

7.6 Records, accounts and reconciliations

7.6.-1 R Where a *firm* establishes one or more *sub-pools*, the provisions of CASS 7.6 (Records, accounts and reconciliations) shall be read as applying separately to the *firm's* general pool and each *sub-pool* in line with CASS 7.19.3R and CASS 7.19.4R.

...

7.6.4 R Unless otherwise stated, A *firm* must ensure that records any record made under ~~CASS 7.6.1R and CASS 7.6.2R~~ are the *client money rules* is retained for a period of five years after they were made starting from the later of:

- (1) the date it was created; and
- (2) (if it has been modified since the date it was created), the date it was most recently modified.

...

7.7 Statutory trust

...

- 7.7.2 R ~~A~~ Subject to CASS 7.7.3R in respect of a trustee firm, a firm receives and holds client money as trustee (or in Scotland as agent) on the following terms:
- (1) ...
 - (2) (a) where a firm maintains only a general pool of client money, subject to (4), for the clients (other than clients which are insurance undertakings when acting as such with respect of to client money received in the course of insurance mediation activity and that was opted in to this chapter) for whom that money is held, according to their respective interests in it;
 - (b) where a firm has established one or more pools of client money, subject to (4):
 - (i) the general pool is held for all the clients of the firm for whom the firm holds client money (other than clients which are insurance undertakings when acting as such with respect to client money received in the course of insurance mediation activity and that was opted in to this chapter) according to their respective interests in it; and
 - (ii) each sub-pool is for the clients of the firm who are beneficiaries of the sub-pool in question in accordance with CASS 7.19.6R(2), according to their respective interests in it;
- ...
- (4) ~~on failure of the firm,~~ for the payment of the costs properly attributable to the distribution of the client money in accordance with (2) if such distribution takes place following the failure of the firm; and
- ...
- 7.7.3 R ~~A trustee firm which is subject to the client money rules by virtue of CASS 7.1.1AR(2);~~ receives and holds client money as trustee (or in Scotland as agent) on the terms in CASS 7.7.2R, subject to its obligations to hold client money as trustee under the relevant instrument of trust.
- (1) ~~must receive and hold client money in accordance with the relevant instrument of trust;~~
 - (2) ~~subject to the relevant instrument of trust, receives and holds client~~

~~money on trust on the terms (or in Scotland on the agency terms) specified in CASS 7.7.2R.~~

- 7.7.4 G If a *trustee firm* holds *client money* ~~in accordance with CASS 7.7.3R(2)~~, the *firm* should follow the provisions in CASS 7.1.15ER ~~and CASS 7.1.15FR~~ to CASS 7.1.15LG.

...

After CASS 7.9 insert the following new sections:

- 7.10** [to follow]
7.11 [to follow]
7.12 [to follow]
7.13 [to follow]
7.14 [to follow]
7.15 [to follow]
7.16 [to follow]
7.17 [to follow]
7.18 [to follow]

After CASS 7.18 insert the following new section. The text is not underlined.

7.19 Clearing member client money sub-pools

- 7.19.1 G (1) Under CASS 7.7.2R(2), a *firm* acts as *trustee* for all *client money* received or held by it for the benefit of the *clients* for whom that *client money* is held, according to their respective interests in it.
- (2) A *firm* that is also a *clearing member* of an *authorised central counterparty* may wish to segregate *client money* specifically for the benefit of a group of *clients* who have chosen to clear positions through a *net margined omnibus client account* maintained by the *firm* with that *authorised central counterparty*, where that segregation might facilitate the *porting* of *client* positions recorded in that *net margined omnibus client account*. To segregate *client money* (that would otherwise be held in the *general pool*) for a specific group of *clients* clearing positions through a particular *net margined omnibus client account*, a *clearing member firm* may, in accordance with these rules, create a *sub-pool* of *client money*.

- (3) Upon the occurrence of a *primary pooling event*, the *client money* for:
- (a) the *general pool*, should be distributed in accordance with CASS 7A to the *clients* for whom the *firm* receives or holds *client money* in that *general pool*; and
 - (b) a *sub-pool*, should either be:
 - (i) transferred to facilitate *porting*; or
 - (ii) distributed to the *clients* who are beneficiaries of that *sub-pool*, according to their respective interests under CASS 7A.2.4R(2)(a).
- (4) All *client money* is received or held by the *firm* as *trustee* for the *clients* of the *firm*. However, a *clearing member* of an *authorised central counterparty* who clears *client* positions through a *net margined omnibus client account* may organise its affairs (with the consent of the relevant *clients*) in such a way that those *clients* need not share in the *general pool* of *client money* following a *primary pooling event*, save to the extent that such *clients* otherwise have an interest in the *general pool*.

7.19.2 R Where a *firm* creates a *sub-pool* for a particular *net margined omnibus client account*, it must not clear positions through that *omnibus client account* for *clients* who are not beneficiaries of that *sub-pool*.

Internal controls

7.19.3 R A *firm* wishing to establish a *sub-pool* must establish and maintain adequate *internal controls* necessary to comply with the *firm's* obligations under CASS 7 for the *general pool* and each *sub-pool* that it may establish.

Records

7.19.4 R Where a *firm* establishes one or more *sub-pools*, CASS 7.6 (Records, accounts and reconciliations) shall be read as applying separately to the *firm's general pool* and each *sub-pool*.

7.19.5 G A *firm* that establishes one or more *sub-pools* must establish and maintain adequate internal controls and records in accordance with CASS 7.6 (Records, accounts and reconciliations) to conduct internal and external reconciliations for each *sub-pool* and the *general pool* individually.

7.19.6 R

- (1) The records maintained for a *sub-pool* under CASS 7.19.4R must identify all the *client* beneficiaries of that *sub-pool*.
- (2) The beneficiaries of each *sub-pool* are those *clients*:
 - (a) from whom the *firm* has received a signed *sub-pool disclosure document* in accordance with CASS 7.19.11R;

- (b) for whom the *firm* maintains, previously maintained or is in the process of establishing a *margin*ed transaction(s) in the relevant *net margin*ed omnibus client account at the *authorised central counterparty*; and
 - (c) to whom any *client equity balance* or other *client money* is required to be segregated for the *client* by the *firm* in respect of the *margin*ed transactions under (2)(b) from that *sub-pool*.
- 7.19.7 R (1) For each *sub-pool* that the *firm* establishes, it must maintain a record of:
- (a) the name of the *sub-pool*;
 - (b) the particular *net margin*ed omnibus client account at an *authorised central counterparty* to which the *sub-pool* relates;
 - (c) each *client bank account* and each *client transaction account* (other than the *net margin*ed omnibus client account) maintained for the *sub-pool*, including the unique identifying reference or descriptor under CASS 7.19.13R(2); and
 - (d) the applicable *sub-pool disclosure document* for the *sub-pool*.
- 7.19.8 R The *firm* must maintain an up-to-date list of all the *sub-pools* it has created.
- Sub-pool disclosure document
- 7.19.9 R (1) A *firm* wishing to establish a *sub-pool* must prepare a *sub-pool disclosure document* for each *sub-pool*.
- (2) The *sub-pool disclosure document* for each *sub-pool* must:
- (a) identify the *sub-pool* by name, as stated in its records under CASS 7.19.7R, the *net margin*ed omnibus client account and the *authorised central counterparty* to which the *sub-pool disclosure document* relates;
 - (b) contain a statement that the *client* consents to the *firm* receiving and holding the *client's client money* in the *sub-pool*;
 - (c) contain a statement that, in the event of the *failure* of the *firm*, the *firm* is directed by the *client* to use any *client money* held by the *firm* in the *sub-pool* to facilitate the *porting* of the positions recorded in that *net margin*ed omnibus client account; and
 - (d) a statement reminding the *client* that, in the event of the *failure* of the *firm*, if *porting* is not effected or if *porting* is effected but any money in the *sub-pool* is not used to facilitate *porting*, the *client* beneficiaries of the *sub-pool* will be entitled to a distribution of any *client money* held for that *sub-pool* in

accordance with CASS 7A. However, the *client* beneficiaries will not have a claim on any other *pool* of *client money*, except to the extent that the *client* is a beneficiary of another *pool*.

- 7.19.10 G In preparing a *sub-pool disclosure document* under CASS 7.19.9R(1), a *firm* may use the template in CASS 7 Annex 6G.
- 7.19.11 R (1) Before receiving or holding *client money* for a *client* for a *sub-pool*, a *firm* must:
- (a) provide to the *client* a copy of the *sub-pool disclosure document* applicable to that *sub-pool*; and
 - (b) obtain a signed copy of that *sub-pool disclosure document* from the *client*.
- (2) A *firm* must provide the beneficiary of a *sub-pool* with a copy of its signed *sub-pool disclosure document* applicable to that *sub-pool* upon the beneficiary's request.

Segregation and operation of sub-pools

- 7.19.12 R Where a *firm* establishes one or more *sub-pools*, CASS 7.4 (Segregation of client money) shall be read as applying separately to the *firm's general pool* and each *sub-pool*.
- 7.19.13 R (1) A *firm* must not hold *client money* for a *sub-pool* in a *client bank account* or a *client transaction account* used for holding *client money* for any other *sub-pool* or the *general pool*.
- (2) A *firm* that establishes a *sub-pool* must ensure that the name of each *client bank account* and each *client transaction account* (other than the *net margined omnibus client account*) maintained for that *sub-pool* includes a unique identifying reference or descriptor that enables the account to be identified with that *sub-pool*.
- (3) Where a *client* of the *firm* is a beneficiary of the *general pool* and wishes to become a beneficiary of a *sub-pool*, the *client* in question shall become a beneficiary of the relevant *sub-pool* when :
- (a) the *firm* has obtained the signed *sub-pool disclosure document* from that *client* in accordance with CASS 7.19.11R(1); and
 - (b) the *firm* has either:
 - (i) transferred the relevant amount of *client money* for that *client* from a *client bank account* maintained for the *general pool* to a *client bank account* maintained for the relevant *sub-pool*; or
 - (ii) if the *firm* is not making a transfer of *client money* from the *general pool*, when it has received that *client's money*

in a *client bank account* maintained for the relevant *sub-pool*.

- (4) Where a *client* of the *firm* is a beneficiary of the *general pool* and wishes to become a beneficiary of a *sub-pool*, the *firm* must ensure that it does not transfer *client money* from a *client bank account* maintained for the *general pool* to a *client bank account* maintained for a *sub-pool* in accordance with CASS 7.19.13R(3)(b)(i), unless the amount of *client money* held for the *general pool* is sufficient, immediately after that transfer, to satisfy the *firm's client money* obligations to the remaining beneficiaries of the *general pool*.
- (5) A *client* of the *firm* who is a beneficiary of a *sub-pool* ceases to be a beneficiary of that *sub-pool* when:
- (a) the *firm* has settled the amount owing to that *client* for all of the *margined transactions* cleared through the related *net margined omnibus client account* and no longer holds any *client money* for that *client* in that *sub-pool*, and so CASS 7.19.6R(2)(b) and (c) no longer apply for that *client*; or
 - (b) the *firm* has complied with (i) or (ii), and in either case (iii):
 - (i) the *firm* has received a written instruction from the *client* stating that the *client* no longer wishes to have its positions cleared through the *net margined omnibus client account* or its *client money* held in that *sub-pool*, or the *firm* has notified the *client* under CASS 7.19.18R that it is making a material change to a *sub-pool*; or
 - (ii) the *firm* has closed or moved that *client's* positions to an account other than the *net margined omnibus client account* referable to that *sub-pool*; and
 - (iii) the *firm* has either transferred the relevant amount of *client money* for that *client* from a *client bank account* maintained for the relevant *sub-pool* to a *client bank account* maintained by the *firm* for the *general pool* (or, if applicable, another *sub-pool*), or transferred the amount owing to that *client* for all of the *margined transactions* cleared through the related *net margined omnibus client account* and no longer holds any *client money* for that *client* in that *sub-pool*.
- (6) In relation to the transfer of *client money* under CASS 7.19.13R(5)(b)(iii), a *firm* must ensure that it does not transfer *client money* from a *client bank account* maintained for a *sub-pool*, unless the amount of *client money* held for the *sub-pool* is sufficient, immediately after that transfer, to satisfy the *firm's client money* obligations to the remaining beneficiaries of that *sub-pool*.

- 7.19.14 R A *firm* that receives *client money* to be credited in part to the *general pool* or one *sub-pool* and in part to another *sub-pool* must:
- (1) take the necessary steps to ensure that the full sum is paid directly into a *client bank account* maintained for the *general pool*; and
 - (2) promptly, and in any event no later than one *business day* after receipt, pay the *money* that is not *client money* for the *general pool* out of that *client bank account* and into a *client bank account* maintained for the appropriate *sub-pool*.
- 7.19.15 G
- (1) If a *primary pooling event* occurs before *client money* is transferred from a *client bank account* maintained for the *general pool* to a *client bank account* maintained for the appropriate *sub-pool* in accordance with CASS 7.19.14R(2), the amount in question will not form part of that *sub-pool*, including for the purposes of CASS 7A.2.4R(1).
 - (2) If a *primary pooling event* occurs before *client money* is transferred from a *client bank account* maintained for a *sub-pool* to a *client bank account* maintained for the *general pool* or another *sub-pool* in accordance with CASS 7.19.13R(5), the amount in question will not form part of the *general pool* or that other *sub-pool*, including for the purposes of CASS 7A.2.4R(1), but will remain part of the original *sub-pool*.
- 7.19.16 R A *client* for whom a *firm* receives or holds *client money* for a *sub-pool* has no claim to or interest in *client money* received or held for the *general pool* or any other *sub-pool* unless:
- (1) that *client* is a beneficiary of that other *sub-pool*; or
 - (2) the *firm* receives or holds *client money* for that *client* for other business which does not relate to any *sub-pool* (and thus the *client* is a beneficiary of the *firm's general pool*).
- 7.19.17 R A *client* for whom a *firm* receives or holds *client money* in more than one *pool* as described in CASS 7.19.16R(1) and/or (2) has an interest in a distribution from each such *pool*, and each interest is separate and distinct.

Material changes to sub-pools

- 7.19.18 R Before making a material change to a *sub-pool*, a *firm* must:
- (1) notify the then current beneficiaries of that *sub-pool* in writing, not less than two months before the date on which the *firm* intends the change to take effect; and
 - (2) include in the notification an explanation of the consequences for the beneficiaries of the proposed change and the options available to them, such as the option of a beneficiary of the affected *sub-pool* to cease to be a beneficiary of that *sub-pool* and to become a beneficiary of the

firm's general pool or, if applicable, another *sub-pool*.

- 7.19.19 G A *firm* should keep in mind its obligations under CASS 7.19.11R(1)(b) (before receiving or holding *client money* for a *client* in a *sub-pool*, a *firm* must obtain a signed copy of the *sub-pool disclosure document* from the client) when making a material change to a *sub-pool*. A *firm* is also reminded of the conditions under CASS 7.19.13R(5)(b) (when a *client* of the *firm* who is a beneficiary of a *sub-pool* ceases to be a beneficiary of that *sub-pool*) if a material change proposed to a *sub-pool* results in a *client* ceasing to be a beneficiary of that *sub-pool*.
- 7.19.20 G The *FCA* would normally consider the dissolution of a *sub-pool*, such that the *firm* no longer operates the *sub-pool* or no longer uses the relevant *net margined omnibus client account* or transfers the business to another *authorised central counterparty*, to be examples of material changes to a *sub-pool*.
- 7.19.21 R Before materially changing a *sub-pool*, a *firm* must provide a copy of the notice provided to clients under CASS 7.19.18R to the *FCA* not less than two months before the date on which the *firm* intends the change to take place.

Notifications

- 7.19.22 R A *firm* that wishes to establish a *sub-pool* of *client money* must notify the *FCA* in writing not less than two months before the date on which the *firm* intends to receive or hold *client money* for that *sub-pool*.
- 7.19.23 R Upon request, a *firm* must deliver to the *FCA* a copy of the *sub-pool disclosure document* for any *sub-pool* established by the *firm*.
- 7.19.24 R A *firm* must inform the *FCA* in writing, without delay, if it has not complied, or is unable to comply with the requirements in CASS 7.19.11R or the requirements in CASS 7.19.18R.

Record-keeping

- 7.19.25 R The records maintained under this section, including the *sub-pool disclosure documents*, are a record of the *firm* that must be kept in a *durable medium* for at least five years following the date on which *client money* was last held by the *firm* for a *sub-pool* to which those records or the *sub-pool disclosure document* applied.

After CASS 7 Annex 1G insert the following new annexes.

7 Annex 2 [to follow]

7 Annex 3 [to follow]

7 Annex 4 [to follow]

7 Annex 5 [to follow]

After CASS 7 Annex 5, insert the following new annex (on the next page). The text is not underlined.

7 Annex 6G Sub-pool disclosure document

[letterhead of firm, including full name and address of firm, firm reference number]

[addressee – client participating in specified sub-pool]

[date]

Sub-pool disclosure document (under the rules of the Financial Conduct Authority)

1. The sub-pool to which this sub-pool disclosure document relates is designated in the firm's records as:

[insert name of sub-pool in firm's records]

(for the purposes of this document, the “sub-pool”)
2. The net margined omnibus client account relating to the sub-pool is held at *[insert name of authorised CCP]* and is designated as:

[insert the account title, the account unique identifier and (if applicable) any abbreviated name of the account as reflected in the authorised CCP's systems]

(for the purposes of this document, the “omnibus client account”).
3. The purpose of this letter is to:
 - (a) provide you with information relating to the sub-pool [operated or to be operated] by *[insert name of CASS firm]* in relation to the omnibus client account held by the firm at *[insert name of authorised CCP]*;
 - (b) obtain your consent to holding your money in the sub-pool; and
 - (c) confirm your direction that upon the failure of *[insert name of CASS firm]*, we are to use any client money held by the firm in the sub-pool to facilitate porting.
4. *[name of CASS firm]* will hold any client money that we receive from you in relation to the cleared transactions that we maintain for you in the omnibus client account in client bank accounts that we open in relation to the sub-pool, or we will allow the CCP to hold this client money in the omnibus client account.
5. In the event of the failure of the *[insert name of CASS firm]*, you hereby direct the *[insert name of CASS firm]* to use any client money held by the *[insert name of CASS firm]* in the sub-pool to facilitate the porting of the positions recorded in the omnibus client account.
6. In the event of the failure of *[insert name of CASS firm]*, if porting is not effected, or if porting is effected but any money in the sub-pool is not used to facilitate porting, you and the other beneficiaries of the sub-pool will be entitled to a distribution from any client money held in respect of this sub-pool, in accordance with the client money distribution rules in CASS 7A. Save to the extent that *[insert name of CASS firm]* holds any other client money for you in the context of any other business or sub-pool, you will not be entitled to a distribution of any other client money held by *[insert name of CASS firm]*.
7. You hereby consent to the firm receiving and holding your money as client money as part of *[sub-pool specified above or specify name of sub-pool]*. Until you sign and return this letter the firm will not hold money for you in the sub-pool and you will not be a beneficiary of the sub-pool.

8. This letter shall be governed by the laws of [England and Wales/Scotland/Northern Ireland /*insert appropriate jurisdiction*].

If you are in agreement with the foregoing terms, please sign and return the enclosed copy of this letter as soon as possible. You should retain a copy of this letter for your records.

[*insert name of CASS firm*]

x _____

Authorised signatory

Print name:

Title:

ACKNOWLEDGED AND AGREED:

[*insert name of client*]

x _____

Authorised signatory

Print name:

Title:

Contact information: [*insert signatory's phone number and email address*]

Date:

Amend the following as shown.

7A Client money distribution

7A.1 Application and purpose

Application

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

7A.1.1A R The *client money distribution rules* do not apply to any *client money* held by a *trustee firm* under CASS 7.1.15FR to 7.1.15LG.

7A.1.1B G As a result of CASS 7A.1.1AR, the *client money distribution 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* 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*.

...

7A.2 Primary pooling events

...

7A.2.3A R If a *primary pooling event* occurs in circumstances where the *firm* had, before the *primary pooling event*, reduced its *marginised transaction requirement* by utilising *approved collateral* under CASS 7 Annex 1G paragraph 15, it must immediately liquidate this *approved collateral* and place the proceeds in a *client bank account*.

7A.2.3B R CASS 7A.2.7R (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 notional pool of *client money* (see CASS 7A.2.4R (Pooling and distribution)); and
- (2) must be distributed in accordance with this chapter.

...

Pooling and distribution

- 7A.2.4 R If a *primary pooling event* occurs, then:
- (1) in respect of the *general pool* or a *sub-pool*, all *client money* held in a *client bank account* or a *client transaction account* of the *firm* relating to that *pool* is treated as ~~pooled (forming a notional pool)~~ a single notional *pool* of *client money* for the beneficiaries of that *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*;
 - (2) ~~the *firm* must distribute *client money* comprising the notional pool in accordance with CASS 7.7.2R, so that each *client* receives a sum which is rateable to the *client money* entitlement calculated in accordance with CASS 7A.2.5R; and;~~
 - (a) distribute *client money* comprising a notional *pool* in accordance with CASS 7.7.2R, so that each *client* who is a beneficiary of that *pool* receives a sum which is rateable to the *client money* entitlement calculated in accordance with CASS 7A.2.5R; 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*, then:

...

 - (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~~ *pool* under CASS 7A.2.4R(1) and be subject to distribution in accordance with CASS 7A.2.4R(2)(a); ~~and~~
 - (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:

...

 - (ii) the amount of such remittance attributable to each *client* of the *omnibus client account* is readily apparent from information provided to the ~~firm~~ *firm* by the *authorised central counterparty* or, in the case of *indirect clients*, the *clearing member*;

in which case the amount of such remittance must be distributed to each such *client* in accordance with the information provided by the *authorised central counterparty* or *clearing member* subject to CASS 7.7.2R(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* to be distributed in accordance with CASS 7A.2.4R(2)(a).

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

...

...

(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 7.2.15R(8).

7A.2.5 R ...

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

...

Client money received after failure of the firm

7A.2.7 R *Client money* received by the *firm* after a *primary pooling event* in respect of a *pool* must not be pooled with *client money* held in any *client money* account operated by the *firm* either in respect of that *pool* or any other *pool* at the time of the *primary pooling event*. It must be placed in a *client bank account* that has been opened after that event and must be handled in accordance with the *client money rules*, and returned to the relevant *client*

without delay, except to the extent that:

...

...

7A.3 Secondary pooling events

...

7A.3.4 G When a bank *fails* and the *firm* decides not to make good the *shortfall* in the amount of *client money* held at that bank, a *secondary pooling event* will occur in accordance with CASS 7A.3.6R. The *firm* would be expected to reflect the *shortfall* that arises at the *failed bank* 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 7.6 (Records, accounts and reconciliations).

...

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

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

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

- (1) any *shortfall* in *client money* held, or which should have been held, in *general client bank accounts* or *client transaction accounts* for the relevant *pool*, that has arisen as a result of the *failure* of the bank, must be borne by all the *clients* of that *pool* whose *client money* is held in ~~either a~~ 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 (1), and the *firm's* records must be amended to reflect the reduced *client money* entitlement;
- ...
- (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), for the purposes of reconciliations pursuant to CASS 7.6.2R (Records and accounts) for that *pool*, and where relevant SYSC 4.1.1R (General organisational requirements) and SYSC 6.1.1R (Compliance).

...

7A.3.10 R For each *client* with a *designated client bank account* maintained by the *firm* for the *general pool* or a particular *sub-pool* and held at the *failed bank*:

- (1) any *shortfall* in *client money* held, or which should have been held, in *designated client bank accounts* 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;

...

- (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), for the purposes of reconciliations pursuant to CASS 7.6.2R (Records and accounts) in respect of 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 of the ~~firm~~ which contain part of the same designated fund and:*

- (1) any *shortfall* in *client money* held, or which should have been held, in *designated client fund accounts* 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 (1), and the *firm's* records must be amended to reflect the reduced *client money* entitlement;

...

- (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), for the purposes of reconciliations pursuant to CASS 7.6.2R (Records and accounts) for the relevant *pool*, and where relevant SYSC 4.1.1R (General organisational requirements) and SYSC 6.1.1R (Compliance).

...

Client money received after the failure of a bank

7A.3.13 R *Client money received by the firm after the failure of a bank, that would otherwise have been paid into a *client bank account* at that bank, for either the general pool or a particular sub-pool:*

...

- (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 bank other than the one that has *failed*; or

(b) returned to the *client* as soon as possible.

...

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.
- 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;

...

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:

...

- (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.

...

After CASS 11 insert the following new chapter. The text is not underlined.

12 Commodity Futures Trading Commission Part 30 exemption order

12.1 Application

- 12.1.1 R This chapter applies to a *firm* conducting business pursuant to the *Part 30 exemption order*.
- 12.1.2 G United States ('US') legislation restricts the ability of non-US firms to trade on behalf of customers resident in the US ('US customers') on non-US futures and options exchanges. The relevant US regulator (the *CFTC*) operates an exemption system for *firms* authorised under the *Act*. Under the *Part 30 exemption order*, eligible *firms* may apply for confirmation of exemptive relief from Part 30 of the General Regulations under the US Commodity Exchange Act. Under this system, both the applicant *firm* and the *FCA* must make certain written representations to the *CFTC*.

12.2 Treatment of client money

- 12.2.1 G Under condition 2(g) of the *Part 30 exemption order*, a *firm* with exemptive relief represents to the *CFTC* that it consents to refuse to allow any US customer the option of not having its *money* treated as *client money* if it is held or received in respect of transactions on non-US exchanges, unless that US customer is an "eligible contract participant" as defined in section 1a(12) of the Commodity Exchange Act, 7 U.S.C.
- 12.2.2 G The *FCA* understands that in complying with condition 2(g) of the *Part 30 exemption order*, a *firm* is representing that it will not:
- (1) make use of the opt-out arrangements in CASS 7.1.7CR to CASS 7.1.7GG; or
 - (2) conduct business to which the *client money rules* do not apply because of the exemption for *CRD credit institutions* and *approved banks* in CASS 7.1.8R to CASS 7.1.11AR; or
 - (3) enter into any arrangement relating to the transfer of full ownership of the *client's money* to the *firm* for the purposes set out in CASS 7.2.3R(1);

in relation to business conducted pursuant to the *Part 30 exemption order*.

LME bond arrangements

- 12.2.3 G For *firms* with exemptive relief under the *Part 30 exemption order*, the *CFTC* has issued certain no-action letters which, on the *FCA's* understanding, would allow such *firms* to use an *LME bond arrangement* as an alternative to complying with condition 2(g) of the *Part 30 exemption order*. Under an *LME bond arrangement*, a *firm* may arrange for a binding letter of credit to be issued to cover the 'secured amount' (as defined by section 30.7 of the General Regulations under the US Commodity Exchange Act). The letter of credit must be drawn up in a pre-specified format and may be issued in respect of either:
- (1) an omnibus account in favour of a specified trustee; or
 - (2) a specified *client* who is the named beneficiary.
- 12.2.4 R A *firm* must not reduce the amount of, or cancel a letter of credit issued under, an *LME bond arrangement* where this will cause the *firm* to be in breach of the conditions of the *Part 30 exemption order*.
- 12.2.5 R A *firm* must notify the *FCA* immediately if it arranges the issue of a letter of *credit* for a specified *client* who is the named beneficiary under an *LME bond arrangement*.
- 12.2.6 G A *firm's* use of an *LME bond arrangement* does not remove the need for the *firm* to act in accordance with the *client money rules*.

Amend the following as shown.

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
...					
10	CASS 7.2.3R(2)		
<u>10</u> <u>A</u>	<u>CASS</u> <u>7.4.11AR(2)</u>	<u>R</u>	(1) <u>The rule in column (1) applies when a firm enters into a new contract with a bank to provide a client bank account.</u> (2) <u>In relation to an</u>	<u>Indefinitely</u>	<u>1 July 2014</u>

			<p><u>arrangement under which a firm holds a client bank account with a bank that is in place as at the date in column (5), and as soon as it is permitted to do so under that arrangement, the firm must terminate any contract that does not comply with the rule in column (1) and enter into a new contract (in respect of which (1) shall apply). If necessary to comply with the rule in column (1), a firm must move client money into another client bank account under compliant terms.</u></p>		
...					

Insert the following new rows in the appropriate numerical position in **Schedule 1 (Record keeping requirements)**. The new text is not underlined.

Sch 1.3G

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
...				
CASS 6.5.3R	Default record keeping provision for CASS 6	Refer to the rule concerned	Refer to the rule concerned	Five years from the later of: (1) the date it was created; and (2) if it has been modified since the date in (1), the date it was most recently modified
CASS 7.1.15GR	Trustee firm's election to comply, or to cease to comply, with specific CASS	Relevant provisions, date of election and of any decision to cease to comply	When election made or decision taken to cease to comply	Five years after ceasing to use the election

	7 provisions			
CASS 7.1.15JR	<i>Trustee firm's</i> election to comply, or to cease to comply, with specific CASS 7 provisions	Relevant provisions, date of election and of any decision to cease to comply	When election made or decision taken to cease to comply	Five years after ceasing to use the election
CASS 7.6.4R	Default record keeping provision for CASS 7	Refer to the rule concerned	Refer to the rule concerned	Five years from the later of: (1) the date it was created; and (2) if it has been modified since the date in (1), the date it was most recently modified
CASS 7.19.6R	For each <i>sub-pool</i> established by the <i>firm</i>	All the <i>client</i> beneficiaries of that <i>sub-pool</i>	From the date on which the <i>sub-pool</i> is created	Five years following the date on which <i>client money</i> was last held by the <i>firm</i> in relation to the <i>sub-pool</i> to which the record applied
CASS 7.19.7R	For each <i>sub-pool</i> established by the <i>firm</i>	(a) The name of the <i>sub-pool</i> (b) The identity of the <i>net margined omnibus account</i> to which the <i>sub-pool</i> relates; (c) Each <i>client bank account</i> and each <i>client transaction account</i> maintained for the <i>sub-pool</i> ; (d) the applicable <i>sub-pool disclosure document</i> for	Prior to the date on which the <i>firm</i> intends to receive or hold client money for that <i>sub-pool</i>	Five years following the date on which <i>client money</i> was last held by the <i>firm</i> in relation to the <i>sub-pool</i> to which the record applied

		the <i>sub-pool</i> .		
CASS 7.19.8R	For each <i>sub-pool</i> established by the <i>firm</i>	A list of all the <i>sub-pools</i> the <i>firm</i> has created.	From the date on which a <i>sub-pool</i> is created	Five years following the date on which <i>client money</i> was last held by the <i>firm</i> in relation to a <i>sub-pool</i> to which the record applied
CASS 7.19.9R	For each <i>sub-pool</i> established by the <i>firm</i>	A <i>sub-pool disclosure document</i>	At the time of establishing the relevant <i>sub-pool</i>	Five years following the date on which <i>client money</i> was last held by the <i>firm</i> in relation to a <i>sub-pool</i> to which the <i>sub-pool disclosure document</i> applied

Amend the following as shown:

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
...				
CASS 7.1.15C R	Not specified (<u>see default provision CASS 7.6.4R</u>)

Insert the following new rows in the appropriate numerical position in **Schedule 2 (Notification requirements)**. The new text is not underlined.

Sch 2.1G

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
CASS 7.19.21R	Material change to <i>sub-pool</i>	Fact of proposed change, risks and consequences to beneficiaries	<i>Firm</i> determining that it wishes to make material change to a <i>sub-pool</i>	Not less than two months before the date on which the <i>firm</i> intends the change to take effect

CASS 7.19.22R	Establishment of a <i>sub-pool</i> of <i>client money</i> to FCA	<i>Firm</i> wishes to establish a <i>sub-pool</i> of <i>client money</i>	<i>Firm</i> determining that it wishes to establish a <i>sub-pool</i> of <i>client money</i>	Not less than two months before the date on which the <i>firm</i> intends to receive or hold <i>client money</i> for that <i>sub-pool</i>
CASS 7.19.24R	Non-compliance, or inability to comply with, with the requirements in CASS 7.19.11R or CASS 7.19.18R	The fact that the <i>firm</i> has not complied with, or is unable to comply with, the requirements of CASS 7.19.11R or CASS 7.19.18R (as applicable)	Non-compliance with the applicable requirement	Without delay

In CASS Sch 2.1G amend the following as shown and move to its appropriate numerical position.

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
CASS 7.4.35R <u>CASS 12.2.5R</u>	<i>LME bond arrangements</i>	Issue of an individual letter of credit issued by the <i>firm</i>	Upon issue of an individual letter of credit under an <i>LME bond arrangement</i>	Immediately

Part 2: Comes into force on 1 December 2014

6 Custody rules

6.1 Application

...

- 6.1.6B** **R** (1) A firm must ensure that any arrangement relating to the transfer of full ownership of a client's safe custody asset to the firm for the purposes set out in CASS 6.1.6R(1) and CASS 6.1.6AR(1) is the subject of a written agreement made on a durable medium between the firm and the client.
- (2) Regardless of the form of the agreement in (1) (which may have additional commercial purposes), it must cover the client's agreement to:
- (a) the terms for the arrangement relating to the transfer of the client's full ownership of the safe custody asset to the firm;
- (b) any terms under which the ownership of the safe custody asset is to transfer from the firm back to the client; and
- (c) (to the extent not covered by the terms under (b)), any terms for the termination of:
- (i) the arrangement under (a); or
- (ii) the overall agreement in (1).
- (3) A firm must retain a copy of the agreement under (1) from the date the agreement is entered into and until five years after the agreement is terminated.
- 6.1.6C** **G** The terms referred to in CASS 6.1.6BR(2)(b) may include, for example, terms under which the arrangement relating to the transfer of full ownership of the safe custody asset to the firm is not in effect from time to time, or is contingent on some other condition.

...

Delivery versus payment ~~transactions~~ transaction exemption

- 6.1.12** **R** (1) A Subject to (2) and CASS 6.1.12BR and with the written agreement of the relevant client, a firm need not treat this chapter as applying in respect of a delivery versus payment transaction through a ~~commercial settlement system~~ commercial settlement system if it is intended that the safe custody asset is either to be:

- (a) ~~in respect of a *client's* purchase, due to the *client* within one *business day* following the *client's* fulfilment of a payment obligation~~ the *firm* intends for the asset in question to be due to the *client* within one *business day* following the *client's* fulfilment of its payment obligation to the *firm*; or
- (b) ~~in respect of a *client's* sale, due to the *firm* within one *business day* following the fulfilment of a payment obligation~~ the *firm* intends for the asset in question to be due to the *firm* within one *business day* following the *firm's* fulfilment of its payment obligation to the *client*.

~~unless the delivery or payment by the *firm* does not occur by the close of business on the third *business day* following the date of payment or delivery of the *safe custody asset* by the *client*.~~

- (2) ~~Until such a delivery versus payment transaction through a commercial settlement system settles, a *firm* may segregate money (in accordance with the *client money chapter*) instead of the *client's safe custody assets*. If the payment or delivery by the *firm* to the *client* has not occurred by the close of business on the third *business day* following the date on which a *firm* makes use of the exemption under (1), the *firm* must stop using that exemption for the transaction.~~
- (3) If the period referred to in CASS 6.1.12R(2) has expired before such a delivery versus payment transaction through a *commercial settlement system* has settled, a *firm* may, until settlement and provided that doing so is consistent with the *firm's permissions* and it complies with (4), segregate the *firm's own money* as *client money* (in accordance with the *client money rules*) of an amount equivalent to the value at which that *safe custody asset* is reasonably expected to settle instead of holding the *client's safe custody assets* (in accordance with the *custody rules*).
- (4) Where a *firm* intends to segregate money as *client money* instead of the *client's safe custody asset* under (3) it must, before doing so, ensure that this would result in money being held for the relevant *client* in respect of the *shortfall* under CASS 7.7.2R (statutory trust).
- (5) Where a *firm* segregates an amount of *client money* instead of the *client's safe custody assets* under (3) it must also:
 - (a) ensure the *money* is segregated under CASS 7.4 (Segregation of client money) and recorded as being held for the relevant *client(s)* under CASS 7.6 (Records, accounts and reconciliations);
 - (b) keep a record of the actions the *firm* has taken under this rule which includes a description of the *safe custody asset* in question, identifies the relevant affected *client*, and specifies the amount of *money* that the *firm* has appropriated as *client*

money to cover the value of the *safe custody asset*; and

- (c) update the record made under (5)(b) when the transaction in question has settled and the *firm* has re-appropriated the *money*.

- 6.1.12A G (1) The amount of *client money* a *firm* segregates for the purposes of CASS 6.1.12R(3) may be determined by the previous day's closing mark to market valuation of the relevant *safe custody asset* or, if in relation to a particular *safe custody asset* none is available, the most recent available valuation.
- (2) Where a *firm* is segregating *money* for the purposes of CASS 6.1.12R(3) it should, as regularly as necessary, and having regard to *Principle 10*:
- (a) review the value of the *safe custody asset* in question in line with (1); and
- (b) where the *firm* has found that the value of the *safe custody asset* has changed, adjust the amount of *money* it has appropriated to ensure that these monies are sufficient to cover the latest value of the *safe custody asset*.
- 6.1.12B R A *firm* cannot, in respect of a particular delivery versus payment transaction, make use of the exemption under CASS 6.1.12R in either or both of the following circumstances:
- (1) it is not a direct member or participant of the relevant *commercial settlement system*, nor is it sponsored by such a member or participant, in accordance with the terms and conditions of that *commercial settlement system*;
- (2) the transaction in question is being settled by another *person* on behalf of the *firm* through an account held at the relevant *commercial settlement system* by that other *person*.
- 6.1.12C G Where a *firm* does not meet the requirements in CASS 6.1.12R or CASS 6.1.12BR for use of the exemption in CASS 6.1.12R, the *firm* is subject to the *custody rules* in respect of any *safe custody asset* it holds in connection with the delivery versus payment transaction in question.
- 6.1.12D G (1) In line with CASS 6.1.12R, where a *firm* receives a *safe custody asset* from a *client* in respect of a delivery versus payment transaction the *firm* is carrying out through a *commercial settlement system* in respect of a *client's* sale, and the *firm* has not fulfilled its payment obligation to the *client* by close of business on the third *business day* following the date of the *client's* fulfilment of its delivery obligation to the *firm*, the *firm* should consider whether the *custody rules* apply in respect of the *safe custody asset* pursuant to CASS 6.1.1R(1A) to (1D).

(2) Upon settlement of a delivery versus payment transaction a firm is carrying out through a commercial settlement system (including when it is settled within the three business day period referred to in CASS 6.1.12R), in respect of:

(a) a client's purchase, the custody rules apply to the relevant safe custody asset the firm receives upon settlement; and

(b) a client's sale, the client money rules will apply to the relevant money received on settlement.

- 6.1.12E R (1) If a firm makes use of the exemption under CASS 6.1.12R, it must obtain the client's written agreement to the firm's use of this exemption.
- (2) In respect of each client, the written agreement in (1) must be retained during the time that the firm makes use, or intends to make use, of the exemption under CASS 6.1.12R in respect of that client's safe custody assets.

...

Trustees and depositaries (except depositaries of AIFs)

...

6.1.16F R ...

Reference	Rule
...	
CASS 6.3.1R to CASS 6.3.4R 6.3.4BG	Depositing safe custody assets with third parties
...	...

...

Arrangers

6.1.16J R Only the custody rules in the table below apply to a firm when arranging safeguarding and administration of assets:

Reference	Rule
...	
CASS 6.3.1R(1A) and CASS 6.3.2G	Arranging for assets to be deposited with third parties

CASS 6.3.4AR and CASS 6.3.4BG

Third-party custody agreements

...

6.2 Holding of client assets

...

Allocated but unclaimed safe custody assets

- 6.2.8 G The purpose of CASS 6.2.10R is to set out the requirements a firm must comply with if it chooses to divest itself of a client's unclaimed safe custody assets.
- 6.2.9 G Before acting in accordance with CASS 6.2.10R to CASS 6.2.16G, a firm should consider whether its actions are permitted by law and consistent with the arrangements under which the safe custody assets are held. These provisions relate to a firm's obligations as an authorised person.
- 6.2.10 R A firm may either (i) liquidate an unclaimed safe custody asset it holds for a client, at market value, and pay away the proceeds or (ii) pay away an unclaimed safe custody asset it holds for a client, in either case, to a registered charity of its choice provided:
- (1) this is permitted by law and consistent with the arrangements under which that safe custody asset is held;
 - (2) it has held that safe custody asset for at least 12 years;
 - (3) in the 12 years preceding the divestment of that safe custody asset, it has not received instructions relating to any safe custody assets from or on behalf of the client concerned;
 - (4) it can demonstrate that it has taken reasonable steps to trace the client concerned and return that safe custody asset; and
 - (5) the firm complies with CASS 6.2.14R: the undertaking requirement.
- 6.2.11 E (1) Taking reasonable steps in CASS 6.2.10R(4) includes following this course of conduct:
- (a) determining, as far as reasonably possible, the correct contact details for the relevant client;
 - (b) writing to the client at the last known address either by post or by electronic mail to inform it:
 - (i) of the name of the firm with which the client first deposited the safe custody asset in question;
 - (ii) of the firm's intention to pay the safe custody asset to charity under CASS 6.2.10R if it does not receive

instructions from the *client* within 28 days;

- (c) where the *client* has not responded after the 28 days referred to in (b), attempting to communicate the information set out in (b) to the *client* on at least one further occasion by any means other than that used in (b) including by post, electronic mail, telephone or media advertisement;
- (d) subject to (e) and (f), where the *client* has not responded within 28 days following the most recent communication, writing again to the *client* at the last known address either by post or by electronic mail to inform them that:
 - (i) as the *firm* received no instructions from the *client*, it will in 28 days pay the *safe custody asset* to charity under CASS 6.2.10R; and
 - (ii) an undertaking will be provided by the *firm* or a member of its *group* to pay to the *client* concerned a sum equal to the value of the *safe custody asset* at the time it was liquidated or paid away in the event of the *client* seeking to claim the *safe custody asset* in future;
- (e) if the *firm* has carried out the steps in (b) or (c) and in response has received positive confirmation in writing that the *client* is no longer at a particular address, the *firm* should not use that address for the purposes of (d);
- (f) if, after carrying out the steps in (a), (b) and (c), the *firm* has obtained positive confirmation that none of the contact details it holds for the relevant *client* are accurate or, if utilised, the communication is unlikely to reach the *client*, the *firm* does not have to comply with (d); and
- (g) waiting a further 28 days following the most recent communication under this *rule* before divesting itself of the *safe custody asset* under CASS 6.2.10R.

(2) Compliance with (1) may be relied on as tending to establish compliance with CASS 6.2.10R(4).

(3) Contravention of (1) may be relied on as tending to establish contravention of CASS 6.2.10R(4).

6.2.12 G For the purpose of CASS 6.2.11E(1)(a), a *firm* may use any available means to determine the correct contact details for the relevant *client*, including telephoning the *client*, searching internal records, media advertising, searching public records, mortality screening, using credit reference agencies or tracing agents.

6.2.13 R Where a *firm* liquidates a *safe custody asset* under CASS 6.2.10R, it must

pay away the proceeds to charity as soon as practicable.

- 6.2.14 R Where a *firm* divests itself of a *client's safe custody asset* under CASS 6.2.10R, it must comply with either (1)(a) or (1)(b) and, in either case, (2).
- (1) (a) The *firm* must unconditionally undertake to pay to the *client* concerned a sum equal to the value of the *safe custody asset* at the time it was liquidated or paid away in the event of the *client* seeking to claim the *safe custody asset* in future.
- (b) The *firm* must ensure that an unconditional undertaking in the terms set out in (1) is made by a member of its *group* and there is suitable information available for relevant *clients* to identify the member of the *group* granting the undertaking.
- (2) Any undertaking under this rule must be:
- (a) authorised by the *firm's governing body* where (1) applies or the *governing body* of the *group* member where (2) applies;
- (b) legally enforceable by any *person* that had a legally enforceable claim to the unclaimed *safe custody asset* in question at the time it was divested by the *firm*, or by an assign or successor in title to such claim; and
- (c) retained by the *firm*, and, where (2) applies, by the *group* member, indefinitely.
- 6.2.15 R (1) If a *firm* pays away a *client's unclaimed safe custody assets* to charity or liquidates a *client's unclaimed safe custody assets* and pays the proceeds to charity under CASS 6.2.10R it must make and retain, or where the *firm* already has such records, retain:
- (a) records of all *safe custody assets* divested under CASS 6.2.10R (including details of the value of each asset at that time and the identity of the *client* to whom the asset was allocated);
- (b) all relevant documentation (including charity receipts); and
- (c) details of the communications the *firm* had or attempted to make with the *client* concerned pursuant to CASS 6.2.10R(4).
- (2) Records in (1) must be retained indefinitely.
- (3) If a member of the *firm's group* has provided an undertaking under CASS 6.2.14R(1)(b), then the records in (1) must be readily accessible to that *group* member.

Costs associated with divesting allocated but unclaimed client assets

- 6.2.16 G Any costs associated with the *firm* divesting itself of *safe custody assets* pursuant to CASS 6.2.10R to CASS 6.2.15R should be paid for from the

firm's own funds, including:

- (1) any costs associated with the firm carrying out the steps in CASS 6.2.10R(4) or CASS 6.2.11E; and
- (2) the cost of any insurance purchased by a firm or the relevant member of its group to cover any legally enforceable claim in respect of the assets divested under CASS 6.2.10R.

6.3 Depositing assets and arranging for assets to be deposited with third parties

...

6.3.3 G ~~A firm should consider carefully the terms of its agreements with third parties with which it will deposit safe custody assets belonging to a client. The following terms are examples of the issues firms should address in this agreement:~~

- (1) ~~that the title of the account indicates that any safe custody asset credited to it does not belong to the firm;~~
- (2) ~~that the third party will hold or record a safe custody asset belonging to the firm's client separately from any applicable asset belonging to the firm or to the third party;~~
- (3) ~~the arrangements for registration or recording of the safe custody asset if this will not be registered in the client's name;~~
- (4) ~~[deleted]~~
- (5) ~~the restrictions over the circumstances in which the third party may withdraw assets from the account~~
- (6) ~~the procedures and authorities for the passing of instructions to or by the firm;~~
- (7) ~~the procedures regarding the claiming and receiving of dividends, interest payments and other entitlements accruing to the client; and~~
- (8) ~~the provisions detailing the extent of the third party's liability in the event of the loss of a safe custody asset caused by the fraud, wilful default or negligence of the third party or an agent appointed by him. [deleted]~~

...

Third-party custody agreements

6.3.4A R A firm must have entered into a written agreement with any person with whom it deposits clients' safe custody assets under CASS 6.3.1R, or with

whom it arranges safeguarding and administration of assets which are clients' safe custody assets. This agreement must, at minimum:

- (1) set out the binding terms of the arrangement between the firm and the third party;
- (2) be in force for the duration of that arrangement; and
- (3) clearly set out the custody service(s) that the third party is contracted to provide.

6.3.4B G A firm should consider carefully the terms of any agreement entered into with a third party under CASS 6.3.4AR. The following terms are examples of the issues that should be addressed in these agreements (where relevant):

- (1) that the title of the account in the third party's books and records indicates that any safe custody asset credited to it does not belong to the firm;
- (2) that the third party will hold or record a safe custody asset belonging to the firm's client separately from any applicable asset belonging to the firm or to the third party;
- (3) the arrangements for registration or recording of the safe custody asset, if this will not be registered in the firm's client's name;
- (4) the restrictions over the circumstances in which the third party may withdraw assets from the account;
- (5) the procedures and authorities for the passing of instructions to, or by, the firm;
- (6) the procedures for the claiming and receiving of dividends, interest payments and other entitlements accruing to the firm's client; and
- (7) the provisions detailing the extent of the third party's liability in the event of the loss of a safe custody asset caused by the fraud, wilful default or negligence of the third party or an agent appointed by him.

...

7 Client money rules

...

7.1.8 R ~~The client money rules do not apply to a CRD credit institution in relation to deposits within the meaning of the CRD held by that institution.~~
 [Note: article 13(8) of MiFID and article 18(1) of the MiFID implementing

~~Directive] [deleted]~~

- 7.1.8A R In relation to the application of the *client money rules* (and any other rule in so far as it relates to matters covered by the *client money rules*) to the firms referred to in (1) and (2), the following is not *client money*:
- (1) any deposits within the meaning of the *CRD* held by a *CRD credit institution*; and
[Note: article 13(8) of *MiFID* and article 18(1) of the *MiFID Implementing Directive*]
- (2) any money held by an *approved bank* that is not a *CRD credit institution* in an account with itself in relation to *designated investment business* carried on for its *clients*.
- 7.1.8B G A firm referred to in CASS 7.1.8AR must comply, as relevant, with CASS 7.1.8BAG to CASS 7.1.10CR.
- 7.1.8BA G The effect of CASS 7.1.8AR is that, unless notified otherwise in accordance with CASS 7.1.8DR or CASS 7.1.10AR, *clients* of *CRD credit institutions* or *approved banks* that are not *CRD credit institutions* should expect that where they pass money to such firms in connection with *designated investment business* these sums will not be held as *client money*.
- 7.1.8C R A firm holding money in either of the ways described in CASS 7.1.8AR must, before providing *designated investment business* services to the *client* in respect of those sums, notify the *client* that:
- (1) the money held for that *client* is held by the firm as banker and not as a trustee under the *client money rules*; and
- (2) if the firm fails, the *client money distribution 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*.
- 7.1.8D R A firm holding money in either of the ways described in CASS 7.1.8AR in respect of a *client* and providing the services to it referred to in CASS 7.1.8CR must:
- (1) explain to its *clients* the circumstances, if any, under which it will cease to hold any money in respect of those services as banker and will hold the money as trustee in accordance with the *client money rules*; and
- (2) set out the circumstances in (1), if any, in its terms of business so that they form part of its agreement with the *client*.
- 7.1.9 G ~~If a *credit institution* that holds money as a deposit with itself is subject to the requirement to disclose information before providing services, it should, in compliance with that obligation, notify the *client* that:~~

- (1) ~~money held for that client in an account with the credit institution will be held by the firm as banker and not as trustee (or in Scotland as agent); and~~
- (2) ~~as a result, the money will not be held in accordance with the client money rules. [deleted]~~

7.1.10 G Pursuant to *Principle 10 (Clients' assets)*, a *credit institution* that holds ~~money as a deposit with itself~~ Where a firm receives money that would otherwise be held as client money but for CASS 7.1.8AR:

- (1) it should be able to account to all of its clients for amounts held on their behalf sums held for them at all times; and
- (2) that money should, pursuant to Principle 10, be allocated to the relevant client promptly. This should be done no later than ten business days after the firm has received the money.

~~A bank account opened with the firm that is in the name of the client would generally be sufficient. When money from clients deposited with the firm is held in a pooled account, this account should be clearly identified as an account for clients. The firm should also be able to demonstrate that an amount owed to a specific client that is held within the pool can be reconciled with a record showing that individual's client balance and is, therefore, identifiable at any time. Similarly, where that money is reflected only in a firm's bank account with other banks (nostro accounts), the firm should be able to reconcile amounts owed to that client within a reasonable period of time.~~

7.1.10A R If a CRD credit institution or an approved bank that is not a CRD credit institution wishes to hold client money for a client (rather than hold the money in either of the ways described in CASS 7.1.8AR) it must, before providing designated investment business services to the client, disclose the following information to the client:

- (1) that the money held for that client in the course of or in connection with the business described under (2) is being held by the firm as client money under the client money rules;
- (2) a description of the relevant business carried on with the client in respect of which the client money rules apply to the firm; and
- (3) that, if the firm fails, the client money distribution rules will apply to money held in relation to the business in question.

7.1.10B G Firms carrying on MiFID business are reminded of their obligation to supply investor compensation scheme information to clients under COBS 6.1.16R (Compensation Information).

7.1.10C R A CRD credit institution or an approved bank that is not a CRD credit institution must, in respect of any client money held in relation to its

designated investment business that is not MiFID business, comply with the obligations referred to in COBS 6.1.16R (Compensation information).

- 7.1.11 G ~~A credit institution is reminded that the exemption for deposits is not an absolute exemption from the client money rules. [deleted]~~
- 7.1.11A R (1) ~~This rule applies to a firm which is an approved bank but not a CRD credit institution. [deleted]~~
- (2) ~~The client money rules do not apply to money held by the approved bank if it is undertaking business which is not MiFID business but only when the money is held in an account with itself, in which case the firm must notify the client in writing that:~~
- (a) ~~money held for that client in an account with the approved bank will be held by the firm as banker and not as trustee (or in Scotland as agent); and~~
- (b) ~~as a result, the money will not be held in accordance with the client money rules. [deleted]~~

7.2 Treatment of client money

...

- 7.2.3B R (1) A firm must ensure that any arrangement relating to the transfer of full ownership of a client's money to the firm for the purposes set out in CASS 7.2.3R(1) and CASS 7.2.3AR(1) is the subject of a written agreement made on a durable medium between the firm and the client.
- (2) Regardless of the form of the written agreement in (1) (which may have additional commercial purposes), it must cover the client's agreement to:
- (a) the terms for the arrangement relating to the transfer of the client's full ownership of money to the firm;
- (b) any terms under which the ownership of money is to transfer from the firm back to the client; and
- (c) (to the extent not covered by the terms under (b)), any terms for the termination of:
- (i) the arrangement under (a); or
- (ii) the overall agreement in (1).
- (3) A firm must retain a copy of the agreement under (1) from the date the agreement is entered into and until five years after the

agreement is terminated.

- 7.2.3C G The terms referred to in CASS 7.2.3BR(2)(b) may include, for example, terms under which the arrangement relating to the transfer of full ownership of money to the firm is not in effect from time to time, or is contingent on some other condition.

...

~~Money in connection with a “delivery versus payment” transaction~~
Delivery versus payment transaction exemption

- 7.2.8 R ~~Money need not be treated as client money in respect of a delivery versus payment transaction through a commercial settlement system if it is intended that either:~~

- (1) ~~in respect of a client’s purchase, money from a client will be due to the firm within one business day upon the fulfilment of a delivery obligation; or~~
- (2) ~~in respect of a client’s sale, money is due to the client within one business day following the client’s fulfilment of a delivery obligation~~

~~unless the delivery or payment by the firm does not occur by the close of business on the third business day following the date of payment or delivery of the investments by the client. [deleted]~~

- 7.2.8A G The exclusion from the *client money rules* for delivery versus payment transactions under ~~CASS 7.2.8R~~ 7.2.8AAR is an example of an exclusion from the *client money rules* which is permissible by virtue of recital 26 of *MiFID*.

- 7.2.8AA R (1) Subject to (2) and CASS 7.2.8ABR and with the agreement of the relevant client, money need not be treated as client money in respect of a delivery versus payment transaction through a commercial settlement system if:
- (a) in respect of a client’s purchase, the firm intends for the money from the client to be due to it within one business day following the firm’s fulfilment of its delivery obligation to the client; or
- (b) in respect of a client’s sale, the firm intends for the money in question to be due to the client within one business day following the client’s fulfilment of its delivery obligation to the firm.

- (2) If the payment or delivery by the *firm* to the *client* has not occurred by the close of business on the third *business day* following the date on which the *firm* makes use of the exemption under (1), the *firm* must stop using that exemption for the transaction.

7.2.8AB R A *firm* cannot, in respect of a particular delivery versus payment transaction, make use of the exemption under CASS 7.2.8AAR in either or both of the following circumstances:

- (1) it is not a direct member or participant of the relevant *commercial settlement system*, nor is it sponsored by such a member or participant, in accordance with the terms and conditions of that *commercial settlement system*;
- (2) the transaction in question is being settled by another *person* on behalf of the *firm* through an account held at the relevant *commercial settlement system* by that other *person*.

7.2.8AC R Where a *firm* does not meet the requirements in CASS 7.2.8AAR or CASS 7.2.8ABR for the use of the exemption in CASS 7.2.8AAR, the *firm* is subject to the *client money rules* in respect of any *money* it holds in connection with the delivery versus payment transaction in question.

7.2.8AD G (1) In line with CASS 7.2.8AAR, where a *firm* receives *money* from the *client* in fulfilment of the *client's* payment obligation in respect of a delivery versus payment transaction the *firm* is carrying out through a *commercial settlement system* in respect of a *client's* purchase and the *firm* has not fulfilled its delivery obligation to the *client* by close of business on the third *business day* following the date of the *client's* fulfilment of its payment obligation to the *firm*, the *firm* must treat the *client money* in accordance with the *client money rules* until delivery by the *firm* to the *client* occurs.

- (2) Upon settlement of a delivery versus payment transaction a *firm* is carrying out through a *commercial settlement system* (including when it is settled within the three *business day* period referred to in CASS 7.2.8AAR(2)) then, in respect of:

- (a) a *client's* purchase, the *custody rules* apply to the relevant *safe custody asset* the *firm* receives upon settlement; and
- (b) a *client's* sale, the *client money rules* will apply to the relevant *money* received on settlement.

7.2.8AE R (1) If a *firm* makes use of the exemption under CASS 7.2.8AAR, it must obtain the *client's* written agreement to the *firm's* use of the exemption.

- (2) In respect of each *client*, the written agreement in (1) must be retained during the time that the *firm* makes use, or intends to make

use, of the exemption under CASS 7.2.8AAR in respect of that client's monies.

...

7.2.15 R *Money ceases to be client money (having regard to CASS 7.2.17R where applicable) if:*

...

(2) *it is:*

...

(c) transferred in accordance with CASS 7.2.17BR; or

(d) transferred in accordance with CASS 7.2.17DR; or

...

...

(9) *it is transferred by the firm to a clearing member in connection with a regulated clearing arrangement and the clearing member remits payment directly to the indirect clients of the firm in accordance with CASS 7.2.15CR(2); or*

(10) it is paid to charity under CASS 7.2.19R or CASS 7.2.25R.

...

Transfer of business

7.2.17A G A firm may transfer client money to a third party as part of transferring all or part of its business if, in respect of each client with an interest in the client money that is sought to be transferred, it:

(1) obtains the consent or instruction of that client at the time of the transfer of business (see CASS 7.2.15R(2)(a)); or

(2) complies with CASS 7.2.17BR (see CASS 7.2.15R(2)(c)); or

(3) complies with CASS 7.2.17DR (see CASS 7.2.15R(2)(d)).

7.2.17B R Subject to CASS 7.2.17DR, money ceases to be client money for a firm if:

(1) it is transferred by the firm to another person as part of a transfer of business to that person where the client money relates to the business being transferred;

(2) it is transferred on terms which require the other person to return a client's transferred sums as soon as practicable at the client's request;

- (3) a written agreement between the *firm* and the relevant *clients* provides that:
- (a) the *firm* may transfer the *client's client money* to another *person*; and
- (b) (i) the sums transferred will be held by the *person* to whom they are transferred in accordance with the *client money rules* for the *clients*; or
- (ii) if not held in accordance with (i), the *firm* will exercise all due skill, care and diligence in assessing whether the *person* to whom the *client money* is transferred will apply adequate measures to protect these sums; and
- (4) the *firm* complies with the requirements in (3)(b)(ii) (if applicable).

7.2.17C G In considering how and whether to introduce the written agreement referred to in CASS 7.2.17BR(3), *firms* should have regard to any relevant obligations to *clients*, including requirements under the *Unfair Terms Regulations*.

Transfer of business: de minimis sums

- 7.2.17D R (1) *Client money* belonging to those categories of *clients* set out in (2) and in respect of those amounts set out in (2) ceases to be *client money* of the *firm* if it is transferred by the *firm* to another *person*:
- (a) as part of a transfer of business to that other *person* where these sums relate to the business being transferred; and
- (b) on terms which require the other *person* to return a *client's* transferred sums as soon as practicable at the *client's* request.
- (2) (a) For *retail clients* the amount is £25.
- (b) For all other *clients* the amount is £100.

7.2.17E G For the avoidance of doubt, sums transferred under CASS 7.2.17DR do not, for the purposes of that *rule*, require the instruction or specific consent of each *client* at the time of the transfer or a written agreement as set out in CASS 7.2.17BR(3).

Transfer of business: client notifications

7.2.17F R Where a *firm* transfers *client money* belonging to its *clients* under either or both of CASS 7.2.17BR and CASS 7.2.17DR, it must ensure that those *clients* are notified no later than seven *days* after the transfer takes place:

- (1) whether or not the sums will be held by the person to whom they have been transferred in accordance with the *client money rules* and, if not, how the sums being transferred will be held by that *person*;
- (2) the extent to which the sums transferred will be protected under a compensation scheme; and
- (3) that the *client* may opt to have the *client's* transferred sum returned to it as soon as practicable at the *client's* request.
- 7.2.17G R The *firm* must notify the *FCA* of its intention to effect any transfer of *client money* under either or both of *CASS 7.2.17BR* and *CASS 7.2.17DR* at least seven *days* before it transfers the *client money* in question.
- ...
- 7.2.18 G The purpose of the *CASS 7.2.19R* ~~rule on allocated but unclaimed *client money*~~ is to allow a *firm*, in the normal course of its business, set out the requirements *firms* must comply with in order to cease to treat as *client money* any unclaimed balances balance which is, allocated to an individual *client*, ~~when those balances remain unclaimed.~~
- 7.2.18A G Before acting in accordance with *CASS 7.2.19R* to *CASS 7.2.26R*, a *firm* should consider whether its actions are permitted by law and consistent with the arrangements under which the *client money* is held. For the avoidance of doubt, these provisions relate to a *firm's* obligations as an *authorised person* and to the treatment of *client money* under the *client money rules*.
- 7.2.19 R A *firm* may cease to treat as *client money* any unclaimed *client money* balance if it can demonstrate that it has taken reasonable steps to trace the *client* concerned and to return the balance. A *firm* may pay away to a registered charity of its choice a *client money* balance which is allocated to a *client* and if it does so the released balance will cease to be *client money* under *CASS 7.2.15R(10)*, provided:
- (1) this is permitted by law and consistent with the arrangements under which the *client money* is held;
- (2) the *firm* held the balance concerned for at least six years following the last movement on the *client's* account (disregarding any payment or receipt of interest, charges or similar items);
- (3) it can demonstrate that it has taken reasonable steps to trace the *client* concerned and to return the balance; and
- (4) the *firm* complies with *CASS 7.2.22R*.
- 7.2.19A G Where the *client money* balance held by a *firm* is, in aggregate, £100 or less for a *client* other than a *retail client* or, for a *retail client*, £25 or less,

the firm may comply with CASS 7.2.25R instead of CASS 7.2.19R.

- 7.2.20 E (1) Taking Reasonable reasonable steps in CASS 7.2.19R(3) should include includes following this course of conduct:
- (a) entering into a written agreement, in which the client consents to the firm releasing, after the period of time specified in (b), any client money balances, for or on behalf of that client, from client bank accounts determining, as far as reasonably possible, the correct contact details for the relevant client;
 - (b) determining that there has been no movement on the client's balance for a period of at least six years (notwithstanding any payments or receipts of charges, interest or similar items) writing to the client at the last known address either by post or by electronic mail to inform it of the firm's intention to no longer treat the client money balance as client money and to pay the sums concerned to charity if the firm does not receive instructions from the client within 28 days;
 - (c) writing to the client at the last known address informing the client of the firm's intention of no longer treating that balance as client money, giving the client 28 days to make a claim where the client has not responded after the 28 days referred to in (b), attempting to communicate the information set out in (b) to the client on at least one further occasion by any means other than that used in (b) including by post, electronic mail, telephone or media advertisement;
 - (d) making and retaining records of all balances released from client bank accounts; and subject to (e) and (f), where the client has not responded within 28 days following the most recent communication, writing again to the client at the last known address either by post or by electronic mail to inform them that:
 - (i) as the firm did not receive a claim for the relevant client money balance, it will in 28 days pay the balance to a registered charity; and
 - (ii) an undertaking will be provided by the firm or a member of its group to pay to the client concerned a sum equal to the balance paid away to charity in the event of the client seeking to claim the balance in future;
 - (e) undertaking to make good any valid claim against any released balances, if the firm has carried out the steps in (b) or (c) and in response has received positive confirmation in

writing that the *client* is no longer at a particular address, the *firm* should not use that address for the purposes of (d);

- (f) if, after carrying out the steps in (a), (b) and (c), the *firm* has obtained positive confirmation that none of the contact details it holds for the relevant *client* are accurate or, if utilised, the communication is unlikely to reach the *client*, the *firm* does not have to comply with (d); and
- (g) waiting a further 28 days following the most recent communication under this *rule* before paying the balance to a registered charity.

...

- 7.2.20A G For the purpose of CASS 7.2.20E(1)(a), a *firm* may use any available means to determine the correct contact details for the relevant *client*, including telephoning the *client*, searching internal records, media advertising, searching public records, mortality screening, using credit reference agencies or tracing agents.
- 7.2.21 G ~~When a *firm* gives an undertaking to make good any valid claim against released balances, it should make arrangements authorised by the *firm's* relevant *controllers* that are legally enforceable by any *person* with a valid claim to such *money*. [deleted]~~
- 7.2.22 R (1) Where a *firm* wishes to release a balance allocated to an individual *client* under CASS 7.2.19R it must comply with either (a) or (b) and, in either case, (2):
- (a) the *firm* must unconditionally undertake to pay to the *client* concerned a sum equal to the balance paid away to charity in the event of the *client* seeking to claim the balance in future; or
 - (b) the *firm* must ensure that an unconditional undertaking in the terms set out in (a) is made by a member of its *group* and there is suitable information available for relevant *clients* to identify the member of the *group* granting the undertaking.
- (2) The undertakings in this *rule* must be:
- (a) authorised by the *firm's* governing body where (1)(a) applies or by the governing body of the *group* member where (1)(b) applies;
 - (b) legally enforceable by any *person* who had a legally enforceable claim to the balance in question at the time it was released by the *firm*, or by an assign or successor in title to such claim; and

- (c) retained by the *firm*, and, where (1)(b) applies, by the *group* member, indefinitely.
- 7.2.23 R (1) If a *firm* pays away *client money* under CASS 7.2.19R(4) it must make and retain, or where the *firm* already has such records, retain:
- (a) records of all balances released from *client bank* accounts under CASS 7.2.19R (including details of the amounts and the identity of the *client* to whom the *money* was allocated);
- (b) all relevant documentation (including charity receipts); and
- (c) details of the communications the *firm* had or attempted to make with the *client* concerned pursuant to CASS 7.2.19R(3).
- (2) The records in (1) must be retained indefinitely.
- (3) If a member of the *firm's group* has provided an undertaking under CASS 7.2.22R(2) then the records in (1) must be readily accessible to that *group* member.

De minimis amounts of unclaimed client money

- 7.2.24 G The purpose of CASS 7.2.25R is to allow a *firm* to pay away to charity *client money* balances of (i) £25 or less for *retail clients* or (ii) £100 or less for other *clients* when those balances remain unclaimed. If a *firm* follows this process, the *money* will cease to be *client money* (see CASS 7.2.15R(10)).
- 7.2.25 R A *firm* may pay away to a registered charity of its choice a *client money* balance which is allocated to a *client* and if it does so the released balance will cease to be *client money* under CASS 7.2.15R(10), provided:
- (1) the balance in question is (i) for a *retail client*, in aggregate, £25 or less, or (ii) for a *professional client*, in aggregate, £100 or less;
- (2) the *firm* held the balance concerned for at least six years following the last movement on the *client's* account (disregarding any payment or receipt of interest, charges or similar items);
- (3) the *firm* has made at least one attempt to contact the *client* to return the balance using the most up-to-date contact details the *firm* has for the *client*, and the *client* has not responded to such communication within 28 days of the communication having been made; and
- (4) the *firm* makes and/or retains records of all balances released from *client bank* accounts in accordance with this rule. Such records must include the information in CASS 7.2.23(1)(a) and (b).

Costs associated with paying away allocated but unclaimed client money

- 7.2.26 G Any costs associated with the firm ceasing to treat unclaimed client money balances as client money pursuant to CASS 7.2.18G to CASS 7.2.25R should be paid for from the firm's own funds, including:
- (1) any costs associated with the firm carrying out the steps in CASS 7.2.19R(3), CASS 7.2.20E or CASS 7.2.25R(3); and
 - (2) the cost of any insurance purchased by a firm or the relevant member of its group to cover any legally enforceable claim in respect of the client money paid away.

.....

7.4 Segregation of client money

...

- 7.4.11C G CASS 7.4.11AR does not prevent a firm from depositing client money in overnight money market deposits which are clearly identified as being client money (for example in the client bank account ~~acknowledgment letter~~ acknowledgment letter).
- 7.4.11D G ~~Firms are reminded of their obligations under CASS 7.8 (Notification and acknowledgement of trust Acknowledgment letters) for client bank accounts.~~ Firms should also ensure that client bank accounts meet the requirements in the relevant Glossary definitions, including regarding the titles given to the accounts.

...

Payment Approaches for the segregation of client money into a client bank account

- 7.4.14 G ~~Two~~ The two approaches that a firm can adopt in discharging its obligations under ~~the client money segregation requirements~~ this section are:
- (1) the 'normal approach'; or
 - (2) the 'alternative approach'.
- 7.4.15 R ~~A firm that does not adopt the normal approach must first send a written confirmation to the FCA from the firm's auditor that the firm has in place systems and controls which are adequate to enable it to operate another approach effectively. [deleted]~~
- 7.4.16 G ~~The alternative approach would be appropriate for a firm that operates in a multi-product, multi-currency environment for which adopting the normal approach would be unduly burdensome and would not achieve the client protection objective. Under the alternative approach, client money is~~

~~received into and paid out of a firm's own bank accounts; consequently the firm should have systems and controls that are capable of monitoring the client money flows so that the firm can comply with its obligations to perform reconciliations of records and accounts (see CASS 7.6.2R). A firm that adopts the alternative approach will segregate client money into a client bank account on a daily basis, after having performed a reconciliation of records and accounts of the entitlement of each client for whom the firm holds client money with the records and accounts of the client money the firm holds in client bank accounts and client transaction accounts to determine what the client money requirement was at the close of the previous business day. [deleted]~~

...

The alternative approach to client money segregation

- 7.4.17A G (1) In certain circumstances, use of the normal approach for a particular business line of a firm could lead to significant operational risks to client money protection. These may include a business line under which clients' transactions are complex, numerous, closely related to the firm's proprietary business and/or involve a number of currencies and time zones. In such circumstances, subject to meeting the relevant criteria and fulfilling the relevant notification and audit requirements, a firm may use the alternative approach to segregating client money for that business line.
- (2) Under the alternative approach, client money is received into and paid out of a firm's own bank account. A firm that adopts the alternative approach to segregating client money should, if it is following the standard method of client money reconciliation (see CASS 7 Annex 1 paragraph 2), carry out an internal client money reconciliation on each business day ('T0') and calculate how much money it either needs to withdraw from, or place in from its own bank account or its client bank account as a result of any discrepancy arising between its client money requirement and its client money resource as at the close of business on the previous business day ('T-1').
- (3) The alternative approach mandatory prudent segregation required under CASS 7.4.18BR is designed to address the risks that:
- (a) client money in a firm's own bank account may not be available to be pooled for distribution to clients on the occurrence of a primary pooling event; and
- (b) at the time of a primary pooling event the firm may not have segregated in its client bank account a sufficient amount of client money to meet its client money requirement.
- 7.4.17B R A firm that wishes to adopt the alternative approach for a particular business line must first establish, and document in writing, its reasons for

concluding, that:

- (1) adopting the normal approach would lead to greater operational risks to *client money* protection compared to the alternative approach;
- (2) adopting the alternative approach (including complying with the requirements for *alternative approach mandatory prudent segregation* under CASS 7.4.18BR) would not result in undue operational risk to *client money* protection; and
- (3) the *firm* has systems and controls that are adequate to enable it to operate the alternative approach effectively and in compliance with *Principle 10 (Clients' assets)*.

7.4.17C R A *firm* must retain any documents created under CASS 7.4.17BR in relation to a particular business line for a period of at least five years after the date it ceases to use the alternative approach in connection with that business line.

7.4.17D R At least three *months* before adopting the alternative approach for a particular business line, a *firm* must:

- (1) inform the *FCA* in writing that it intends to adopt the alternative approach for that particular business line; and
- (2) if requested by the *FCA*, make any documents it created under CASS 7.4.17BR available to the *FCA* for inspection.

7.4.17E R (1) In addition to the requirement under CASS 7.4.17DR, before adopting the alternative approach, a *firm* must send a written report to the *FCA* prepared by an independent auditor of the *firm* in line with a *reasonable assurance engagement*, stating the matters set out in (2).

- (2) The written report in (1) must state whether, in the auditor's opinion:
 - (a) the *firm's* systems and controls are suitably designed to enable it to comply with CASS 7.4.18AR to CASS 7.4.18BR; and
 - (b) the *firm's* calculation of its *alternative approach mandatory prudent segregation* amount under CASS 7.4.18BR is suitably designed to enable the *firm* to comply with CASS 7.4.18BR.

7.4.17F R (1) A *firm* that uses the alternative approach must review, at least on an annual basis and with no more than one year between each review, whether its reasons for adopting the alternative approach for a particular business line, as documented under CASS 7.4.17BR, continue to be valid.

- (2) If, following the review in (1), a *firm* finds that its reasons for adopting the alternative approach are no longer valid for a particular business line, it must stop using the alternative approach for that

business line as soon as reasonably practicable, and in any event within six months of the conclusion of its review in (1).

- 7.4.17G R A firm that uses the alternative approach must not materially change how it will calculate and maintain the *alternative approach mandatory prudent segregation* amount under CASS 7.4.18BR unless:
- (1) an auditor of the firm has prepared a report that complies with the requirements in CASS 7.4.17ER(2)(b) in respect of the firm's proposed changes; and
 - (2) the firm provides a copy of the report prepared by the auditor under (a) to the FCA before implementing the change.
- 7.4.17H G A firm is reminded that, under SUP 3.4.2R, it must take reasonable steps to ensure that its auditor has the required skill, resources and experience to perform its function.
- 7.4.18 G ~~Under the alternative approach, a firm that receives client money should:~~
- (1) (a) ~~pay any money to or on behalf of clients out of its own account; and~~
 - (b) ~~perform a reconciliation of records and accounts required under CASS 7.6.2R (Records and accounts), and where relevant SYSC 4.1.1R (General requirements) and SYSC 6.1.1R (Compliance), adjust the balance held in its client bank accounts and then segregate the money in the client bank account until the calculation is re-performed on the next business day; or~~
 - (2) ~~pay it out in accordance with the rule regarding the discharge of a firm's fiduciary duty to the client (see CASS 7.2.15R). [deleted]~~
- 7.4.18A R A firm that uses the alternative approach for a particular business line must, on each business day ('T0'):
- (1) receive any money from and pay any money to (or, in either case, on behalf of) clients into and out of its own bank accounts;
 - (2) perform the necessary reconciliations of records and accounts required under CASS 7.6 (Records, accounts and reconciliations);
 - (3) adjust the balances held in its client bank account (by effecting transfers between its own bank account and its client bank account) to address any difference arising between its client money requirement and its client money resource as at the close of business on the previous business day ('T-1'), so that the correct amount reflected in the reconciliations under (2) is segregated in its client bank account; and

- (4) subject to CASS 7.4.18AAR below, keep segregated in its *client bank account* the balance held under (3) until it has performed a reconciliation on the following *business day* ('T+1') and as a result of that reconciliation is undertaking further adjustments under (3).

7.4.18A R During the period between the adjustment in CASS 7.4.18AR(3) and the completion of the next reconciliations in CASS 7.4.18AR(2), a *firm* that uses the alternative approach for a particular business line may:

A

- (1) increase the balance held in its *client bank account* by making intra-day transfers (during T0) from its own *bank account* to its *client bank account* before the completion of the internal *client money* reconciliation under CASS 7.4.18AR(2) (that is expected sometime later on T0) only if:
- (a) the *firm* reasonably expects that the *client money requirement* for the previous *business day* (T-1) will increase above the *client money resource* currently (during T0) held in its *client bank account*; and
 - (b) such reasonable expectations are based on the working calculation of the *client money requirement* relating to the previous *business day* (T-1) that the *firm* has already determined on that *business day* (during T0) (as part of the process of completing its internal *client money* reconciliation); or
- (2) decrease the balance held in its *client bank account* by making intra-day transfers (during T0) from its *client bank account* to its own *bank account* before the completion of the internal *client money* reconciliation under CASS 7.4.18AR(2) (that is expected sometime later on T0) only if:
- (a) the *firm* reasonably expects that the *client money requirement* for the previous *business day* (T-1) will decrease below the *client money resource* currently held (during T0) in its *client bank account*; and
 - (b) such reasonable expectations are based on the working calculation of the *client money requirement* relating to the previous *business day* (T-1) that the *firm* has already determined on that *business day* (during T0) (as part of the process of completing its internal *client money* reconciliation).

However, in doing so, a *firm* must act prudently and should take appropriate steps to manage the risk of not having segregated an amount that appropriately reflects its actual *client money requirement* at any given time.

- 7.4.18A G It is anticipated that CASS 7.4.18AAR may be used by firms which maintain client bank accounts in a number of different time zones and making adjustments to the balances of those client bank accounts is dependent on meeting cut off times for money transfers in those time zones.
- 7.4.18B R (1) A firm that uses the alternative approach must, in addition to CASS 7.4.18AR, 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.
- (2) The amount required to be segregated under this rule must be an amount that a firm reasonably determines would be sufficient, at the time it makes the determination, to protect client money against the risk that at any time in the following three months the following categories of client money may not have been fully segregated in its client bank account or may not be (or become) available for pooling under CASS 7A.2.4R(1), were a primary pooling event to occur:
- (a) client money that is received and held by the firm in its own bank account during the period between:
- (i) the firm's adjustment of client bank account balances under CASS 7.4.18AR(3) on a particular business day; and
- (ii) the firm's subsequent adjustments under CASS 7.4.18AR(3) on the following business day; and
- (b) money received and held by the firm in its own bank account which the firm does not initially identify as part of its client money requirement, but which subsequently does become part of its client money requirement;
- with the effect that the firm's alternative approach mandatory prudent segregation under this rule will reduce, as far as possible, any shortfall that might have been produced as a result of (a) or (b) on the occurrence of a primary pooling event.
- (3) (a) Subject to (c), in reaching its determination under (2) of the amount of money that would be sufficient to address the risks referred to in (2) for the forthcoming three months, a firm must take into account the following in respect of each business line for which it uses the alternative approach, and for at least the previous three months:

- (i) the firm's client money requirement over the course of that prior period (excluding any amount that was required to be segregated under this rule during that prior period for the purposes of alternative approach mandatory prudent segregation);
- (ii) the daily adjustment payments that the firm made into its client bank account under CASS 7.4.18AR(3); during that prior period; and
- (iii) the amount of money received by the firm in its own bank account which it did not initially identify as part of its client money requirement, but which subsequently, and during that prior period, became part of its client money requirement;

as shown in its internal records.

- (b) In reaching its determination under (2) a firm must also take into account, but at all times having regard to the requirement under (2), any impact that particular events, the seasonal nature of each relevant business line, or any other aspect of those business lines may have on:
 - (i) the firm's client money requirement during the forthcoming three months for which the amount of alternative approach mandatory prudent segregation required under this rule is being determined;
 - (ii) the daily adjustment payments that the firm is likely to make into its client bank account under CASS 7.4.18AR(3) in that same period; and
 - (iii) the amount of unidentified receipts of money that the firm is likely to receive into its own bank account and which will subsequently, in that same period, become part of its client money requirement.
- (c) If, at the time of its determination under (2), the firm has not been trading for three months in a business line for which it is using the alternative approach, then it must use the records that are available to it and must also factor in reasonable forecasts, as required under (b), to establish a three-month reference period.
- (4) (a) A firm must, at regular intervals that are at least quarterly, repeat and complete the combined process of:

- (i) determining the amount that it is required to segregate for the purposes of *alternative approach mandatory prudent segregation* under (2) and (3);
 - (ii) making necessary adjustments to its records to reflect any changes to its *client money requirement*; and
 - (iii) paying any additional amounts of its own *money* into its *client bank account* to increase the *firm's alternative approach mandatory prudent segregation* or withdrawing any excess amounts from its *client bank account* to decrease the *firm's alternative approach mandatory prudent segregation* after it has adjusted its records under (ii).
- (b) The combined process of (a)(i) to (iii) must take no longer than 10 *business days*.
 - (c) To the extent that a *firm's* compliance with (a)(i) and (ii) results in there being an excess in the *firm's client bank account*, the *firm* may cease to treat that *money* as *client money*.
- (5) A *firm* must ensure that the individual responsible for CASS oversight under CASS 1A.3.1R, CASS 1A.3.1AR or CASS 1A.3.1CR (as appropriate) reviews the adequacy of the amount of the *firm's alternative approach mandatory prudent segregation* maintained under this *rule* at least annually.

7.4.19 G A *firm* that adopts the alternative approach may:

- (1) receive all *client money* into its own bank account;
- (2) choose to operate the alternative approach for some types of business (for example, overseas equities transactions) and operate the normal approach for other types of business (for example, *contingent liability investments*) if the *firm* can demonstrate that its systems and controls are adequate (see CASS 7.4.15R); and
- (3) use an historic average to account for uncleared cheques (see paragraph 4 of CASS 7 Annex 1G). [deleted]

Alternative approach mandatory prudent segregation record

7.4.19A R A *firm* must create and keep up-to-date records so that any amount of *money* that is, pursuant to CASS 7.4.18BR:

- (1) paid into a *client bank account* and retained as *client money*; or

(2) withdrawn from a *client bank account*;

can be easily ascertained (the *alternative approach mandatory prudent segregation record*).

7.4.19B R The *alternative approach mandatory prudent segregation record* under CASS 7.4.19AR must record:

(1) the date of the first determination under CASS 7.4.18BR(2) and each subsequent review undertaken under CASS 7.4.18BR(4), and the total amount that the *firm* determined was required to be segregated under CASS 7.4.18BR(2) as at that date;

(2) the date of any payment of the *firm's* own money into a *client bank account*, or withdrawal of any excess from a *client bank account* under CASS 7.4.18BR, and for each such occasion:

(a) the amount of the payment or withdrawal;

(b) the fact that the *money* was paid or withdrawn by the *firm* in accordance with CASS 7.4.18BR; and

(c) as at that date, the total amount actually segregated by the *firm* under CASS 7.4.18BR.

7.4.19C R The *alternative approach mandatory prudent segregation record* must be retained for five years after the *firm* ceases to segregate any *money* in accordance with CASS 7.4.18BR.

7.4.19D G Nothing in CASS 7.4.17AG to CASS 7.4.19CR prevents a *firm* from also making use of the prudent segregation rule in CASS 7.4.21R.

...

7.6 Records, accounts and reconciliations

...

Non-standard method of internal client money reconciliation

7.6.6A R (1) Before using a *non-standard method of internal client money reconciliation*, a *firm* must:

(a) establish and document in writing its reasons for concluding that the method of internal *client money* reconciliation it proposes to use will:

(i) (for the normal approach to segregating *client money*) check whether the amount of *client money* recorded in the *firm's* records as being segregated in *client bank accounts* meets the *firm's* obligation to its *clients* under the *client money rules* on a

daily basis; or

- (ii) (for the alternative approach to segregating *client money*) calculate the amount of *client money* to be segregated in *client bank accounts* which meets the *firm's* obligations to its *clients* under the *client money rules* on a daily basis;
 - (b) notify the *FCA* of its intentions to use a *non-standard method of internal client money reconciliation*; and
 - (c) send a written report to the *FCA* prepared by an independent auditor of the *firm* in line with a *reasonable assurance engagement* and stating the matters set out in *CASS 7.6.6AR(2)*.
- (2) The written report in (1)(c) must state whether in the auditor's opinion:
- (a) the method of internal *client money* reconciliation which the *firm* will use is suitably designed to enable it to (as applicable):
 - (i) (for the normal approach to segregating *client money*) check whether the amount of *client money* recorded in the *firm's* records as being segregated in *client bank accounts* meets the *firm's* obligation to its *clients* under the *client money rules* on a daily basis; or
 - (ii) (for the alternative approach to segregating *client money*) calculate the amount of *client money* to be segregated in *client bank accounts* which meets the *firm's* obligations to its *clients* under the *client money rules* on a daily basis; and
 - (b) the *firm's* systems and controls are suitably designed to enable it to carry out the method of internal *client money* reconciliation the *firm* will use.
- (3) A *firm* using a *non-standard method of internal client money reconciliation* must not materially change its method of undertaking internal reconciliations of *client money* balances unless:
- (a) the *firm* has established and documented in writing its reasons for concluding that the changed methodology will meet the requirements in (1)(a)(i) and (ii), as applicable;
 - (b) an auditor of the *firm* has prepared a report that complies with the requirements in (1)(c) and (2) in respect of the

firm's proposed changes; and

- (c) the firm provides a copy of the report prepared by the auditor under (3)(a) to the FCA before implementing the change.

7.6.6B G A firm is reminded that, under SUP 3.4.2R, it must take reasonable steps to ensure that its auditor has the required skill, resources and experience to perform its function.

Records

7.6.7 R (1) ~~A firm must make records, sufficient to show and explain the method of internal reconciliation of client money balances under CASS 7.6.2R used, and if different from the standard method of internal client money reconciliation, to show and explain that:~~

~~(a) the method of internal reconciliation of client money balances used affords an equivalent degree of protection to the firm's clients to that afforded by the standard method of internal client money reconciliation; and~~

~~(b) in the event of a primary pooling event or a secondary pooling event, the method used is adequate to enable the firm to comply with the client money distribution rules. [deleted]~~

~~(2) A firm must make these records on the date it starts using a method of internal reconciliation of client money balances and must keep it for a period of five years after ceasing to use it. [deleted]~~

7.6.8 R ~~A firm that does not use the standard method of internal client money reconciliation must first send a written confirmation to the FCA from the firm's auditor that the firm has in place systems and controls which are adequate to enable it to use another method effectively. [deleted]~~

7.8 Notification and acknowledgement of trust Acknowledgment letters

Purpose

7.8.-1 G The main purposes of an acknowledgement letter are:

(1) to put the bank, exchange, clearing house, intermediate broker, OTC counterparty or other person (as the case may be) on notice of a firm's clients' interests in client money that has been deposited with, or has been allowed to be held by, such person;

(2) to ensure that the client bank account or client transaction account has been opened in the correct form (eg, whether the client bank account is being correctly opened as a general client bank account,

a designated client bank account or a designated client fund account), and is distinguished from any account containing money that belongs to the firm; and

- (3) to ensure that the bank, exchange, clearing house, intermediate broker, OTC counterparty or other person (as the case may be) understands and agrees that it will not have any recourse or right against money standing to the credit of the client bank account or client transaction account, in respect of any sum owed to such person, or to any other third person, on any other account.

Banks Client bank account acknowledgment letters

- 7.8.1 R (1) ~~When a firm opens a~~ For each client bank account, the a firm must give or have given written notice, in accordance with CASS 7.8.5R, complete and sign a client bank account acknowledgement letter clearly identifying the client bank account, and send it to the bank with whom the client bank account is, or will be, opened, requesting the bank to acknowledge to it in writing that: and agree to the terms of the letter by countersigning it and returning it to the firm.
- (a) ~~all money standing to the credit of the account is held by the firm as trustee (or if relevant, as agent) and that the bank is not entitled to combine the account with any other account or to exercise any right of set off or counterclaim against money in that account in respect of any sum owed to it on any other account of the firm; and~~
- (b) ~~the title of the account sufficiently distinguishes that account from any account containing money that belongs to the firm, and is in the form requested by the firm.~~
- (2) ~~In the case of a client bank account in the United Kingdom, if the bank does not provide the required acknowledgement within 20 business days after the firm dispatched the notice, the firm must withdraw all money standing to the credit of the account and deposit it in a client bank account with another bank as soon as possible. Subject to CASS 7.8.13R and CASS 7.8.14R, a firm must not hold or receive any client money in or into a client bank account unless it has received a duly countersigned client bank account acknowledgement letter from the relevant bank that has not been inappropriately redrafted (see CASS 7.8.7R) and clearly identifies the client bank account.~~

Exchanges, clearing houses, intermediary brokers or OTC counterparties Client transaction account acknowledgement letters

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

OTC counterparty: This rule does not apply to a firm to which CASS 7.8.3R(1) applies.

- (a) ~~notify the person with whom the account is to be opened that the firm is under an obligation to keep client money separate from the firm's own money, placing client money in a client bank account;~~
 - (b) ~~instruct the person with whom the account is to be opened that any money paid to it in respect of that transaction is to be credited to the firm's client transaction account; and~~
 - (c) ~~require the person with whom the account is to be opened to acknowledge in writing that the firm's client transaction account is not to be combined with any other account, nor is any right of set-off to be exercised by that person against money credited to the client transaction account in respect of any sum owed to that person on any other account.~~
- (2) ~~If the exchange, clearing house, intermediate broker or OTC counterparty does not provide the required acknowledgement within 20 business days of the dispatch of the notice and instruction, the firm must cease using the client transaction account with that exchange, clearing house, intermediate broker or OTC counterparty and arrange as soon as possible for the transfer or liquidation of any open positions and the repayment of any money. For each client transaction account, a firm must, in accordance with CASS 7.8.5R, complete and sign a client transaction account acknowledgement letter clearly identifying the client transaction account. That letter must be sent to the person with whom the client transaction account is, or will be, opened, requesting such person to acknowledge and agree to the terms of the letter by countersigning it and returning it to the firm.~~
- (3) Subject to CASS 7.8.13R and CASS 7.8.14R, a firm must not allow the relevant person to hold any client money in a client transaction account maintained by that person for the firm unless the firm has received a duly countersigned client transaction account acknowledgement letter from that person that has not been inappropriately redrafted (see CASS 7.8.7R) and that clearly identifies the client transaction account.

Authorised central counterparty acknowledgment letters

- 7.8.3 R (1) A firm which places client money at an authorised central counterparty in connection with a regulated clearing arrangement must, in accordance with CASS 7.8.5R, complete and sign an authorised central counterparty acknowledgement letter clearly identifying the relevant client transaction account. That letter must be sent to the authorised central counterparty with whom the client transaction account is, or will be, opened, requesting such

authorised central counterparty to acknowledge receipt of the letter by countersigning it and returning it to the firm.

- (2) A firm which has complied with CASS 7.8.3R(1) may allow the authorised central counterparty to hold client money on the relevant client transaction account, whether or not the authorised central counterparty has countersigned and returned the authorised central counterparty acknowledgement letter it received from the firm.

Acknowledgement letters in general

- 7.8.4 G In drafting acknowledgement letters under CASS 7.8.1R, CASS 7.8.2R or CASS 7.8.3R, a firm is required to use the relevant template in CASS 7 Annex 2R, CASS 7 Annex 3R or CASS 7 Annex 4R, respectively.
- 7.8.5 R When completing an acknowledgement letter under CASS 7.8.1R(1), CASS 7.8.2R(1) or CASS 7.8.3R(1), a firm:
- (1) must not amend any of the acknowledgement letter fixed text;
- (2) subject to (3), must ensure the acknowledgement letter variable text is removed, included or amended as appropriate; and
- (3) must not amend any of the acknowledgement letter variable text in a way that would alter or otherwise change the meaning of the acknowledgement letter fixed text.
- 7.8.6 G CASS 7 Annex 5G contains guidance on using the template acknowledgement letters, including when and how firms should amend the acknowledgement letter variable text that is in square brackets.
- 7.8.7 R (1) If, on countersigning and returning the acknowledgement letter to a firm, the relevant person has also:
- (a) made amendments to any of the acknowledgement letter fixed text; or
- (b) made amendments to any of the acknowledgement letter variable text in a way that would alter or otherwise change the meaning of the acknowledgement letter fixed text;
- the acknowledgement letter will have been inappropriately redrafted for the purposes of CASS 7.8.1R(2) or CASS 7.8.2R(3) (as applicable).
- (2) For the purposes of CASS 7.8.1R(2) or CASS 7.8.2R(3), amendments made to the acknowledgement letter variable text in the acknowledgement letter returned to a firm by the relevant person, will not have the result that the letter has been inappropriately redrafted if those amendments do not affect the meaning of the acknowledgement letter fixed text, have been specifically agreed with the firm and do not cause the acknowledgement letter to be

inaccurate.

- 7.8.8 R A firm must use reasonable endeavours to ensure that any individual that has countersigned an *acknowledgement letter* that has been returned to the firm was authorised to countersign the letter on behalf of the relevant person.
- 7.8.9 R (1) A firm must retain each countersigned *client bank account acknowledgement letter* and *client transaction account acknowledgement letter* it receives, from the date of receipt until the expiry of five years from the date on which the last *client bank account* or *client transaction account* to which the *acknowledgement letter* relates is closed.
- (2) A firm must retain a copy of each *authorised central counterparty acknowledgement letter* it sends to an *authorised central counterparty* under CASS 7.8.3R(1) from the date it was sent until the expiry of five years from the date the last *client transaction account* to which the *acknowledgement letter* relates is closed.
- 7.8.10 R A firm must also retain any other documentation or evidence it believes is necessary to demonstrate that it has complied with each of the applicable requirements in this section (such as any evidence it has obtained to ensure that the individual that has countersigned an *acknowledgment letter* returned to the firm was authorised to countersign the letter on behalf of the relevant person).
- 7.8.11 R (1) This rule applies to:
- (a) any countersigned *client bank account acknowledgement letter* or *client transaction account acknowledgement letter* received by a firm under CASS 7.8.1R(2) or CASS 7.8.2R(3) respectively; and
- (b) any *authorised central counterparty acknowledgement letter* sent by a firm under CASS 7.8.3R(1), whether or not it has been countersigned by the relevant *authorised central counterparty* and received by the firm.
- (2) A firm must, periodically (at least annually and whenever it is aware that something referred to in an *acknowledgement letter* has changed) review each of its *acknowledgement letters* to ensure that they all remain accurate.
- (3) Whenever a firm finds an inaccuracy in an *acknowledgement letter*, it must promptly draw up a replacement *acknowledgement letter* under CASS 7.8.1R, CASS 7.8.2R or CASS 7.8.3R, as applicable, and, if it is an *acknowledgement letter* required to be sent under CASS 7.8.1R or CASS 7.8.2R, ensure that the new *acknowledgement letter* is duly countersigned and returned by the relevant person.
- 7.8.12 G Under CASS 7.8.11R, a firm should draw up and send out a replacement

acknowledgement letter whenever:

- (1) there has been a change in any of the parties' names or addresses as set out in the letter; or
- (2) the firm becomes aware of an error or misspelling in the drafting of the letter.

7.8.13 R If a firm's client bank account or client transaction account is transferred to another person, the firm must promptly draw up a new acknowledgement letter under CASS 7.8.1R, CASS 7.8.2R or CASS 7.8.3R, as applicable, and, if it is an acknowledgement letter required to be sent under CASS 7.8.1R or CASS 7.8.2R, ensure that the new acknowledgement letter is duly countersigned and returned by the relevant person within 20 business days of the firm sending it to that person.

7.8.14 R If a firm opens a client bank account after a primary pooling event, the firm must:

- (1) promptly draw up and send out a new acknowledgement letter under CASS 7.8.1R;
- (2) not hold or receive any client money in or into the client bank account unless it has sent the acknowledgement letter to the relevant person; and
- (3) if the firm has not received a duly countersigned acknowledgement letter that has not been inappropriately redrafted (see CASS 7.8.7R) within 20 business days of the firm sending the acknowledgement letter, withdraw all money standing to the credit of the account and deposit it in a client bank account with another bank as soon as possible.

...

After CASS 7 Annex 1G insert the following new annexes. The text is not underlined.

7 Annex 2R Client bank account acknowledgment letter template

[letterhead of firm subject to CASS 7.8.1R, including full name and address of firm]
[name and address of bank]

[date]

Client Money Acknowledgment Letter (pursuant to the rules of the Financial Conduct Authority)

We refer to the following [current/deposit account[s]] [and/or] [money market deposit[s]] which [*name of CASS firm*], regulated by the Financial Conduct Authority (Firm Reference Number [*FRN*]), (“us”, “we” or “our”) [has opened or will open] [and/or] [has deposited or will deposit] with [*name of bank*] (“you” or “your”):

[insert the account title[s], the account unique identifier[s] (for example, as relevant, sort code and account number, deposit number or reference code) and (if applicable) any abbreviated name of the account[s] as reflected in the bank’s systems]

([collectively,] the “Client Bank Account[s]”).

In relation to [each of] the Client Bank Account[s] identified above you acknowledge that we have notified you that:

- (a) we are under an obligation to keep money we hold belonging to our clients separate from our own money;
- (b) we have opened, or will open, the Client Bank Account for the purpose of depositing money with you on behalf of our clients; and
- (c) we hold all money standing to the credit of the Client Bank Account in our capacity as trustee under the laws applicable to us.

In relation to [each of] the Client Bank Account[s] above you agree that:

- (d) you do not have any recourse or right against money in the Client Bank Account in respect of any sum owed to you, or owed to any third party, on any other account (including any account we use for our own money), and this means for example that you do not have any right to combine the Client Bank Account with any other account and any right of set-off or counterclaim against money in the Client Bank Account;
- (e) you will title, or have titled, the Client Bank Account as stated above and that such title is different to the title of any other account containing money that belongs to us or to any third party; and
- (f) you are required to release on demand all money standing to the credit of the Client Bank Account upon proper notice and instruction from us or a liquidator, receiver, administrator, or trustee (or similar person) appointed for us in bankruptcy (or similar procedure), in any relevant jurisdiction, except for:

- (1) any properly incurred charges or liabilities owed to you on, and arising from the operation of, the Client Bank Account; and
- (2) until the fixed term expires, any amounts held for the time being under a fixed term deposit arrangement which cannot be terminated before the expiry of the fixed term,

provided that you have a contractual right to retain such money under (1) or (2) and that this right is notwithstanding paragraphs (a) to (c) above and without breach of your agreement to paragraph (d) above.

We acknowledge that:

- (g) you are not responsible for ensuring compliance by us with our own obligations, including as trustee, in respect of the Client Bank Account[s].

You and we agree that:

- (h) the terms of this letter shall remain binding upon the parties, their successors and assigns, and, for the avoidance of doubt, regardless of any change in name of any party;
- (i) this letter supersedes and replaces any previous agreement between the parties in connection with the Client Bank Account[s], to the extent that such previous agreement is inconsistent with this letter;
- (j) in the event of any conflict between this letter and any other agreement between the parties in connection with the Client Bank Account[s], this letter agreement shall prevail;
- (k) no variation to the terms of this letter shall be effective unless it is in writing, signed by the parties and permitted under the rules of the Financial Conduct Authority;
- (l) this letter shall be governed by the laws of [*insert appropriate jurisdiction*] [*firms may optionally use this space to insert additional wording to record an intention to exclude any rules of private international law that could lead to the application of the substantive law of another jurisdiction*]; and
- (m) the courts of [*insert same jurisdiction as previous*] shall have non-exclusive jurisdiction to settle any dispute or claim arising out of or in connection with this letter or its subject matter or formation (including non-contractual disputes or claims).

Please sign and return the enclosed copy of this letter as soon as possible. We remind you that, pursuant to the rules of the Financial Conduct Authority, we are not allowed to use the Client Bank Account[s] to deposit any money belonging to our clients with you until you have acknowledged and agreed to the terms of this letter.

For and on behalf of [*name of CASS firm*]

x _____

Authorised Signatory

[Signed by [*name of third party administrator*] on behalf of [*CASS firm*]]

Print Name:

Title:

ACKNOWLEDGED AND AGREED:

For and on behalf of [*name of bank*]

x_____

Authorised Signatory

Print Name:

Title:

Contact Information: [*insert signatory's phone number and email address*]

Date:

7 Annex 3R Client transaction account acknowledgment letter template

[letterhead of firm subject to CASS 7.8.2R, including full name and address of firm]
[name and address of counterparty]

[date]

Client Money Acknowledgment Letter (pursuant to the rules of the Financial Conduct Authority)

We refer to the following transaction account[s] which *[name of CASS firm]*, regulated by the Financial Conduct Authority (Firm Reference Number *[FRN]*), (“us”, “we” or “our”) has opened or will open with *[name of counterparty]* (“you” or “your”):

[insert the account title[s], the account unique identifier[s] (for example, as relevant, account number, reference code or pool ID) and (if applicable) any abbreviated name of the account[s] as reflected in the counterparty’s systems]

([collectively,] the “Client Transaction Account[s]”).

In relation to [each of] the Client Transaction Account[s] identified above you acknowledge that we have notified you that:

- (a) we are under an obligation to keep money we hold belonging to our clients separate from our own money;
- (b) we have opened, or will open, the Client Transaction Account for the purpose of placing money with you on behalf of our clients in connection with carrying out one or more transactions with or through you; and
- (c) you are instructed to promptly credit to this Client Transaction Account any money you receive in respect of any transaction that we have notified to you as being carried out on behalf of our clients.

In relation to [each of] the Client Transaction Account[s] identified above you agree that:

- (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) of Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012];
- (e) you do not have any recourse or right against money credited to the Client Transaction Account in respect of any sum owed to you, or owed to any third party, on any other account (including any account we use for our own money), and this means for example that you do not have any right to combine the Client Transaction Account with any other account and any right of set-off or counterclaim against money in the Client Transaction Account; and
- (f) you will title, or have titled, the Client Transaction Account as stated above and that such title is different to the title of any other account containing money that is payable to us in a capacity other than as trustee or that is payable to any third party.

You and we agree that:

- (g) the terms of this letter shall remain binding upon the parties, their successors and assigns, and, for the avoidance of doubt, regardless of any change in name of any party;
- (h) this letter supersedes and replaces any previous agreement between the parties in connection with the Client Transaction Account[s], to the extent that such previous agreement is inconsistent with this letter;
- (i) in the event of any conflict between this letter and any other agreement between the parties in connection with the Client Transaction Account[s], this letter agreement shall prevail;
- (j) no variation to the terms of this letter shall be effective unless it is in writing, signed by the parties and permitted under the rules of the Financial Conduct Authority;
- (k) this letter shall be governed by the laws of *[insert appropriate jurisdiction]* *[firms may optionally use this space to insert additional wording to record an intention to exclude any rules of private international law that could lead to the application of the substantive law of another jurisdiction]*; and
- (l) the courts of *[insert same jurisdiction as previous]* shall have non-exclusive jurisdiction to settle any dispute or claim arising out of or in connection with this letter or its subject matter or formation (including non-contractual disputes or claims).

Please sign and return the enclosed copy of this letter as soon as possible. We remind you that, pursuant to the rules of the Financial Conduct Authority, we are not allowed to permit you to hold any money belonging to our clients on the Client Transaction Account[s] until you have acknowledged and agreed to the terms of this letter.

For and on behalf of *[name of CASS firm]*

x_____

Authorised Signatory

Print Name:

Title:

ACKNOWLEDGED AND AGREED:

For and on behalf of *[name of counterparty]*

x_____

Authorised Signatory

Print Name:

Title:

Contact Information: *[insert signatory's phone number and email address]*

Date:

7 Annex 4R **Authorised central counterparty acknowledgment letter template**

[letterhead of firm subject to CASS 7.8.3R, including full name and address of firm]
[name and address of authorised central counterparty]
[date]

Client Money Acknowledgment Letter (pursuant to the rules of the Financial Conduct Authority)

We refer to the following transaction account[s] which *[name of CASS firm]*, regulated by the Financial Conduct Authority (Firm Reference Number *[FRN]*), (“us”, “we” or “our”) has opened or will open with *[name of authorised Central counterparty]* (“you” or “your”):

[insert the account title[s], the account unique identifier[s] (for example, as relevant, account number, reference code or pool ID) and (if applicable) any abbreviated name of the account[s] as reflected in the authorised central counterparty’s systems]

(*[collectively,]* the “Client Transaction Account[s]”).

In relation to *[each of]* the Client Transaction Account[s] identified above we are writing to put you on notice that:

- (a) we are under an obligation to keep money we hold belonging to our clients separate from our own money;
- (b) we have opened, or will open, the Client Transaction Account for the purpose of placing money with you on behalf of our clients in connection with carrying out one or more transactions with or through you;
- (c) you are instructed to promptly credit to this Client Transaction Account any money you receive in respect of any transaction that we have notified to you as being carried out on behalf of our clients;
- (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, as a part of your default management process 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 48 of Regulation (EU) No 648/2012 of 4 July 2012;
- (e) you do not have any recourse or right against money credited to the Client Transaction Account in respect of any sum owed to you, or owed to any third party, on any other account (including any account we use for our own money), and this means for example that you do not have any right to combine the Client Transaction Account with any other account and any right of set-off or counterclaim against money in the Client Transaction Account; and
- (f) we understand the title of the Client Transaction Account is, or will be, as stated above and that such title is different to the title of any other account containing money that is payable to us in a capacity other than as trustee or is payable to any third party.

[Please confirm your receipt of this letter by signing and returning the enclosed copy of this letter as soon as possible.]

For and on behalf of [*name of CASS firm*]

x_____

Authorised Signatory

Print Name:

Title:

[RECEIPT CONFIRMED:

For and on behalf of [*name of authorised central counterparty*]

x_____

Authorised Signatory

Print Name:

Title:

Contact Information: [*insert signatory's phone number and email address*]

Date:]

7 Annex 5G Guidance notes for acknowledgement letters (CASS 7.8)

Introduction

- 1 This annex contains *guidance* on the use of the templates for *acknowledgment letters* in CASS 7 Annex 2R, CASS 7 Annex 3R and CASS 7 Annex 4R.
- 2 Unless stated otherwise, a reference to ‘counterparty’ in this annex is:
 - (a) in the context of a *client bank account acknowledgment letter* (and CASS 7 Annex 2R), to the relevant *bank*;
 - (b) in the context of a *client transaction account acknowledgment letter* (and CASS 7 Annex 3R), to the relevant exchange, *clearing house, intermediate broker, OTC counterparty* or other *person* (as the case may be); and
 - (c) in the context of an *authorised central counterparty acknowledgment letter* (and CASS 7 Annex 4R), to the relevant *authorised central counterparty*.

General

- 3 Under CASS 7.8.1R(2) and CASS 7.8.2R(3), *firms* are required to have in place a duly signed and countersigned *acknowledgment letter* for a *client bank account* or *client transaction account* (respectively) before they are allowed to hold or receive *client money* in or into the *client bank account*, or allow the relevant *person* to hold any *client money* on the *client transaction account* (respectively).
- 4 However, a *firm* may place *client money* at an *authorised central counterparty* in connection with a *regulated clearing arrangement* if it has provided the relevant *authorised central counterparty* with a signed and completed *authorised central counterparty acknowledgment letter* (see CASS 7.8.3R).
- 5 For each *client bank account* or *client transaction account*, a *firm* is required to complete, sign and send to the counterparty an *acknowledgment letter* identifying that account and in the form set out in CASS 7 Annex 2R (Client bank account acknowledgment letter template), CASS 7 Annex 3R (Client transaction account acknowledgment letter template) or CASS 7 Annex 4R (Authorised central counterparty acknowledgment letter), as appropriate.
- 6 When completing an *acknowledgment letter* using the appropriate template, a *firm* is reminded that it must not amend any of the text which is not in square brackets (*acknowledgment letter fixed text*). A *firm* should also not amend the non-italicised text that is in square brackets. It may remove or include square bracketed text from the letter, or replace bracketed and italicised text with the necessary wording, in either case as appropriate. The notes below give further guidance on this.

Clear identification of relevant accounts

- 7 A *firm* is reminded that for each *client bank account* or *client transaction account* it

needs to have in place an *acknowledgment letter*. Accordingly, it is important that it is clear to which account or accounts each *acknowledgement letter* relates. As a result, the templates in *CASS 7 Annex 2R*, *CASS 7 Annex 3R* and *CASS 7 Annex 4R* require that the *acknowledgment letter* include the full title and at least one unique identifier, such as a sort code and account number, deposit number, reference code or pool ID, for each *client bank account* or *client transaction account* to which the letter relates.

- 8 The title and unique identifiers included in an *acknowledgment letter* for a *client bank account* or *client transaction account* should be the same as those reflected in both the records of the *firm* and the relevant counterparty, as appropriate, for that account. Where a counterparty's systems are not able to reflect the full title of an account, that title may be abbreviated to accommodate that system, provided that:
- (a) the account may continue to be appropriately identified in accordance with the requirements of *CASS 7* (eg, 'designated' may be shortened to 'des', 'designated fund' may be shortened to 'des fnd', 'segregated' may be shortened to 'seg', 'account' may be shortened to 'acct', etc); and
 - (b) when completing an *acknowledgment letter*, such letter must include both the long and short versions of the account title.
- 9 A *firm* should ensure that all relevant account information is contained in the space provided in the body of the *acknowledgment letter*. Nothing should be appended to an *acknowledgement letter*.
- 10 In the space provided in the template letters for setting out the account title and unique identifiers for each relevant account/deposit, a *firm* may include the required information in the format of the following table:

Full account title	Unique identifier	Title reflected in [<i>name of bank</i>] systems
[<i>Investment Firm Client Bank Account</i>]	[00-00-00 12345678]	[<i>INV FIRM CLIENT A/C</i>]

- 11 Where an *acknowledgment letter* is intended to cover a range of *client bank accounts* or *client transaction accounts*, some of which may not exist as at the date the *acknowledgment letter* is countersigned by the relevant *person* (or, in the case of an *authorised central counterparty acknowledgment letter*, the date it is sent by the *firm* to the relevant *authorised central counterparty*), a *firm* should set out in the space provided in the body of the *acknowledgment letter* that it is intended to apply to all present and future accounts which: (a) are titled in a specified way (eg, with the word 'client' in their title); and (b) which possess a common unique identifier

or which may be clearly identified by a range of unique identifiers (eg, all accounts numbered between XXXX1111 and ZZZZ9999). For example, in the space provided in the template letter in CASS 7 Annex 2R which allows a *firm* to include the account title and a unique identifier for each relevant account, a *firm* should include a statement to the following effect:

Any account open at present or to be opened in the future which contains the term ['client']*[insert appropriate abbreviation of the term 'client' as agreed and to be reflected in the Bank's systems]* in its title and which may be identified with [the following *[insert common unique identifier]*][an account number from and including [XXXX1111] to and including [ZZZZ9999]]*[clearly identify range of unique identifiers]*.

Signature and countersignatures

- 12 A *firm* should ensure that each *acknowledgment letter* is signed and countersigned by all relevant parties and individuals (including where a *firm* or its counterparty may require more than one signatory).
- 13 An *acknowledgment letter* that is signed or countersigned electronically should not, for that reason alone, result in a breach of the rules in CASS 7.8. However, where electronic signatures are used, a *firm* should consider whether, under CASS 7.4.7R and taking into account the governing law and choice of competent jurisdiction, it needs to ensure that the electronic signature and the certification by any person of such signature would be admissible as evidence in any legal proceedings in the relevant jurisdiction in relation to any question as to the authenticity or integrity of the letter.

Completing an acknowledgment letter

- 14 A *firm* should use at least the same level of care and diligence when completing an *acknowledgment letter* as it would in managing its own commercial agreements.
- 15 A *firm* should ensure that each *acknowledgment letter* is legible (eg, any handwritten details should be easy to read), produced on the *firm's* own letter-headed paper, dated and addressed to the correct legal entity (eg, where the counterparty belongs to a group of companies).
- 16 A *firm* should also ensure each *acknowledgment letter* includes all the required information (such as account names and numbers, the parties' full names, addresses and contact information, and each signatory's printed name and title).
- 17 A *firm* should similarly ensure that no square brackets remain in the text of each *acknowledgment letter* (ie, after having removed or included square bracketed text, as appropriate, or having replaced square bracketed and italicised text with the required information as indicated in the templates in CASS 7 Annex 2R, CASS 7 Annex 3R and CASS 7 Annex 4R) and that each page of the *acknowledgment letter* is numbered.
- 18 A *firm* should complete an *acknowledgment letter* so that no part of the letter can

be easily altered (eg, the letter should be signed in ink rather than pencil).

- 19 In respect of a *client bank account acknowledgement letter's* governing law and choice of competent jurisdiction (see paragraphs (l) and (m) of the template in CASS 7 Annex 2R) or a *client transaction account acknowledgement letter's* governing law and choice of competent jurisdiction (see paragraphs (k) and (l) of the template in CASS 7 Annex 3R), the letter should reflect a *firm's* agreement with its counterparty that the laws of a particular jurisdiction will govern the *acknowledgment letter* and that the courts of that same jurisdiction will have non-exclusive jurisdiction to settle any disputes arising out of, or in connection with, the *acknowledgment letter*, its subject matter or formation.
- 20 If a *firm* does not, in any *client bank account acknowledgement letter* or *client transaction account acknowledgement letter*, utilise the governing law and choice of competent jurisdiction that is the same as either or both:
- (a) the law and the jurisdiction under which either the *firm* or the relevant counterparty are organised; and
 - (b) that specified in the underlying agreement/s (eg, banking, custody or clearing services agreement) with the relevant counterparty;

then the *firm* should consider whether it is at risk of breaching either CASS 7.8.5R(3) or, in the case of a *client bank account acknowledgement letter*, CASS 7.4.7R.

- 21 The *FCA* recognises that some *firms* and their counterparties may wish to clarify through additional words in the governing law provision (see paragraph (l) of the template in CASS 7 Annex 2R and paragraph (k) of the template in CASS 7 Annex 3R) that they are agreeing that the substantive law of the governing jurisdiction shall apply and that their intention is that a court should not decide to apply the substantive provisions of some other law instead of the parties' chosen governing law (a 'renvoi'). Where this is the case *firms* are permitted to insert additional text that seeks to provide increased legal certainty in the space provided. There is no restriction as to what additional words may be used (eg, additional words such as "*without regard to the principles of choice of law*") may be appropriate in the circumstances), but a *firm* should at all times have regard to the need to comply with CASS 7.8.5R(3). However, for the majority of *firms* the *FCA* does not expect additional wording for the governing law provision to be necessary. This is likely to be the case where only a court that is subject to 'Rome I' (Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008) is likely to accept jurisdiction over a dispute arising out of or in connection with the relevant *acknowledgement letter*.

Authorised signatories

- 22 A *firm* is required, under CASS 7.8.8R, to use reasonable endeavours to ensure that any individual that has countersigned an *acknowledgement letter* returned to the *firm* was authorised to countersign the letter on behalf of the relevant counterparty.
- 23 If an individual that has countersigned an *acknowledgement letter* does not provide

the *firm* with sufficient evidence of his/her authority to do so then the *firm* is expected to make appropriate enquires to satisfy itself of that individual's authority.

- 24 Evidence of an individual's authority to countersign an *acknowledgment letter* may include a copy of the counterparty's list of authorised signatories, a duly executed power of attorney, use of a company seal or bank stamp, and/or material verifying the title or position of the individual countersigning the *acknowledgment letter*.
- 25 A *firm* should ensure it obtains at least the same level of assurance over the authority of an individual to countersign the *acknowledgment letter* as the *firm* would seek when managing its own commercial arrangements.

Third party administrators

- 26 If a *firm* uses a third party administrator ('TPA') to carry out the administrative tasks of drafting, sending and processing a *client bank account acknowledgment letter*, the text "[Signed by [Name of Third Party Administrator] on behalf of [CASS Firm]]" should be inserted to confirm that the *acknowledgment letter* was signed by the TPA on behalf of the *firm*.
- 27 In these circumstances, the *firm* should first provide the TPA with the requisite authority (such as a power of attorney) before the TPA will be able to sign the *client bank account acknowledgment letter* on the *firm's* behalf. A *firm* should also ensure that the *acknowledgment letter* continues to be drafted on letter-headed paper belonging to the *firm*.

Designated client bank accounts and designated client fund accounts

- 28 A *firm* must ensure that each of its *client bank accounts* follows the naming conventions prescribed in the *Glossary*. This includes ensuring that (i) all *client bank accounts* include the term 'client' in their title; and (ii) all *designated client bank accounts* or *designated client fund accounts* include, as appropriate, the terms 'designated' or 'designated fund' in their title, or in each case an appropriate abbreviation in circumstances where this is permitted by the *Glossary* definition.
- 29 All references to the term "Client Bank Account[s]" in a *client bank account acknowledgment letter* should also be made consistently in either the singular or plural, as appropriate.

Indirect clearing arrangements

- 30 For use with *client transaction accounts* maintained with a *clearing member* who facilitates indirect clearing through a *regulated clearing arrangement*, the square-bracketed text in paragraph (d) of the template letter in CASS 7 Annex 3R should remain in the letter.
- 31 All references to the term "Client Transaction Account[s]" in a *client transaction account acknowledgment letter* should be made consistently in either the singular or plural, as appropriate.

Direct clearing arrangements

32 For use with *client transaction accounts* maintained with an *authorised central counterparty* in respect of a *regulated clearing arrangement*, a *firm* may identify whether each account is an *omnibus client account* or an *individual client account* in the space provided in the body of the template letter in CASS 7 Annex 4R. For example, if using the table mentioned in paragraph 10 above, a *firm* may include an additional column in which for each account it includes the reference “Individual Client Account” or “Omnibus Client Account”, as appropriate.

33 All references to the term “Client Transaction Account[s]” in an *authorised central counterparty acknowledgment letter* should be made consistently in either the singular or plural, as appropriate.

Money market deposits

34 The *client bank account acknowledgment letter* in CASS 7 Annex 2R may be used with money market deposits identified as being *client money*.

35 A *firm* should ensure that *client money* placed in a money market deposit is clearly identified as *client money* (see CASS 7.4.11CG).

36 Before a *firm* places *client money* in a money market deposit, it must have a *client bank account acknowledgment letter* for that deposit. If the unique identifier which will be associated with a money market deposit consisting of *client money* is unable to be included in a *client bank account acknowledgment letter* before it is duly countersigned and returned to the *firm*, a *firm* should set out in the body of the letter: (a) the title and other account information for the *client bank account* from which the deposits will be placed with the bank; and (b) how the *firm* will notify the bank that a money market deposit placed with it consists of *client money* (eg, by the inclusion of the words ‘Client Money Deposit’). For example, in the space provided in the template letter in CASS 7 Annex 2R which allows a *firm* to include the account title and a unique identifier for each relevant account/deposit, a *firm* should include a statement to the following effect:

[[CASS Firm] money market deposits placed from [title of relevant [client bank account], [sort code], [account number]] and identified with the reference ‘[Client Money Deposit]’ as being client money)]

37 A *firm* which operates the alternative approach to *client money* segregation (see CASS 7.4.18AR) might not make deposits of *client money* in a money market deposit from another *client bank account*. In these circumstances, the *firm* need only include in the body of the letter how the *firm* will notify the bank that a money market deposit placed with it consists of *client money*. For example, the relevant space in the template letter in CASS 7 Annex 2R may set out that:

[[CASS firm] money market deposits identified with the reference ‘[Client Money Deposit]’ as being client money]

Amend the following as shown.

7A Client money distribution

...

7A.2 Primary pooling events

...

7A.2.7A G If a firm opens a client bank account after a primary pooling event, it must comply with CASS 7.8.14R regarding acknowledgement letters.

...

9 ~~Prime brokerage~~ Information to clients

After CASS 9.3 insert the following new section. The text is not underlined.

9.4 Information to clients concerning custody assets and client money

9.4.1 G *Firms* are reminded that, under COBS 6.1.7R, a *firm* that holds *client designated investments* or *client money* must provide its *clients* with specific information about how the *firm* holds those *client designated investments* and *client money* and how certain arrangements might give rise to specific consequences or risks for those *client designated investments* and *client money*.

9.4.2 R A *firm* that holds *custody assets* or *client money* must:

- (1) provide the information in COBS 6.1.7R for any *custody assets* the *firm* may hold for a *client*, including any *custody assets* which are not *designated investments*; and
- (2) provide the information in COBS 6.1.7R and in (1) to each of its *clients*.

9.4.3 G A *firm* should provide the information required in CASS 9.4.2R to any client for whom it holds *custody assets* or *client money*, including a *retail client*, a *professional client* and an *eligible counterparty*.

9.4.4 G (1) *Firms* are reminded of their obligation, under COBS 4.2.1R, to be fair, clear and not misleading in their communications with *clients*.

(2) *Firms* are also reminded of the requirements in respect of communications made to *retail clients* under COBS 4.5.

...

Transitional Provisions and Schedules

TP 1 Transitional Provisions

TP 1.1

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional provision	Transitional provision: date in force	Handbook provisions: coming into force
...					
<u>7A</u>	<u>CASS 6.1.6BR</u>	<u>R</u>	<u>Firms need not comply with this rule in respect of any arrangement relating to the transfer of full ownership of a client's safe custody asset to the firm for the purposes set out in CASS 6.1.6R(1) and CASS 6.1.6AR(1) that existed before 1 December 2014, unless and until the arrangement is materially amended on or after that date. Firms must comply with this rule in respect of any arrangement for such purposes that is entered into on or after 1 December 2014.</u>	<u>From 1 December 2014 to 1 June 2015</u>	<u>1 December 2014</u>
<u>7B</u>	<u>CASS 6.1.12R to CASS 6.1.12CR</u>	<u>R</u>	<u>(1) Firms need not comply with these rules in respect of a business relationship with a particular client consisting of the provision of either or both MiFID business and designated investment business services that</u>	<u>From 1 December 2014 to 1 June 2015</u>	<u>1 December 2014</u>

			<p><u>existed before 1 December 2014, unless and until the terms governing the relationship are materially amended on or after that date. <i>Firms must comply with these rules in respect of any such relationship that is entered into on or after 1 December 2014.</i></u></p> <p><u>(2) Where the <i>rules in column (2)</i> are disapplied by (1), <i>CASS 6.1.12R to CASS 6.1.16G</i> will continue to apply as they were in force as at 30 November 2014.</u></p>		
<u>7C</u>	<u>CASS 6.3.4BR</u>	<u>R</u>	<p><u><i>Firms need not comply with this rule in respect of arrangements with third parties with whom it deposits clients' safe custody assets or arranges safeguarding and administration of assets which are clients' safe custody assets that were entered into before 1 December 2014, unless and until they are materially amended on or after that date. Firms must comply with this rule in respect of any arrangements with such third parties that are entered into on or after 1 December 2014.</i></u></p>	<u>From 1 December 2014 to 1 June 2015</u>	<u>1 December 2014</u>
<u>9A</u>	<u>CASS 7.1.8CR to CASS 7.1.8DR and CASS 7.1.10A to CASS 7.1.10CR</u>	<u>R</u>	<p><u><i>Firms need not comply with these rules in respect of a business relationship with a particular client that existed before 1 December 2014, unless and until the terms governing the relationship are materially amended on</i></u></p>	<u>From 1 December 2014 to 1 June 2015</u>	<u>1 December 2014</u>

			or after that date. <i>Firms</i> must comply with this <i>rule</i> in respect of any such relationship that is entered into on or after 1 December 2014.		
<u>9B</u>	<u>CASS 7.2.3BR</u>	<u>R</u>	<i>Firms</i> need not comply with this <i>rule</i> in respect of any arrangement relating to the transfer of full ownership of a <i>client's</i> money to the <i>firm</i> for the purposes set out in CASS 7.2.3R(1) and CASS 7.2.3AR(1) that existed before 1 December 2014, unless and until the arrangement is materially amended on or after that date. <i>Firms</i> must comply with this <i>rule</i> in respect of any arrangement for such purposes that is entered into on or after 1 December 2014.	From 1 December 2014 to 1 June 2015	1 December 2014
<u>10B</u>	<u>CASS 7.2.8AAR to CASS 7.2.8ER</u>	<u>R</u>	(1) These <i>rules</i> do not apply in respect of a business relationship with a particular <i>client</i> that existed before 1 December 2014, unless and until the terms governing the relationship are materially amended on or after that date. <i>Firms</i> must comply with this <i>rule</i> in respect of any such relationship that is entered into on or after 1 December 2014. (2) Where the <i>rules</i> in column (2) are disapplied by (1), CASS 7.2.8R to CASS 7.2.11G will continue to apply as they were in force as at 30 November 2014.	From 1 December 2014 to 1 June 2015	1 December 2014

<u>10C</u>	<u>CASS 7.4.17BR to CASS 7.4.19CR</u>	<u>R</u>	<p>(1) <u>Firms that are operating the alternative approach for any business line on 30 November 2014, having previously sent a written confirmation to the FCA under CASS 7.4.15R, need not comply with the rules in column (1) for such business line during the period in column (5) and may continue to segregate client money during that period for such business line on the basis set out in that confirmation to the FCA, unless and until during the period in column (5) they start complying with CASS 7.4.18AR to CASS 7.4.19CR for such business line having already complied with CASS 7.4.17BR to CASS 7.4.17ER.</u></p> <p>(2) <u>In circumstances where the rules in column (2) are disapplied by (1), CASS 7.4.16G to CASS 7.4.19G will continue to apply as they were in force as at 30 November 2014.</u></p>	<u>From 1 December 2014 to 31 May 2015</u>	<u>1 December 2014</u>
<u>10D</u>	<u>CASS 7.6.6AR</u>	<u>R</u>	<p>(1) <u>A firm operating an internal reconciliation of client money balances that is not a standard method of internal client money reconciliation as at 30 November 2014 need not comply with this rule, except to the extent referred to in (3).</u></p> <p>(2) <u>Where a firm does not comply with the rule in column (2) in accordance</u></p>	<u>From 1 December 2014 to 31 May 2015</u>	<u>1 December 2014</u>

			<p>with (1), <u>CASS 7.6.7R and CASS 7.6.8R will continue to apply to that firm as they were in force as at 30 November 2014.</u></p> <p><u>(3)(a) In order for a firm within (1) to operate an internal reconciliation that is not a standard method of internal client money reconciliation on 1 June 2015 it must, before that date, have complied with CASS 7.6.6AR(1)(b) and (c).</u></p> <p><u>(3)(b) A firm within paragraph (1) that materially changes its internal reconciliation method that is not a standard method of internal client money reconciliation on or after 1 December 2014 must, notwithstanding (1), comply with the rule in column (2) from the date it makes these material changes.</u></p> <p><u>(4) In order for any firm not within (1) to operate an internal reconciliation that is not a standard method of internal client money reconciliation on 1 December 2014 it must, before that date, have complied with CASS 7.6.6AR(1)(b) and (c).</u></p>		
<u>10E</u>	<u>The changes to CASS 7.8 in Part 2 of Annex C of the Client Assets Sourcebook (Amendment No 5) Instrument 2014</u>	<u>R</u>	<u>(1) Where the conditions in (2) are met in respect of a firm's client bank account or client transaction account, the changes effected by the provisions in the Annex listed in column (2) do not apply to the firm in</u>	<u>From 1 December 2014 to 1 June 2015</u>	<u>1 December 2014</u>

			<p>respect of the <i>client bank account</i> or <i>client transaction account</i> and therefore the provisions in <u>CASS 7.8.1R</u> and <u>CASS 7.8.2R</u> amended by that <u>Annex</u> will continue to apply as they were in force as at 31 November 2014.</p> <p>(2) The conditions are: (a) <u>the <i>client bank account</i> or <i>client transaction account</i> was opened by the <i>firm</i> before 1 December 2014;</u> (b) <u>the <i>firm</i> complied with <u>CASS 7.8.1R</u> or <u>CASS 7.8.2R</u> (as appropriate) in respect of the <i>client bank account</i> or <i>client transaction account</i> before 1 December 2014;</u> and (c) <u>the <i>client bank account</i> or <i>client transaction account</i> is not transferred to another <i>person</i> during the period in column (5).</u></p>		
<u>12A</u>	<u>CASS 9.4R</u>	<u>R</u>	<p><u><i>Firms</i> need not comply with this <i>rule</i> in respect of a business relationship with a particular <i>client</i> consisting of the provision of either or both <i>MiFID business</i> and <i>designated investment business</i> services that existed before 1 December 2014, unless and until the terms governing the relationship are materially amended on or after that date. <i>Firms</i> must comply with this <i>rule</i> in respect of any such relationship that is entered into on or after 1 December 2014.</u></p>	<p><u>From 1 December 2014 to 1 June 2015</u></p>	<p><u>1 December 2014</u></p>

Insert the following new rows in the appropriate numerical position in **Schedule 1 (Record keeping requirements)**. The new text is not underlined.

Sch 1.3G

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
CASS 6.1.6BR(3)	Written agreement regarding any arrangement relating to the transfer of full ownership of a <i>client's safe custody asset</i> to the <i>firm</i> for the purposes set out in CASS 6.1.6R(1) and CASS 6.1.6AR(1)	The agreement	When agreement made	Five years from date agreement terminated
CASS 6.1.12R(4)	<i>Firm's</i> segregation of <i>money as client money</i> under this rule	Description of <i>safe custody asset</i> in question, identity of relevant <i>client</i> , amount of <i>money</i> segregated	Maintain up to date	Not specified (see default provision CASS 6.5.3R)
CASS 6.1.12ER	<i>Client's</i> agreement to <i>firm's</i> use of exemption in CASS 6.1.12R	<i>Client's</i> written agreement	At the time of <i>client's</i> agreement	During the time the <i>firm</i> makes use or intends to make use of the exemption in CASS 6.1.12R in respect of that <i>client's safe custody assets</i>
CASS 6.2.15R	<i>Safe custody assets</i> divested by the <i>firm</i> under CASS 6.2.10R	Details of asset divested, relevant documentation and the <i>firm's</i> attempts to	When asset divested	Indefinite

		contact the <i>client</i> concerned		
CASS 7.2.8ADR	<i>Client's</i> agreement to <i>firm's</i> use of exemption in CASS 7.2.8R	<i>Client's</i> written agreement	At the time of <i>client's</i> agreement	During the time the <i>firm</i> makes use or intends to make use of the exemption in CASS 7.2.8R in respect of that <i>client's</i> monies
CASS 7.2.23R	<i>Client money</i> paid to charity by the <i>firm</i> under CASS 7.2.19R	Details of balances released, relevant documentation and the <i>firm's</i> attempts to contact the <i>client</i> concerned	When balance released	Indefinite
CASS 7.2.25R(4)	<i>Client money</i> paid to charity by the <i>firm</i> under CASS 7.2.25R	Details of balances released and relevant documentation	When balance released	Not specified (see default provision CASS 7.6.4R)
CASS 7.4.17BR	<i>Firm's</i> adoption of the alternative approach	Reasons for concluding that the normal approach would lead to greater risk to <i>client money</i> , adopting the alternative approach would not result in undue risk to <i>client money</i> , the alternative approach is appropriate for use by the particular business line, and the <i>firm</i> has adequate systems and controls	Before adopting alternative approach	Five years after it ceases to use the alternative approach in connection with that business line

CASS 7.4.19AR to CASS 7.4.1CR	Alternative approach <i>alternative approach mandatory prudent segregation record</i>	Details of <i>money</i> segregated under CASS 7.4.18BR required by these rules	Maintain up to date	Five years (after the firm ceases to retain <i>money</i> as <i>client money</i> under CASS 7.4.18BR)
CASS 7.8.9R(1)	<i>Acknowledgment letters</i>	Countersigned <i>acknowledgment letter</i>	From date of receipt	Five years from closure of last account to which the <i>acknowledgment letter</i> relates
CASS 7.8.9R(2)	<i>Acknowledgment letters</i>	Copy of <i>acknowledgment letter</i> sent to <i>authorised central counterparty</i> under CASS 7.8.3R(1)	From date <i>firm</i> sends the letter	Five years from closure of last account to which the <i>acknowledgment letter</i> relates
CASS 7.8.10R	<i>Acknowledgment letters</i>	Any other documentation or evidence the <i>firm</i> believes necessary to demonstrate compliance with CASS 7.8	None specified	None specified (see default provision CASS 7.6.4R)

Insert the following new rows in the appropriate numerical position in **Schedule 2 (Notification requirements)**. The new text is not underlined.

Sch 2.1G

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
CASS 7.2.17GR	The <i>firm's</i> intention to transfer <i>client money</i> under CASS 7.2.17BR and/or 7.2.17DR	That intention	Forming the intention	Not less than seven days before the transfer of the <i>client money</i> in question

CASS 7.4.17DR	<i>Firm's intention to adopt the alternative approach for a particular business line</i>	<i>Firm's intention to adopt the alternative approach for a particular business line</i>	At least three months prior to adopting the alternative approach for that business line	At least three months prior to adopting the alternative approach for that business line
CASS 7.6.6AR	<i>Firm's intention to use a non-standard method of internal client money reconciliation</i>	<i>Firm's intention to use a non-standard method of internal client money reconciliation</i>	Forming the intention	Before using a <i>non-standard method of internal client money reconciliation</i>

Part 3: Comes into force on 1 June 2015

[*Editor's Note:* Some of the amendments set out in this Part amend provisions set out in Parts 1 and 2 of this Annex.]

Application for affiliates

1.2.9A G ...

- (2) For business that is not *MiFID business*, the operation of the *custody chapter* or the *client money chapter* may differ if a *firm's client* is an *affiliated company* and depending on certain other conditions (see, for example, CASS 6.1.10BR and ~~CASS 7.1.12AR~~ 7.10.26R).

...

1.2.11 R (1) ...

- (2) In accordance with ~~CASS 7.1.15HR~~ 7.10.36R, a *firm* which is subject to the *client money chapter* and holds *money* both (i) in its capacity as a *trustee firm* and (ii) other than in its capacity as a *trustee firm* must not keep *money* held in in its capacity as a *trustee firm* in the same *client bank account* or *client transaction account* as *money* held other than in its capacity as a *trustee firm*.

...

...

- 1.2.13 G A *firm* may opt to hold under a single chapter *money* that would otherwise be held under different chapters (see ~~CASS 7.1.3R~~ 7.10.3R and ~~CASS 7.1.15BAR~~ 7.10.30R). However, making such an election does not remove the requirement under CASS 1.2.11R(1).

3 Collateral

3.2 Requirements

...

Application

- 3.2.4 G When appropriate, *firms* that enter into the arrangements with *retail clients* covered in this chapter will be expected to identify in the statement of *custody assets* sent to the *client* in accordance with COBS 16.4 (Statements of client designated investments or client money) or CASS 9.5 (Reporting to clients on request) details of the assets which form the basis of the arrangements. Where the *firm* utilises global netting arrangements, a statement of the assets held on this basis will suffice.

...

6 Custody rules

6.1 Application

...

Termination of title transfer collateral arrangements

- 6.1.8A R (1) If a *client* communicates to a *firm* that it wishes (whether pursuant to a contractual right or otherwise) to terminate an arrangement relating to the transfer of full ownership of its *safe custody asset* to a *firm* for the purposes set out in CASS 6.1.6R(1) and CASS 6.1.6AR(1) and the *client's* communication is not in writing, the *firm* must make a written record of the *client's* communication which also records the date the communication was received.
- (2) A *firm* must keep a *client's* written communication, or a written record of the *client's* communication in (1), for five years, starting from the date the communication was received by the *firm*.
- (3) (a) If a *firm* agrees to the termination of an arrangement relating to the transfer of full ownership of a *client's safe custody asset* to the *firm*, it must notify the *client* of its agreement in writing. The notification must state when the termination is to take effect and whether or not the *client's safe custody*

asset will be held under the custody rules by the firm thereafter.

(b) If a firm does not agree to terminate an arrangement relating to the transfer of full ownership of a client's safe custody asset to the firm, it must notify the client of its disagreement in writing.

(4) A firm must keep a written record of any notification it makes to a client under (3) for a period of five years, starting from the date the notification was made.

6.1.8B G CASS 6.1.8AR(3)(a) refers only to a firm's agreement to terminate an existing arrangement relating to the transfer of full ownership of a client's safe custody asset to the firm. Such agreement by a firm does not necessarily need to amount to the termination of its entire agreement with the client.

6.1.8C G When a firm notifies a client under CASS 6.1.8AR(3)(a) of when the termination of an arrangement relating to the transfer of full ownership of the safe custody asset to a firm is to take effect, it should take into account:

(1) any relevant terms relating to such a termination that have been agreed with the client; and

(2) the period of time it reasonably requires to return the safe custody asset to the client or to update the registration under CASS 6.2 (Holding of client assets) and update its records under CASS 6.6 (Records, accounts and reconciliations).

6.1.8D R If an arrangement relating to the transfer of full ownership of safe custody assets to a firm for the purposes set out in CASS 6.1.6R(1) and CASS 6.1.6AR(1) is terminated, then the exemption at CASS 6.1.6R(1) no longer applies.

6.1.8E G (1) Following the termination of an arrangement relating to the transfer of full ownership of safe custody assets to a firm for the purposes set out in CASS 6.1.6R(1) and CASS 6.1.6AR(1), where a firm does not immediately return the safe custody assets to the client the firm should consider whether the custody rules apply in respect of the safe custody assets pursuant to CASS 6.1.1R(1A) to (1C).

(2) Where the custody rules apply to a firm for safe custody assets in these circumstances then the firm is required to comply with those rules and should, for example, update the registration under CASS 6.2 (Holding of client assets), update its records under CASS 6.6 (Records, accounts and reconciliations) and treat any shortfall in accordance with CASS 6.6.54R (in each case as appropriate).

...

6.1.12 R ...

(4) Where a *firm* intends to segregate *money* as *client money* instead of the *client's safe custody asset* under (3) it must, before doing so, ensure that this would result in *money* being held for the relevant *client* in respect of the *shortfall* under ~~CASS 7.7.2R~~ 7.12.2R (statutory trust).

(5)

... (a) ensure the *money* is segregated under ~~CASS 7.4~~ 7.13 (Segregation of client money) and recorded as being held for the relevant *client(s)* under ~~CASS 7.6~~ 7.15 (Records, accounts and reconciliations);

6.1.16F R ...

Reference	Rule
...	
CASS 6.2.3R and CASS 6.2.6G <u>CASS 6.2.3BG</u>	Registration and recording of legal title
...	
CASS 6.5 <u>6.6</u>	Records, accounts and reconciliations

...

6.1.16IA R (1) Subject to (2), when a *firm* is acting as trustee or depositary of an AIF the *firm* need comply only with the *custody rules* in the table below:

Reference	Rule
...	
CASS 6.2.3R, CASS 6.2.4R <u>6.2.3BG to CASS 6.2.6G</u>	Registration and recording of legal title
...	
CASS 6.3.1R(1A) and CASS 6.3.1R(4)	Arranging registration
CASS 6.5.1R, CASS 6.5.2AR, CASS 6.5.3R, CASS 6.5.13R(1A) and CASS 6.5.14G <u>CASS 6.6.2R, CASS 6.6.4R, CASS 6.6.6R,</u>	Records, accounts and reconciliations

<u>CASS 6.6.7R, CASS 6.6.57R(2) and CASS 6.6.58G</u>	
--	--

- (2) When a *firm* is acting as trustee or depositary of an AIF that is an authorised AIF the *firm* must, in addition to the *custody rules* set out in (1), also comply with the *custody rules* in the table below:

Reference	Rule
...	
CASS 6.5.4 G(1A) to CASS 6.5.4G(4), CASS 6.5.5R, CASS 6.5.7AG, CASS 6.5.8AG, CASS 6.5.9G and CASS 6.5.15G <u>CASS 6.6.8R, CASS 6.6.11R to CASS 6.6.32G, CASS 6.6.41G, CASS 6.6.43G and CASS 6.6.47G.</u>	Records, accounts and reconciliations

...

- 6.1.16J R Only the *custody rules* in the table below apply to a *firm* when *arranging safeguarding and administration of assets*:

Reference	Rule
...	
CASS 6.3.1R(1A) and CASS 6.3.2G	Arranging for assets to be deposited with third parties
...	

...

Registration and recording of legal title

- 6.2.3 R ~~To the extent practicable, a A *firm* must effect appropriate registration or recording of legal title to a *safe custody asset* in the name of:~~

- (1) ~~the *client* (or, where appropriate the *trustee firm*), unless the *client* is an *authorised person* acting on behalf of its *client*, in which case it may be registered in the name of the *client* of that *authorised person*;~~

...

- (3) any other third party, if the *firm* is not a *trustee firm* but is prevented from registering or recording legal title in the way set out in (1) or (2) and provided that:

...

- (4) the *firm*, if either:
- (a) it is not a *trustee firm* but is prevented from registering or recording legal title in the way set out in (1), (2) or (3) and provided that:
- (i) the *safe custody asset* is subject to the law or market practice of a jurisdiction outside the *United Kingdom* and the *firm* has taken reasonable steps to determine that it is in the *client's* best interests to register or record it in that way, or that it is not feasible to do otherwise, because of the nature of the applicable law or market practice; and
- ~~(b)~~ the *firm* has notified the *client* if a *professional client*,
(ii) or obtained prior written consent if a *retail client*; or
- (b) it is a *trustee firm* and is prevented from registering or recording legal title in the way set out in (1) or (2).

...

- 6.2.3B G A *firm*, when complying with CASS 6.2.3R(3) or CASS 6.2.3R(4)(a), will be expected to demonstrate that adequate investigations have been made of the jurisdiction concerned by reference to local sources, which may include an appropriate legal opinion.
- 6.2.4 R A *firm* must accept the same level of responsibility to its *client* for any *nominee company* controlled by the *firm*, or any *nominee company* controlled by an *affiliated company* of the *firm*, with respect of any requirements of the *custody rules*.
- 6.2.5 R A *firm* may only register or record legal title to its own *applicable assets asset* in the same name as that in which legal title to a *client's safe custody asset* is registered or recorded if the *firm's applicable asset* is separately identified from the *client's safe custody asset* in the *firm's* records, and either or both of the conditions in (1) and (2) are met:
- (1) ~~the *firm's applicable assets* are separately identified in the *firm's* records from the *safe custody assets*; or~~ The *firm's* holding of its own *applicable asset* arises incidentally to:
- (a) *designated investment business* it carries on for the account of any *client*; or
- (b) steps taken by the *firm* to comply with an applicable *custody rule*;
- and, in the case of either (a) or (b), the situation where registration or

recording of legal title of the *firm's applicable asset* is in the same name as the *client's safe custody asset* under this rule remains in place only to the extent that it is reasonably necessary.

- (2) The registration or recording of legal title of the *firm's own applicable asset* in the same name as the *client's safe custody asset* is only as a result of the law or market practice of a jurisdiction outside of the *United Kingdom* the *firm* registers or records a *safe custody asset* in accordance with CASS 6.2.3R(4).

6.2.6 G ~~A *firm* when complying with CASS 6.2.3R(3) or CASS 6.2.3R(4) will be expected to demonstrate that adequate investigations have been made of the market concerned by reference to local sources, which may include an appropriate legal opinion.~~

- (1) Consistent with a *firm's* requirements to protect *clients' safe custody assets* and have adequate organisation arrangements in place (CASS 6.2.1R and CASS 6.2.2R), before a *firm* registers or records legal title to its own *applicable asset* in the same name as that in which legal title to a *client's safe custody asset* is registered or recorded under CASS 6.2.5R, it should consider whether there are any means to avoid doing so.

- (2) Examples of where the conditions under CASS 6.2.5R(1) might be met include in the course of a *firm*:

- (a) correcting a dealing error that relates to a transaction for the account of a *client*; or
- (b) maintaining a small balance of the *firm's* own *applicable assets* for purely operational or compliance purposes (eg, as a float to cover potential custody *shortfalls*) in an amount that is proportionate to the total amount of *safe custody assets* held for *clients*; or
- (c) allocating *safe custody assets* to *clients* following settlement of a bulk order; or
- (d) facilitating a *client* transaction that involves fractional entitlements; or
- (e) making good a *shortfall*.

...

Depositing safe custody assets with third parties

6.3.1 R ...

- (1A) ~~A *firm* which arranges the registration of a *safe custody investment* through a third party must exercise all due skill, care and diligence in~~

~~the selection and appointment of the third party. [deleted]~~

- (2) ~~A firm must take the necessary steps to ensure that any client's safe custody assets deposited with a third party, in accordance with this rule are identifiable separately from the applicable assets belonging to the firm and from the applicable assets belonging to that third party, by means of differently titled accounts on the books of the third party or other equivalent measures that achieve the same level of protection. [deleted]~~

...

- (4) ~~A firm must make a record of the grounds upon which it satisfies itself as to the appropriateness of its selection of a third party as required in this rule. The firm must make the record on the date it makes the selection and must keep it from the date of such selection until five years after the firm ceases to use the third party to hold safe custody assets belonging to clients. [deleted]~~

[Note: ~~articles 16(1)(d) and article 17(1) of the MiFID implementing Directive]~~

6.3.2 G In discharging its obligations under ~~this section~~ CASS 6.3.1R, a firm should also consider, as appropriate, together with any other relevant matters:

- (1) ~~once a safe custody asset has been lodged by the firm with the third party, the third party's performance of its services to the firm;~~

...

- (3) ~~current industry standard reports, for example Financial Reporting and Auditing Group (FRAG) 21 report “Assurance reports on internal controls of services organisations made available to third parties” made in line with Technical Release AAF 01/06 of The Institute of Chartered Accountants in England and Wales or its equivalent;~~

...

- (5) ~~the credit rating credit-worthiness of the third party; and~~
- (6) ~~any other activities undertaken by the third party and, if relevant, any affiliated company; and~~
- (7) ~~whether the third party has the appropriate regulatory permissions.~~

6.3.2A R (1) A firm must make a record of the grounds upon which it satisfies itself as to the appropriateness of its selection and appointment of a third party under CASS 6.3.1R. The firm must make the record on the date it makes the selection or appointment and must keep it from that date until five years after the firm ceases to use the third party to

hold safe custody assets belonging to clients.

- (2) A firm must make a record of each periodic review of its selection and appointment of a third party that it conducts under CASS 6.3.1R, its considerations and conclusions. The firm must make the record on the date it completes the review and must keep it from that date until five years after the firm ceases to use the third party to hold safe custody assets belonging to clients.

6.3.3 G ~~A firm should consider carefully the terms of its agreements with third parties with which it will deposit safe custody assets belonging to a client. The following terms are examples of the issues firms should address in this agreement:~~

- (1) ~~that the title of the account indicates that any safe custody asset credited to it does not belong to the firm;~~
- (2) ~~that the third party will hold or record a safe custody asset belonging to the firm's client separately from any applicable asset belonging to the firm or to the third party;~~
- (3) ~~the arrangements for registration or recording of the safe custody asset if this will not be registered in the client's name;~~
- (4) ~~[deleted]~~
- (5) ~~the restrictions over the circumstances in which the third party may withdraw assets from the account;~~
- (6) ~~the procedures and authorities for the passing of instructions to or by the firm;~~
- (7) ~~the procedures regarding the claiming and receiving of dividends, interest payments and other entitlements accruing to the client; and~~
- (8) ~~the provisions detailing the extent of the third party's liability in the event of the loss of a safe custody asset caused by the fraud, wilful default or negligence of the third party or an agent appointed by him. [deleted]~~

6.3.4 R (1) A Subject to (2), a firm must only deposit safe custody assets with a third party in a jurisdiction which specifically regulates and supervises the safekeeping of safe custody assets for the account of another person with a third party who is subject to such regulation.

...

6.3.4A-1 R A firm must take the necessary steps to ensure that any client's safe custody assets deposited with a third party are identifiable separately from the applicable assets belonging to the firm and from the applicable assets belonging to that third party, by means of differently titled accounts on the books of the third party or other equivalent measures that achieve the same

level of protection.

[Note: article 16(1)(d) of the MiFID implementing Directive]

...

CASS 6.5 (Records, accounts and reconciliations) is deleted in its entirety. The deleted text is not shown.

After CASS 6.5 (deleted) insert the following new section. The text is not underlined

6.6 Records, accounts and reconciliations

Records and accounts

- 6.6.1 G This section sets out the requirements a *firm* must meet when keeping records and accounts of the *safe custody assets* it holds for *clients*.
- 6.6.2 R A *firm* must keep such records and accounts as necessary to enable it at any time and without delay to distinguish *safe custody assets* held for one *client* from *safe custody assets* held for any other *client*, and from the *firm's* own *applicable assets*.
[Note: article 16(1)(a) of the MiFID implementing Directive]
- 6.6.3 R A *firm* must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the *safe custody assets* held for *clients*.
[Note: article 16(1)(b) of the MiFID implementing Directive]
- 6.6.4 R A *firm* must maintain a *client-specific safe custody asset record*.
- 6.6.5 G The requirements in CASS 6.6.2R to CASS 6.6.4R are for a *firm* to keep internal records and accounts of *clients' safe custody assets*. Therefore, any records falling under those requirements should be maintained by the *firm*, and should be separate to any records the *firm* may have obtained from any third parties, such as those with whom it may have deposited, or through whom it may have registered legal title to, *clients' safe custody assets*.

Right to use agreements

- 6.6.6 R A *firm* must keep a copy of every executed *client* agreement that includes that *firm's* right to use *safe custody assets* for its own account (see CASS 6.4.1R), including in the case of a *prime brokerage agreement* the disclosure annex referred to in CASS 9.3.1R.

General record-keeping

- 6.6.7 R Unless otherwise stated, a *firm* must ensure that any record made under the *custody rules* is retained for a period of five years starting from the later of:
- (1) the date it was created; and
 - (2) (if it has been modified since the date it was created), the date it was most recently modified.
- 6.6.8 R For each *internal custody record check*, each *physical asset reconciliation* and each *external custody reconciliation* carried out by a firm, it must make a record including:
- (1) the date it carried out the relevant process;
 - (2) the actions the firm took in carrying out the relevant process; and
 - (3) a list of any discrepancies the *firm* identified and the actions the *firm* took to resolve those discrepancies.

Policies and procedures

- 6.6.9 G *Firms* are reminded that they must, under SYSC 6.1.1R, establish, implement and maintain adequate policies and procedures sufficient to ensure compliance of the *firm* with the *rules* in this chapter. This should include, for example, establishing and maintaining policies and procedures concerning:
- (1) the frequency and method of the checks and reconciliations the *firm* is required to carry out under this section;
 - (2) the frequency with which the *firm* is required to review its arrangements in compliance with this chapter; and
 - (3) the resolution of discrepancies and the treatment of *shortfalls* under this section.

Internal custody record checks

- 6.6.10 G (1) An *internal custody record check* is one of the steps a *firm* takes to satisfy its obligations under:
- (a) *Principle 10* (Clients' assets);
 - (b) CASS 6.2.2R (Requirement to have adequate organisational arrangements);
 - (c) CASS 6.6.2R to CASS 6.6.4R (Records and accounts); and
 - (d) where relevant, SYSC 4.1.1R (General requirements) and SYSC 6.1.1R (Compliance).
- (2) An *internal custody record check* is a check as to whether the *firm's* records and accounts of the *safe custody assets* held by the *firm*

(including, for example, those deposited with third parties under CASS 6.3 (Depositing safe custody assets with third parties)) correspond with the *firm's* obligations to its *clients* to hold those *safe custody assets*.

- 6.6.11 R (1) A *firm* must perform an *internal custody record check*:
- (a) subject to (2), as regularly as is necessary but without allowing more than one month to pass between each *internal custody record check*; and
 - (b) as soon as reasonably practicable after the date to which the *internal custody record check* relates.
- (2) A *firm* that holds no *safe custody assets* other than *physical safe custody assets* must perform an *internal custody record check* as regularly as necessary but, in any case, no less often than its *physical asset reconciliations* under CASS 6.6.22R.
- 6.6.12 G CASS 6.6.44R sets out the matters which a *firm* must have regard to when determining the frequency at which to undertake an *internal custody record check*.
- 6.6.13 R A *firm* must perform an *internal custody record check* using either the *internal custody reconciliation method* or the *internal system evaluation method*. It must not use a combination of these methods.
- 6.6.14 R A *firm* must only use its internal records (for example, its depot and *client-specific* ledgers for *safe custody assets* or other internal accounting records) in order to perform an *internal custody record check*.
- 6.6.15 G CASS 6.6.14R means that a *firm* must not base its *internal custody record checks* on any records that the *firm* may have obtained from any third parties, such as those with whom it may have deposited, or through whom it may have registered legal title to, *clients' safe custody assets*.

The internal custody reconciliation method for internal custody record checks

- 6.6.16 R A *firm* may only use the *internal custody reconciliation method* if:
- (1) it separately maintains an *aggregate safe custody asset record* and a *client-specific safe custody asset record*; and
 - (2) its *aggregate safe custody asset record* and its *client-specific safe custody asset record* are capable of being compared.
- 6.6.17 R The *internal custody reconciliation method* requires a *firm* to perform a comparison between its *aggregate safe custody asset record* and its *client-specific safe custody asset record*, as at the date of the *internal custody record check*.

The internal system evaluation method for internal custody record checks

- 6.6.18 G (1) The *internal system evaluation method* is available to any *firm*, including one that is not able to use the *internal custody reconciliation method* because it does not meet the requirements at CASS 6.6.16R(1) and (2).
- (2) The purpose of the *internal system evaluation method* is to detect weaknesses in a *firm's* systems and controls and any recordkeeping discrepancies. However, this method is not designed to substitute a *firm's* other measures for ensuring compliance with the *custody rules*, such as monitoring the accuracy of its records (see also CASS 6.2.2R and CASS 6.6.3R).
- 6.6.19 R The *internal system evaluation method* requires a *firm* to:
- (1) establish a process that evaluates:
- (a) the completeness and accuracy of the *firm's* internal records and accounts of *safe custody assets* held by the *firm* for *clients*, in particular whether sufficient information is being completely and accurately recorded by the *firm* to enable it to:
- (i) comply with CASS 6.6.4R; and
- (ii) readily determine the total of all the *safe custody assets* that the *firm* holds for its *clients*; and
- (b) whether the *firm's* systems and controls correctly identify and resolve all discrepancies in its internal records and accounts of *safe custody assets* held by the *firm* for *clients*;
- (2) run the evaluation process established under (1) on the date of each *internal custody record check*; and
- (3) promptly investigate and, without undue delay, resolve any causes of discrepancies that the evaluation process reveals.
- 6.6.20 G The evaluation process under CASS 6.6.19R(1) should verify that the *firm's* systems and controls correctly identify and resolve at least the following types or causes of discrepancies:
- (1) items in the *firm's* records and accounts that might be erroneously overstating or understating the *safe custody assets* held by a *firm* (for example, 'test' entries and 'balancing' entries);
- (2) negative balances;
- (3) processing errors;

- (4) journal entry errors (eg, omissions and unauthorised system entries); and
- (5) IT errors (eg, software issues that could lead to inaccurate records).

Physical asset reconciliations

- 6.6.21 G (1) A *physical asset reconciliation* is a separate process to the *internal custody record check*. Firms that hold *physical safe custody assets* for *clients* are required to perform both processes.
- (2) The purpose of a *physical asset reconciliation* is to check that a *firm's* internal records and accounts of the *physical safe custody assets* kept by the *firm* for *clients* are accurate and complete, and to ensure any discrepancies are investigated and resolved.
- 6.6.22 R A *firm* that holds *physical safe custody assets* must perform a *physical asset reconciliation* for all the *physical safe custody assets* it holds for *clients*:
- (1) as regularly as is necessary but without allowing more than six months to pass between each *physical asset reconciliation*; and
- (2) as soon as reasonably practicable after the date to which the *physical asset reconciliation* relates.
- 6.6.23 G CASS 6.6.44R sets out the matters which a *firm* must have regard to when determining the frequency at which to undertake a *physical asset reconciliation*.
- 6.6.24 R When performing a *physical asset reconciliation* a *firm* must:
- (1) count all the *physical safe custody assets* held by the *firm* for *clients* as at the date to which the *physical asset reconciliation* relates; and
- (2) compare the count in (1) against what the *firm's* internal records and accounts state as being in the *firm's* possession as at the same date.
- 6.6.25 R A *firm* must perform each *physical asset reconciliation* under CASS 6.6.24R using the *total count method* or the *rolling stock method*.
- 6.6.26 G Regardless of the method used, a *firm* should ensure that all *safe custody assets* held by the *firm* as *physical safe custody assets* for *clients* are subject to a *physical asset reconciliation* at the frequency required under CASS 6.6.22R.
- 6.6.27 R If a *firm* completes a *physical asset reconciliation* in a single stage, such that the *firm*:
- (1) performs a single count under CASS 6.6.24R(1) which encompasses all the *physical safe custody assets* held by the *firm* for *clients* as at the date to which the *physical asset reconciliation* relates; and

- (2) compares that count against the *firm's* internal records and accounts in accordance with CASS 6.6.24R(2),

then the *firm* will have used the *total count method* for that *physical asset reconciliation*.

- 6.6.28 R If a *firm* completes a *physical asset reconciliation* in two or more stages, such that the *firm*:
- (1) performs two or more counts under CASS 6.6.24R(1) (each on a separate occasion and relating to a different stock line or group of stock lines forming part of the *firm's* overall holdings of *physical safe custody assets*) which, once all of the counts are complete, encompass all the *physical safe custody assets* held by the *firm* for *clients*; and
- (2) compares each of those counts against the *firm's* internal records and accounts in accordance with CASS 6.6.24R(2),
- then the *firm* will have used the *rolling stock method* for that *physical asset reconciliation*.
- 6.6.29 G (1) The *rolling stock method* allows a *firm* to perform its *physical asset reconciliation* in several stages, with each stage referring to a line of stock or group of stock lines in a *designated investment* selected by a *firm* (for example, all the *shares* with an *issuer* whose name begins with the letter 'A' or all the stock lines held in connection with a particular business line).
- (2) Where a *firm* uses the *rolling stock method* to perform a *physical asset reconciliation*, all the stages in that *physical asset reconciliation* must be completed in time to ensure the *firm* complies with CASS 6.6.22R.
- 6.6.30 R (1) If a *firm* wishes to use the *rolling stock method* to perform a *physical asset reconciliation* it must first establish and document in writing its reasons for concluding that the way in which it will carry out its *physical asset reconciliation* is adequately designed to mitigate the risk of the *firm's* records being manipulated or falsified.
- (2) A *firm* must retain any documents created under (1) for a period of at least five years after the date it ceases to use the *rolling stock method* to perform its *physical asset reconciliation*.
- 6.6.31 G The documents under CASS 6.6.30R(1) should, for example, cover the systems and controls the *firm* will have in place to mitigate the risk of 'teeming and lading' in respect of all the *physical safe custody assets* held by the *firm* for *clients* and across all the *firm's* business lines.
- 6.6.32 G To meet the requirement to have adequate organisational arrangements under CASS 6.2.2R, a *firm* should consider performing 'spot checks' as to

whether title to an appropriate sample of *physical safe custody assets* that it holds is registered correctly under CASS 6.2.3R (Registration and recording of legal title).

External custody reconciliations

- 6.6.33 G The purpose of an *external custody reconciliation* is to ensure the completeness and accuracy of a *firm's* internal records and accounts of *safe custody assets* held by the *firm* for *clients* against those of relevant third parties.
- 6.6.34 R A *firm* must conduct, on a regular basis, reconciliations between its internal records and accounts of *safe custody assets* held by the *firm* for *clients* and those of any third parties by whom those *safe custody assets* are held.
- [Note: article 16(1)(c) of the *MiFID implementing Directive*]
- 6.6.35 R In CASS 6.6.34R, the third parties whose records and accounts a *firm* is required to reconcile its own internal records and accounts with must include:
- (1) the third parties with which the *firm* has deposited *clients' safe custody assets*; and
 - (2) where the *firm* has not deposited a *client's safe custody asset* with a third party, the third parties responsible for the registration of legal title to that *safe custody asset*.
- 6.6.36 G Examples of the sorts of third parties referred to at CASS 6.6.35R(2) include central securities depositories, *operators of collective investment schemes*, and administrators of offshore funds.
- 6.6.37 R A *firm* must conduct *external custody reconciliations*:
- (1) as regularly as necessary but with no more than one month between each *external custody reconciliation*; and
 - (2) as soon as reasonably practicable after the date to which the *external custody reconciliation* relates.
- 6.6.38 G CASS 6.6.44R sets out the matters which a *firm* must consider when determining the frequency at which to undertake an *external custody reconciliation*.
- 6.6.39 G Where a *firm* holds *clients' safe custody assets* electronically with a central securities depository which is able to provide adequate information to the *firm* on its holdings on a daily basis, it is best practice under CASS 6.6.37R(1) for the *firm* to conduct an *external custody reconciliation* each *business day* in respect of those assets.
- 6.6.40 G Where a *firm* deposits *safe custody assets* belonging to a *client* with a third party, in complying with the requirements of CASS 6.6.34R, the *firm* should

seek to ensure that the third party provides the *firm* with adequate information (for example, in the form of a statement) as at a date specified by the *firm* which details the description and amounts of all the *safe custody assets* credited to the relevant account(s) and that this information is provided in sufficient time to allow the *firm* to carry out its *external custody reconciliations* under CASS 6.6.37R.

- 6.6.41 G If a *firm acting as trustee or depositary of an AIF* that is an *authorised AIF* deposits *safe custody assets* belonging to a *client* with a third party, under article 89(1)(c) (Safekeeping duties with regard to assets held in custody) of the *AIFMD level 2 regulation*, the *firm* should seek to ensure that the third party provides the *firm* with adequate information (for example, in the form of a statement) as at a date or dates specified by the *firm* which details the description and amounts of all the *safe custody assets* credited to the account(s) and that this information is provided in adequate time to allow the *firm* to carry out the periodic reconciliations required under article 89(1)(c) (Safekeeping duties with regard to assets held in custody) of the *AIFMD level 2 regulation*.
- 6.6.42 G *External custody reconciliations* must be performed for each *safe custody asset* held by the *firm* for its *clients*, except for *physical safe custody assets*. A reconciliation of transactions involving *safe custody assets*, rather than of the *safe custody assets* themselves, will not satisfy the requirement under CASS 6.6.34R.
- 6.6.43 G A *firm acting as trustee or depositary of an AIF* that is an *authorised AIF* should perform the reconciliation under article 89(1)(c) (Safekeeping duties with regard to assets held in custody) of the *AIFMD level 2 regulation*:
- (1) as regularly as is necessary having regard to the frequency, number and value of transactions which the *firm* undertakes in respect of *safe custody assets*, but with no more than one month between each reconciliation; and
 - (2) as soon as reasonably practicable after the date to which the reconciliation relates;

to ensure the accuracy of its internal records and accounts against those of third parties by whom *client's safe custody assets* are held.

Frequency of checks and reconciliations under this section

- 6.6.44 R When determining the frequency at which it will undertake its *internal custody record checks* under CASS 6.6.11R, *physical asset reconciliations* under CASS 6.6.22R, and *external custody reconciliations* under CASS 6.6.37R, a *firm* must have regard to:
- (1) the frequency, number and value of transactions which the *firm* undertakes in respect of *clients' safe custody assets*; and
 - (2) the risks to which *clients' safe custody assets* are exposed, such as

the nature, volume and complexity of the *firm's* business and where and with whom *safe custody assets* are held.

- 6.6.45 R (1) A *firm* must make and retain records sufficient to show and explain any decision it has taken under CASS 6.6.44R when determining the frequency of its *internal record custody checks, physical asset reconciliations* and *external custody reconciliations*. Subject to (2), such records must be retained indefinitely.
- (2) If any decision under CASS 6.6.44R is superseded by a subsequent decision under that *rule* then the record of that earlier decision retained in accordance with (1) need only be retained for a further period of five years from the subsequent decision.
- 6.6.46 R (1) Subject to (3), a *firm* must review the frequency at which it conducts *internal custody record checks, physical asset reconciliations* and *external custody reconciliations* at least annually to ensure that it continues to comply with CASS 6.6.11R, CASS 6.6.22R and CASS 6.6.37R, respectively, and has given due consideration to the matters in CASS 6.6.44R.
- (2) For each review a *firm* undertakes under (1), it must record the date and the actions it took in reviewing the frequency of its *internal custody record checks, physical asset reconciliations* and *external custody reconciliations*.
- (3) A *firm* need not carry out a review under (1) in respect of its *internal custody record checks, physical asset reconciliations* or *external custody reconciliations*, if it already conducts the particular process in respect of all relevant *safe custody assets* each *business day*.

Independence of person performing checks and reconciliations

- 6.6.47 G Whenever possible, a *firm* should ensure that checks and reconciliations are carried out by a *person* (for example an *employee* of the *firm*) who is independent of the production or maintenance of the records to be checked and/or reconciled.

Resolution of discrepancies

- 6.6.48 G In this section, a discrepancy should not be considered to be resolved until it is fully investigated and corrected, and any associated *shortfall* is made good by way of the *firm* ensuring that:
- (1) it is holding (under the *custody rules*) each of the *safe custody assets* that the *firm* ought to be holding for each of its *clients*; and
- (2) its own records, and the records of any relevant other *person* (such as a third party with whom the *firm* deposited the *safe custody assets*) accurately correspond to the position under (1).

- 6.6.49 R When a *firm* identifies a discrepancy as a result of carrying out an *internal custody record check*, *physical asset reconciliation* or *external custody reconciliation*, the *firm* must promptly investigate the reason for the discrepancy and resolve it without undue delay and must take appropriate steps under CASS 6.6.54R for the treatment of any *shortfalls* until that discrepancy is resolved.
- 6.6.50 R When a *firm* identifies a discrepancy outside of its processes for an *internal custody record check*, *physical asset reconciliation* or *external custody reconciliation*, the *firm* must take all reasonable steps both to investigate the reason for the discrepancy and to resolve it. It must also take appropriate steps under CASS 6.6.54R for the treatment of *shortfalls* until that discrepancy is resolved.
- 6.6.51 G Where the discrepancy identified under CASS 6.6.49R or CASS 6.6.50R has arisen as a result of a breach of the *custody rules*, the *firm* should ensure it takes sufficient steps to avoid a reoccurrence of that breach (see *Principle 10* (Clients' assets), CASS 6.6.3R and, as applicable, SYSC 4.1.1R(1) and SYSC 6.1.1R).
- 6.6.52 G Items recorded or held within a suspense or error account fall within the scope of discrepancies in this section.
- 6.6.53 G Items recorded in a *firm's* records and accounts that are no longer recorded by relevant third parties (such as 'liquidated stocks') also fall within the scope of discrepancies in this section.

Treatment of shortfalls

- 6.6.54 R (1) This *rule* applies where a *firm* identifies a discrepancy as a result of, or that reveals, a *shortfall*, which the *firm* has not yet resolved.
- (2) Subject to (3), until the discrepancy is resolved a *firm* must do one of the following:
- (a) appropriate a sufficient number of its own *applicable assets* to cover the value of the *shortfall* and hold them for the relevant *clients* under the *custody rules* in such a way that the *applicable assets*, or the proceeds of their liquidation, will be available for distribution for the benefit of the relevant *clients* in the event of the *firm's failure* and, in doing so:
- (i) ensure that the *applicable assets* are clearly identifiable as separate from the *firm's* own property and are recorded by the *firm* in its *client-specific safe custody asset record* as being held for the relevant *client*;
- (ii) keep a record of the actions the *firm* has taken under this *rule* which includes a description of the *shortfall*, identifies the relevant affected *clients*, and

lists the *applicable assets* that the *firm* has appropriated to cover the *shortfall*; and

- (iii) update the record made under (ii) whenever the discrepancy is resolved and the *firm* has re-appropriated the *applicable assets*; or
- (b) (provided that doing so is consistent with the *firm's permissions* and would result in *money* being held for the relevant *client*) in respect of the *shortfall* under CASS 7.7.2R (statutory trust) appropriate a sufficient amount of its own *money* to cover the value of the *shortfall*, hold it for the relevant *client* as *client money* under the *client money rules* and, in doing so:
- (i) ensure the *money* is segregated under CASS 7.13 (Segregation of client money) and recorded as being held for the relevant *client* under CASS 7.15 (Records, accounts and reconciliations);
 - (ii) keep a record of the actions the *firm* has taken under this *rule* which includes a description of the *shortfall*, identifies the relevant affected *clients*, and specifies the amount of *money* that the *firm* has appropriated to cover the *shortfall*; and
 - (iii) update the record made under (ii) whenever the discrepancy is resolved and the *firm* has re-appropriated the *money*; or
- (c) appropriate a number of *applicable assets* in accordance with (a) and an amount of *money* in accordance with (b) which, in aggregate, are sufficient to cover the value of the *shortfall*.
- (3) If the *firm*, where justified, concludes that another *person* is responsible for the discrepancy then, regardless of any dispute with that other *person* or whether the discrepancy is due to a timing difference between the accounting systems of that other *person* and that of the *firm*, the *firm* must take all reasonable steps to resolve the situation without undue delay with the other *person*. Until the discrepancy is resolved the *firm* must consider whether it would be appropriate to notify the affected *client* of the situation, and may take steps under (2) for the treatment of *shortfalls* until that discrepancy is resolved.

- 6.6.55 G In considering whether it should notify affected *clients* under CASS 6.6.54R (3), a *firm* should have regard to its obligations under the *client's best interests rule* to act honestly, fairly and professionally in accordance with the best interests of its *clients*, and to *Principle 7* (communications with clients).

- 6.6.56 G (1) The value of a *shortfall* for the purposes of CASS 6.6.54R may be determined by the previous day's closing mark to market valuation or, if in relation to a particular *safe custody asset* none is available, the most recently available valuation.
- (2) Where a *firm* is taking the measures under CASS 6.6.54R(2) in respect of a particular *shortfall* it should, as regularly as necessary, and having regard to *Principle 10*:
- (a) review the value of the *shortfall* in line with (1); and
- (b) where the *firm* has found that the value of the *shortfall* has changed, adjust either or both the number of own *applicable assets* and the amount of *money* it has appropriated to ensure that in aggregate the assets and monies set aside are sufficient to cover the changed value of the *shortfall*.

Notification requirements

- 6.6.57 R A *firm* must inform the *FCA* in writing without delay if:
- (1) its internal records and accounts of the *safe custody assets* held by the *firm* for *clients* are materially out of date, or materially inaccurate or invalid, so that the *firm* is no longer able to comply with the requirements in CASS 6.6.2R to CASS 6.6.4R; or
- (2) if it is a *firm acting as trustee or depositary of an AIF* and has not complied with, or is materially unable to comply with, the requirements in CASS 6.6.2R or in article 89(1)(b) or 89(1)(c) (Safekeeping duties with regard to assets held in custody) of the *AIFMD level 2 regulation*; or
- (3) it will be unable, or materially fails, to take the steps required under CASS 6.6.54R for the treatment of *shortfalls*; or
- (4) it will be unable, or materially fails, to conduct an *internal custody record check* in compliance with CASS 6.6.11R to CASS 6.6.19R; or
- (5) it will be unable, or materially fails, to conduct a *physical asset reconciliation* in compliance with CASS 6.6.22R to CASS 6.6.30R; or
- (6) it will be unable, or materially fails, to conduct an *external custody reconciliation* in compliance with CASS 6.6.34R to CASS 6.6.37R.

Annual audit of compliance with the custody rules

- 6.6.58 G *Firms* are reminded that the auditor of the *firm* has to confirm in the report submitted to the *FCA* under SUP 3.10 (Duties of auditors: notification and report on client assets) that the *firm* has maintained systems adequate to enable it to comply with the *custody rules*.

...

CASS 7.1 to CASS 7.8 and CASS 7 Annex 1 are deleted in their entirety. The deleted text is not shown.

After CASS 7.9 [deleted] insert the following new sections. The text is not underlined.

7 Client money rules

7.10 Application and purpose

7.10.1 R This chapter applies to a *firm* that receives *money* from or holds *money* for, or on behalf of, a *client* in the course of, or in connection with, its:

- (1) *MiFID business*; and/or
- (2) *designated investment business*;

unless otherwise specified in this section.

7.10.2 G A *firm* is reminded that when CASS 7.10.1R applies it should treat *client money* in an appropriate manner so that, for example:

- (1) if it holds *client money* in a *client bank account* that account is held in the *firm's* name in accordance with CASS 7.13.13R;
- (2) if it allows another *person* to hold *client money* this is effected under CASS 7.14; and
- (3) its *internal client money reconciliation* takes into account any *client equity balance* relating to its *margined transaction requirements*.

Opt-in to the client money rules

7.10.3 R (1) A *firm* that receives or holds *money* to which this chapter applies in relation to:

- (a) its *MiFID business*; or
- (b) its *MiFID business* and its *designated investment business* which is not *MiFID business*;

and holds *money* in respect of which CASS 5 applies, may elect to comply with the provisions of this chapter in respect of all such *money* and if it does so, this chapter applies as if all such *money* were *money* that the *firm* receives and holds in the course of, or in connection with, its *MiFID business*.

- (2) A *firm* that receives or holds *money* to which this chapter applies solely in relation to its *designated investment business* which is not *MiFID*

business and receives or holds *money* in respect of which the *insurance client money chapter* applies, may elect to comply with the provisions of this chapter in respect of all such *money* and if it does so, this chapter applies as if all such *money* were *money* that the *firm* receives and holds in the course of or in connection with its *designated investment business*.

(3) A *firm* must make and retain a written record of any election it makes under this *rule*, including the date from which the election is to be effective. The *firm* must make the record on the date it makes the election and must keep it for a period of five years after ceasing to use it.

(4) This *rule* is subject to CASS 1.2.11R.

7.10.4 G *Firms* are reminded that, under CASS 1.2.11R, they must not keep *money* in respect of which the *client money chapter* applies in the same *client bank account* or *client transaction account* as *money* for which the *insurance client money chapter* applies.

7.10.5 G The opt-in to the *client money rules* in this chapter does not apply in respect of *money* that a *firm* holds outside of the scope of the *insurance client money chapter*.

7.10.6 G If a *firm* has opted to comply with this chapter, the *insurance client money chapter* will have no application to the activities to which the election applies.

7.10.7 G A *firm* that is only subject to the *insurance client money chapter* may not opt to comply with this chapter.

Money that is not client money: 'opt outs' for any business other than insurance mediation activity

7.10.8 R CASS 7.10.9G to CASS 7.10.15G do not apply to a *firm* in relation to *money* held in connection with its *MiFID business* to which this chapter applies or in relation to *money* for which the *firm* has made an election under CASS 7.10.3R(1) .

Professional client opt-out

7.10.9 G The 'opt out' provisions provide a *firm* with the option of allowing a *professional client* to choose whether their *money* is subject to the *client money rules* (unless the *firm* is conducting *insurance mediation activity*).

7.10.10 R Subject to CASS 7.10.12R, *money* is not *client money* when a *firm* (other than a sole trader) holds that *money* on behalf of, or receives it from, a *professional client*, other than in the course of *insurance mediation activity*, and the *firm* has obtained written acknowledgement from the *professional client* that:

- (1) *money* will not be subject to the protections conferred by the *client money rules*;
- (2) as a consequence, this *money* will not be segregated from the *money* of the *firm* in accordance with the *client money rules* and will be used by the *firm* in the course of its own business; and
- (3) the *professional client* will rank only as a general creditor of the *firm*.

'Opt-outs' for non-IMD business

- 7.10.11 G For a *firm* whose business is not governed by the *Insurance Mediation Directive*, it is possible to 'opt out' on a one-way basis. However, in order to maintain a comparable regime to that applying to *MiFID business*, all 'MiFID type' business undertaken outside the scope of *MiFID* should comply with the *client money rules* or be 'opted out' on a two-way basis.
- 7.10.12 R *Money* is not *client money* if a *firm*, in respect of *designated investment business* which is not an *investment service or activity*, an *ancillary service*, a *listed activity* or *insurance mediation activity*:
- (1) holds it on behalf of or receives it from a *professional client* who is not an *authorised person*; and
 - (2) has sent a separate written notice to the *professional client* stating the matters set out in CASS 7.10.10R (1) to (3).
- 7.10.13 G When a *firm* undertakes a range of business for a *professional client* and has separate agreements for each type of business undertaken, the *firm* may treat *client money* held on behalf of the *client* differently for different types of business; for example, a *firm* may, under CASS 7.10.10R or CASS 7.10.12R, elect to segregate *client money* in connection with *securities* transactions and not segregate (by complying with CASS 7.10.10R or CASS 7.10.12R) *money* in connection with contingent liability investments for the same *client*.
- 7.10.14 R When a *firm* transfers *client money* to another *person*, the *firm* must not enter into an agreement under CASS 7.10.10R or CASS 7.10.12R with that other person in relation to that *client money* or represent to that other person that the *money* is not *client money*.
- 7.10.15 G CASS 7.10.14R prevents a *firm*, when passing *client money* to another *person* under CASS 7.14.2R (Transfer of *client money* to a third party), from making use of the 'opt out' provisions under CASS 7.10.10R or CASS 7.10.12R.

Credit institutions and approved banks

- 7.10.16 R In relation to the application of the *client money rules* (and any other *rule* in so far as it relates to matters covered by the *client money rules*) to the *firms* referred to in (1) and (2), the following is not *client money*:
- (1) any deposits within the meaning of the *CRD* held by a *CRD credit*

institution; and

[**Note:** article 13(8) of *MiFID* and article 18(1) of the *MiFID Implementing Directive*]

- (2) any *money* held by an *approved bank* that is not a *CRD credit institution* in an account with itself in relation to *designated investment business* carried on for its *clients*.

- 7.10.17 G A *firm* referred to in CASS 7.10.16R must comply, as relevant, with CASS 7.10.18G to CASS 7.10.24R.
- 7.10.18 G The effect of CASS 7.10.16R is that, unless notified otherwise in accordance with CASS 7.10.20R or CASS 7.10.22R, *clients* of *CRD credit institutions* or *approved banks* that are not *CRD credit institutions* should expect that where they pass *money* to such *firms* in connection with *designated investment business* these sums will not be held as *client money*.
- 7.10.19 R A *firm* holding *money* in either of the ways described in CASS 7.10.16R must, before providing *designated investment business* services to the *client* in respect of those sums, notify the *client* that:
- (1) the *money* held for that *client* is held by the *firm* as banker and not as a trustee under the *client money rules*; and
- (2) if the *firm fails*, the *client money distribution 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*.
- 7.10.20 R A *firm* holding *money* in either of the ways described in CASS 7.10.16R in respect of a *client* and providing the services to it referred to in CASS 7.10.19R must:
- (1) explain to its *clients* the circumstances, if any, under which it will cease to hold any *money* in respect of those services as banker and will hold the *money* as trustee in accordance with the *client money rules*; and
- (2) set out the circumstances in (1), if any, in its terms of business so that they form part of its agreement with the *client*.
- 7.10.21 G Where a *firm* receives *money* that would otherwise be held as *client money* but for CASS 7.10.16R:
- (1) it should be able to account to all of its *clients* for sums held for them at all times; and
- (2) that *money* should, pursuant to *Principle 10*, be allocated to the relevant *client* promptly. This should be done no later than ten *business days* after the *firm* has received the *money*.
- 7.10.22 R If a *CRD credit institution* or an *approved bank* that is not a *CRD credit*

institution wishes to hold *client money* for a *client* (rather than hold the *money* in either of the ways described in CASS 7.10.16R) it must, before providing *designated investment business* services to the *client*, disclose the following information to the *client*:

- (1) that the *money* held for that *client* in the course of or in connection with the business described under (2) is being held by the *firm* as *client money* under the *client money rules*;
- (2) a description of the relevant business carried on with the *client* in respect of which the *client money rules* apply to the *firm*; and
- (3) that, if the *firm fails*, the *client money distribution rules* will apply to *money* held in relation to the business in question.

7.10.23 G *Firms* carrying on *MiFID business* are reminded of their obligation to supply investor compensation scheme information to *clients* under COBS 6.1.16R (Compensation Information).

7.10.24 R A *CRD credit institution* or an *approved bank* that is not a *CRD credit institution* must, in respect of any *client money* held in relation to its *designated investment business* that is not *MiFID business*, comply with the obligations referred to in COBS 6.1.16R (Compensation information).

Affiliated companies: MiFID business

7.10.25 G A *firm* that holds *money* on behalf of, or receives *money* from, an *affiliated company* in respect of *MiFID business* must treat the *affiliated company* as any other *client* of the *firm* for the purposes of this chapter.

Affiliated companies: non-MiFID business

7.10.26 R A *firm* that holds *money* on behalf of, or receives *money* from, an *affiliated company* in respect of *designated investment business* which is not *MiFID business* must not treat the *money* as *client money* unless:

- (1) the *firm* has been notified by the *affiliated company* that the *money* belongs to a *client* of the *affiliated company*; or
- (2) the *affiliated company* is a *client* dealt with at arm's length; or
- (3) the *affiliated company* is a manager of an *occupational pension scheme* or is an overseas company; and
 - (a) the *money* is given to the *firm* in order to carry on *designated investment business* for or on behalf of the *clients* of the *affiliated company*; and
 - (b) the *firm* has been notified by the *affiliated company* that the *money* is to be treated as *client money*.

Coins

- 7.10.27 R The *client money rules* do not apply with respect to coins held on behalf of a *client* if the *firm* and the *client* have agreed that the *money* (or *money* of that type) is to be held by the *firm* for the intrinsic value of the metal which constitutes the coin.

Solicitors

- 7.10.28 R (1) An *authorised professional firm* regulated by the Law Society (of England and Wales), the Law Society of Scotland or the Law Society of Northern Ireland that, with respect to its regulated activities, is subject to the following rules of its *designated professional body*, must comply with those rules and, where relevant paragraph (3), and if it does so, it will be deemed to comply with the *client money rules*.
- (2) The relevant rules are:
- (a) if the *firm* is regulated by the Law Society (of England and Wales), the SRA Accounts Rules 2011;
- (b) if the *firm* is regulated by the Law Society of Scotland, the Law Society of Scotland Practice Rules 2011; and
- (c) if the *firm* is regulated by the Law Society of Northern Ireland, the Solicitors' Accounts Regulations 1998.
- (3) If the *firm* in (1) is a *MiFID investment firm* that receives or holds *money* for, or on behalf of a *client* in the course of, or in connection with its *MiFID business*, it must also comply with the *MiFID client money (minimum implementing) rules* in relation to that business.

Long term insurers and friendly societies

- 7.10.29 R This chapter does not apply to the *permitted activities* of a *long-term insurer* or a *friendly society*, unless it is a *MiFID investment firm* that receives *money* from or holds *money* for or on behalf of a *client* in the course of, or in connection with, its *MiFID business*.

Contracts of insurance

- 7.10.30 R (1) Provided it complies with CASS 1.2.11R, a *firm* that receives or holds *client money* in relation to *contracts of insurance* may elect to comply with the provisions of the *insurance client money chapter*, instead of this chapter, in respect of all such *money*.
- (2) This *rule* is subject to CASS 1.2.11R.

- 7.10.31 R A *firm* must make and retain a written record of any election which it makes under CASS 7.10.30R.

Life assurance business

- 7.10.32 G (1) A *firm* which receives and holds *client money* in respect of life assurance business in the course of its *designated investment business* that is not *MiFID business* may:
- (a) under CASS 7.10.3R (2) elect to comply with the *client money chapter* in respect of such *client money* and in doing so avoid the need to comply with the *insurance client money chapter* which would otherwise apply to the *firm* in respect of *client money* received in the course of its *insurance mediation activity*; or
 - (b) under CASS 7.10.30R, elect to comply with the *insurance client money chapter* in respect of such *client money*.
- (2) These options are available to a *firm* irrespective of whether it also receives and holds *client money* in respect of other parts of its *designated investment business*. A *firm* may not however choose to comply with the *insurance client money chapter* in respect of *client money* which it receives and holds in the course of any part of its *designated investment business* which does not involve an *insurance mediation activity*.

Trustee firms

- 7.10.33 R A *trustee firm* which holds *money* in relation to its *designated investment business* which is not *MiFID business* to which this chapter applies, must hold any such *client money* separate from its own *money* at all times.
- 7.10.34 R Subject to CASS 7.10.35R only the *client money rules* listed in the table below apply to a *trustee firm* in connection with *money* that the *firm* receives, or holds for or on behalf of a *client* in the course of or in connection with its *designated investment business* which is not *MiFID business*.

Reference	Rule
CASS 7.10.1R to CASS 7.10.6G, and CASS 7.10.16R to CASS 7.10.27R	Application
CASS 7.10.33R to CASS 7.10.40G	Trustee firms
CASS 7.10.41G	General purpose
CASS 7.13.3R to CASS 7.13.4G	Depositing client money
CASS 7.13.8R to CASS 7.13.11G	Selection, appointment and review of third parties
CASS 7.13.12R to CASS 7.13.19G	Client bank accounts
CASS 7.13.20R to CASS 7.13.25G	Diversification of client money

CASS 7.13.26R to CASS 7.13.29G	Qualifying money market funds
CASS 7.15.5R(3), CASS 7.15.7R and CASS 7.15.12R to CASS 7.15.34R	Reconciliation of client money balances
CASS 7.16	The standard methods of internal client money reconciliation
CASS 7.17.2R to CASS 7.17.4G	Requirement

- 7.10.35 R (1) A *trustee firm* to which CASS 7.10.34R applies may, in addition to the *client money rules* set out at CASS 7.10.34R, also elect to comply with:
- (a) all the *client money rules* in CASS 7.13 (Segregation of client money);
 - (b) CASS 7.14 (Client money held by a third party);
 - (c) all the *client money rules* in CASS 7.15 (Records, accounts and reconciliations); or
 - (d) CASS 7.18 (Acknowledgement letters).
- (2) A *trustee firm* must make a written record of any election it makes under this *rule*, including the date from which the election is to be effective. The *firm* must make the record on the date it makes the election and must keep it for a period of five years after ceasing to use it.
- (3) Where a *trustee firm* has made an election under (1) which it subsequently decides to cease to use, it must make a written record of this decision, including the date from which the decision is to be effective, and keep that record from the date the decision is made for a period of five years after the date it is to be effective.
- 7.10.36 R A *trustee firm* to which CASS 7.10.34R applies and which is otherwise subject to the *client money rules* must ensure that any *client money* it holds other than in its capacity as *trustee firm* is segregated from *client money* it holds as a *trustee firm*.
- 7.10.37 G A *trustee firm* to which CASS 7.10.34R applies and which is otherwise subject to the *client money rules* should ensure that in designing its systems and controls it:
- (1) takes into account that the *client money distribution rules* will only apply in relation to any *client money* that the *firm* holds other than in its capacity as *trustee firm*; and
 - (2) has regard to other legislation that may be applicable.

- 7.10.38 R (1) A *trustee firm* to which CASS 7.10.34R applies may elect that:
- (a) the applicable provisions of CASS 7.13 (Segregation of client money) and CASS 7.15 (Records, accounts and reconciliations) under CASS 7.10.34R; and
 - (b) and any further provisions it elects to comply with under CASS 7.10.35R(1);
- will apply separately and concurrently for each distinct trust that the *trustee firm* acts for.
- (2) A *trustee firm* must make a written record of any election it makes under this *rule*, including the date from which the election is to be effective. The *firm* must make the record on the date it makes the election and must keep it for a period of five years after ceasing to use it.
- (3) Where a *trustee firm* has made an election under (1) which it subsequently decides to cease to use, it must make a written record of this decision, including the date from which the decision is to be effective, and must keep that record from the date the decision is made for a period of five years after the date it is to be effective.
- 7.10.39 G A *trustee firm* may wish to make an election under CASS 7.10.38R if, for example, it acts for a number of distinct trusts which it wishes, or is required, to keep operationally separate. If a *firm* makes such an election then it should:
- (1) establish and maintain adequate internal systems and controls to effectively segregate *client money* held for one trust from *client money* held for another trust; and
 - (2) conduct *internal client money reconciliations* as set out in CASS 7.16 and *external client money reconciliations* under CASS 7.15.20R for each trust.
- 7.10.40 G The provisions in CASS 7.10.34R to CASS 7.10.39G do not affect the general application of the *client money rules* regarding *money* that is held by a *firm* other than in its capacity as a *trustee firm*.

General purpose

- 7.10.41 G (1) *Principle 10* (Clients' assets) requires a *firm* to arrange adequate protection for *clients'* assets when the *firm* is responsible for them. An essential part of that protection is the proper accounting and treatment of *client money*. The *client money rules* provide requirements for *firms* that receive or hold *client money*, in whatever form.
- (2) The *client money rules* also, where relevant, implement the

provisions of *MiFID* which regulate the obligations of a *firm* when it holds *client money* in the course of its *MiFID business*.

7.11 Treatment of client money

Title transfer collateral arrangements

- 7.11.1 R (1) Where a *client* transfers full ownership of *money* to a *firm* for the purpose of securing or otherwise covering present or future, actual or contingent or prospective obligations, such *money* should no longer be regarded as *client money*.

[Note: recital 27 to *MiFID*]

- (2) Excepted from (1) is a transfer of the full ownership of *money*:

- (a) belonging to a *retail client*;
- (b) whose purpose is to secure or otherwise cover that *client's* present or future, actual, contingent or prospective obligations under a *contract for differences* or a *rolling spot forex contract* that is a *future*, and in either case where that contract is entered into with a *firm* acting as *market maker*; and
- (c) which is made to that *firm* or to any other *person* arranging on its behalf.

- 7.11.2 R (1) Subject to (2), where a *firm* makes arrangements for the purpose of securing or otherwise covering present or future, actual, contingent or prospective obligations of a *retail client* those arrangements must not provide for the taking of a transfer of full ownership of any of that *client's money*.

- (2) The application of (1) is confined to the taking of a transfer of full ownership:

- (a) whose purpose is to secure or otherwise cover that *retail client's* obligations under a *contract for differences* or a *rolling spot forex contract* that is a *future*, and in either case where that contract is entered into with a *firm* acting as *market maker*; and
- (b) which is made to that *firm* or to any other *person* arranging on its behalf.

- 7.11.3 R (1) A *firm* must ensure that any arrangement relating to the transfer of full ownership of a *client's money* to the *firm* for the purposes set out in CASS 7.11.1R(1) and CASS 7.11.2R(1) is the subject of a written agreement made on a *durable medium* between the *firm* and the *client*.

- (2) Regardless of the form of the written agreement in (1) (which may have additional commercial purposes), it must cover the *client's* agreement to:
- (a) the terms for the arrangement relating to the transfer of the *client's* full ownership of *money* to the *firm*;
 - (b) any terms under which the ownership of *money* is to transfer from the *firm* back to the *client*; and
 - (c) (to the extent not covered by the terms under (b)), any terms for the termination of:
 - (i) the arrangement under (a); or
 - (ii) the overall agreement in (1).
- (3) A *firm* must retain a copy of the agreement under (1) from the date the agreement is entered into and until five years after the agreement is terminated.
- 7.11.4 G The terms referred to in CASS 7.11.3R(2)(b) may include, for example, terms under which the arrangement relating to the transfer of full ownership of *money* to the *firm* is not in effect from time to time, or is contingent on some other condition.
- 7.11.5 G A title transfer financial collateral arrangement under the *Financial Collateral Directive* is an example of a type of transfer of *money* to cover obligations where that *money* will not be regarded as *client money*.
- 7.11.6 G Where a *firm* has received full title or full ownership to *money* under a collateral arrangement, the fact that it has also granted a security interest to its *client* to secure its obligation to repay that *money* to the *client* would not result in the *money* being *client money*. This can be compared to a situation in which a *firm* takes a charge or other security interest over *money* held in a *client bank account*, where that *money* would still be *client money* as there would be no absolute transfer of title to the *firm*. However, where a *firm* has received *client money* under a security interest and the security interest includes a "right to use arrangement", under which the *client* agrees to transfer all of its rights to *money* in that account to the *firm* upon the exercise of the right to use, the *money* may cease to be *client money*, but only once the right to use is exercised and the *money* is transferred out of the *client bank account* to the *firm*.
- 7.11.7 G *Firms* are reminded of the *client's best interest rule*, which requires a *firm* to act honestly, fairly and professionally in accordance with the best interests of its *clients* when structuring its business particularly in respect of the effect of that structure on *firms'* obligations under the *client money rules*.
- 7.11.8 G Pursuant to the *client's best interests rule*, a *firm* should ensure that where a *retail client* transfers full ownership of *money* to a *firm*:

- (1) the *client* is notified that full ownership of the *money* has been transferred to the *firm* and, as such, the *client* no longer has a proprietary claim over this *money* and the *firm* can deal with it on its own right;
- (2) the transfer is for the purposes of securing or covering the *client's* obligations;
- (3) an equivalent transfer is made back to the *client* if the provision of collateral by the *client* is no longer necessary; and
- (4) there is a reasonable link between the timing and the amount of the collateral transfer and the obligation that the *client* owes, or is likely to owe, to the *firm*.

Termination of title transfer collateral arrangements

- 7.11.9 R (1) If a *client* communicates to a *firm* that it wishes (whether pursuant to a contractual right or otherwise) to terminate an arrangement relating to the transfer of full ownership of its *money* to the *firm* for the purposes set out in CASS 7.11.1R(1) and CASS 7.11.2R(1), and the *client's* communication is not in writing, the *firm* must make a written record of the *client's* communication, which also records the date the communication was received.
- (2) A *firm* must keep a *client's* written communication, or a written record of the *client's* communication in (1), for five years starting from the date the communication was received by the *firm*.
- (3) (a) If a *firm* agrees to the termination of an arrangement relating to the transfer of full ownership of a *client's money* to the *firm*, it must notify the *client* of its agreement in writing. The notification must state when the termination is to take effect and whether or not the *client's money* will be treated as *client money* by the *firm* thereafter.
- (b) If a *firm* does not agree to terminate an arrangement relating to the transfer of full ownership of a *client's money* to the *firm*, it must notify the *client* of its disagreement in writing.
- (4) A *firm* must keep a written record of any notification it makes to a *client* under (3) for a period of five years, starting from the date the notification was made.
- 7.11.10 G CASS 7.11.9R(3)(a) refers only to a *firm's* agreement to terminate an existing arrangement relating to the transfer of full ownership of a *client's money* to the *firm*. Such agreement by a *firm* does not necessarily need to amount to the termination of its entire agreement with the *client*.
- 7.11.11 G When a *firm* notifies a *client* under CASS 7.11.9R(3)(a) of when the termination of an arrangement relating to the transfer of full ownership of

the *client's money* to the *firm* is to take effect, it should take into account:

- (1) any relevant terms relating to such a termination that have been agreed with the *client*; and
- (2) the period of time it reasonably requires to return the *money* to the *client*, or to update its records under CASS 7.15 (Records, accounts and reconciliations) and to segregate the *money* as *client money* under CASS 7.13 (Segregation of client money).

7.11.12 R If an arrangement relating to the transfer of full ownership of a *client's money* to a *firm* for the purposes set out in CASS 7.11.1R(1) and CASS 7.11.2R(1) is terminated then, unless otherwise permitted under the *client money rules* and notified to the *client* under CASS 7.11.9R(3)(a), the *firm* must treat that *money* as *client money* from the start of the next *business day* following the date of termination as set out in the *firm's* notification under CASS 7.11.9R(3)(a). Where the *firm's* notification under CASS 7.11.9R(3)(a) does not state when the termination of the arrangement will take effect, the *firm* must treat that *money* as *client money* from the start of the next *business day* following the date on which the *firm's* notification is made.

7.11.13 G A *firm* to which CASS 7.11.12R applies should, for example, update its records under CASS 7.15 (Records, accounts and reconciliations) and segregate the *money* as *client money* under CASS 7.13 (Segregation of client money), from the relevant time at which the *firm* is required to treat the *money* as *client money*.

Delivery versus payment transaction exemption

7.11.14 R (1) Subject to (2) and CASS 7.11.16R and with the agreement of the relevant *client*, *money* need not be treated as *client money* in respect of a delivery versus payment transaction through a *commercial settlement system* if:

- (a) in respect of a *client's* purchase, the *firm* intends for the *money* from the *client* to be due to it within one *business day* following the *firm's* fulfilment of its delivery obligation to the *client*; or
- (b) in respect of a *client's* sale, the *firm* intends for the *money* in question to be due to the *client* within one *business day* following the *client's* fulfilment of its delivery obligation to the *firm*.

(2) If the payment or delivery by the *firm* to the *client* has not occurred by the close of business on the third *business day* following the date on which the *firm* makes use of the exemption under (1), the *firm* must stop using that exemption for the transaction.

7.11.15 G The exclusion from the *client money rules* for delivery versus payment

transactions under CASS 7.11.14R is an example of an exclusion from the *client money rules* which is permissible by virtue of recital 26 of *MiFID*.

- 7.11.16 R A *firm* cannot, in respect of a particular delivery versus payment transaction, make use of the exemption under CASS 7.11.14R in either or both of the following circumstances:
- (1) it is not a direct member or participant of the relevant *commercial settlement system*, nor is it sponsored by such a member or participant, in accordance with the terms and conditions of that *commercial settlement system*;
 - (2) the transaction in question is being settled by another *person* on behalf of the *firm* through an account held at the relevant *commercial settlement system* by that other *person*.
- 7.11.17 R Where a *firm* does not meet the requirements in CASS 7.11.14R or CASS 7.11.16R for the use of the exemption in CASS 7.11.14R, the *firm* is subject to the *client money rules* in respect of any *money* it holds in connection with the delivery versus payment transaction in question.
- 7.11.18 G
- (1) In line with CASS 7.11.14R, where a *firm* receives *money* from the *client* in fulfilment of the *client's* payment obligation in respect of a delivery versus payment transaction the *firm* is carrying out through a *commercial settlement system* in respect of a *client's* purchase, and the *firm* has not fulfilled its delivery obligation to the *client* by close of business on the third *business day* following the date of the *client's* fulfilment of its payment obligation to the *firm*, the *firm* must treat the *client money* in accordance with the *client money rules* until delivery by the *firm* to the *client* occurs.
 - (2) Upon settlement of a delivery versus payment transaction a *firm* is carrying out through a *commercial settlement system* (including when it is settled within the three *business day* period referred to in CASS 7.11.14R(2)) then, in respect of:
 - (a) a *client's* purchase, the *custody rules* apply to the relevant *safe custody asset* the *firm* receives upon settlement; and
 - (b) a *client's* sale, the *client money rules* will apply to the relevant *money* received on settlement.
- 7.11.19 R A *firm* will not be in breach of the requirement under CASS 7.13.6R to receive *client money* directly into a *client bank account* if it:
- (1) receives the *money* in question:
 - (a) in accordance with CASS 7.11.14R(1)(a) but it is subsequently required under CASS 7.11.14R(2) to hold that *money* in accordance with the *client money rules*; or

- (b) in the circumstances referred to in CASS 7.11.18G(2)(b); and
 - (2) pays the *money* in question into a *client bank account* promptly, and in any event by close of business on the *business day* following:
 - (a) the expiration of the relevant period referred to in CASS 7.11.14R(2); or
 - (b) receipt of the *money* in the circumstances referred to in CASS 7.11.18G(2)(b).
- 7.11.20 R (1) If a *firm* makes use of the exemption under CASS 7.11.14R, it must obtain the *client's* written agreement to the *firm's* use of the exemption.
- (2) In respect of each *client*, the record created in (1) must be retained during the time that the *firm* makes use, or intends to make use, of the exemption under CASS 7.11.14R in respect of that *client's* monies.
- 7.11.21 R (1) Subject to (2), *money* need not be treated as *client money*:
- (a) in respect of a delivery versus payment transaction for the purpose of settling a transaction in relation to *units* in a *regulated collective investment scheme* in either of the following circumstances:
 - (i) the *authorised fund manager* receives the *money* from a *client* in relation to the *authorised fund manager's* obligation to issue *units*, in an *AUT* or *ACS*, or to arrange for the issue of *units* in an *ICVC*, in accordance with *COLL*; or
 - (ii) the *money* is held in the course of redeeming *units* where the proceeds of that redemption are paid to a *client* within the time specified in *COLL*;
 - (2) Where, in respect of *money* received in any of the circumstances set out in (1), the *authorised fund manager* has not, by close of business on the *business day* following the date of receipt of the *money*, paid this *money* to the *depository* of an *AUT* or *ACS*, the *ICVC* or to the *client* as the case may be, the *authorised fund manager* must stop using the exemption under (1) for that transaction.
- 7.11.22 R An *authorised fund manager* will not be in breach of the requirement under CASS 7.13.6R to receive *client money* directly into a *client bank account* if it received the *money* in accordance with CASS 7.11.21R(1) and is subsequently required under CASS 7.11.21R(2) to hold that *money* in accordance with the *client money rules*.
- 7.11.23 G Where proceeds of redemption paid to the *client* in accordance with CASS

7.11.21R(1)(a)(ii) are paid by cheque, the cheque should be issued from the relevant *client bank account*.

- 7.11.24 R (1) If a *firm* makes use of the exemption under CASS 7.11.21R, it must obtain the *client's* written agreement to the *firm's* use of the exemption.
- (2) In respect of each *client*, the record created in (1) must be retained for the duration of the time that the *firm* makes use of the exemption under CASS 7.11.21R in respect of that *client's money*.

Money due and payable to the firm

- 7.11.25 R (1) *Money* is not *client money* when it becomes properly due and payable to the *firm* for its own account.
- (2) For these purposes, if a *firm* makes a payment to, or on the instructions of, a *client*, from an account other than a *client bank account*, until that payment has cleared, no equivalent sum from a *client bank account* for reimbursement will become due and payable to the *firm*.
- 7.11.26 G *Money* will not become properly due and payable to the *firm* merely through the *firm* holding that *money* for a specified period of time. If a *firm* wishes to cease to hold *client money* for a *client* it must comply with CASS 7.11.34R (Discharge of fiduciary duty) or, if the balance is allocated but unclaimed *client money*, CASS 7.11.50R (Allocated but unclaimed client money) or CASS 7.11.57R (De minimis amounts of unclaimed client money).
- 7.11.27 G *Money* held as *client money* becomes due and payable to the *firm* or for the *firm's* own account, for example, because the *firm* acted as *principal* in the contract or the *firm*, acting as agent, has itself paid for *securities* in advance of receiving the purchase *money* from its *client*. The circumstances in which it is due and payable will depend on the contractual arrangement between the *firm* and the *client*.
- 7.11.28 G *Firms* are reminded that, notwithstanding that *money* may be due and payable to them, they have a continuing obligation to segregate *client money* in accordance with the *client money rules*. In particular, in accordance with CASS 7.15.2R, *firms* must ensure the accuracy of their records and accounts and are reminded of the requirement to carry out *internal client money reconciliations* either in accordance with the *standard methods of internal client money reconciliation* or the requirements for a *non-standard method of internal client money reconciliation*.
- 7.11.29 G When a *client's* obligation or liability, which is secured by that *client's* asset, crystallises, and the *firm* realises the asset in accordance with an agreement entered into between the *client* and the *firm*, the part of the proceeds of the asset to cover such liability that is due and payable to the *firm* is not *client money*. However, any proceeds of sale in excess of the

amount owed by the *client* to the *firm* should be paid over to the *client* immediately or be held in accordance with the *client money rules*.

Commission rebate

7.11.30 G When a *firm* has entered into an arrangement under which *commission* is rebated to a *client*, those rebates need not be treated as *client money* until they become due and payable to the *client* in accordance with the terms of the contractual arrangements between the parties.

7.11.31 G When *commission* rebate becomes due and payable to the *client*, the *firm* should:

- (1) treat it as *client money*; or
- (2) pay it out in accordance with the *rule* regarding the discharge of a *firm's* fiduciary duty to the *client* (see CASS 7.11.34R);

unless the *firm* and the *client* have entered into an arrangement under which the *client* has agreed to transfer full ownership of this *money* to the *firm* as collateral against payment of future professional fees (see CASS 7.11.1R (Title transfer collateral arrangements)).

Interest

7.11.32 R A *firm* must pay a *retail client* any interest earned on *client money* held for that *client* unless it has otherwise notified him in writing.

7.11.33 G (1) The *firm* may, under the terms of its agreement with the *client*, pay some, none, or all interest earned to the relevant *client*.

- (2) Where interest is payable on *client money* by a *firm* to *clients*:
 - (a) such sums are *client money* and so, if not paid to, or to the order of the *clients*, are required to be segregated in accordance with CASS 7.13 (Segregation of client money);
 - (b) the interest should be paid to *clients* in accordance with the *firm's* agreement with each *client*; and
 - (c) if the *firm's* agreement with the *client* is silent as to when interest should be paid to the *client* the *firm* should follow CASS 7.13.36R (Allocation of client money receipts);

irrespective of whether the *client* is a *retail client* or otherwise.

Discharge of fiduciary duty

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

- (1) it is paid to the *client*, or a duly authorised representative of the

client; or

- (2) it is:
- (a) paid to a third party on the instruction of, or with the specific consent of, the *client* unless it is transferred to a third party in the course of effecting a transaction under CASS 7.14.2R (Transfer of client money to a third party); or
 - (b) paid to a third party pursuant to an obligation on the *firm* where:
 - (i) that obligation arises under an enactment; and
 - (ii) the obligation under that enactment is applicable to the *firm* as a result of the nature of the business being undertaken by the *firm* for its *client*; or
 - (c) transferred in accordance with CASS 7.11.42R; or
 - (d) transferred in accordance with CASS 7.11.44R; or
- (3) subject to CASS 7.11.38R, it is paid into a bank account of the *client* (not being an account which is also in the name of the *firm*); or
- (4) it is due and payable to the *firm* in accordance with CASS 7.11.25R (Money due and payable to the firm); or
- (5) it is paid to the *firm* as an excess in the *client bank account* (see CASS 7.15.29R(2) (Reconciliation discrepancies)); or
- (6) it is paid by an *authorised central counterparty* to a clearing member other than the *firm* in connection with a *porting* arrangement in accordance with CASS 7.11.35R; or
- (7) it is paid by an *authorised central counterparty* directly to the *client* in accordance with CASS 7.11.36R; or.
- (8) it is transferred by the *firm* to a *clearing member* in connection with a *regulated clearing arrangement* and the *clearing member* remits payment to another *firm* or to another *clearing member* in accordance with CASS 7.11.37R(1); or
- (9) it is transferred by the *firm* to a *clearing member* in connection with a *regulated clearing arrangement* and the *clearing member* remits payment directly to the *indirect clients* of the *firm* in accordance with CASS 7.11.38R(2); or
- (10) it is paid to charity under CASS 7.11.50R or 7.11.57R.

7.11.35 R *Client money* which the *firm* places at an *authorised central counterparty*

in connection with a *regulated clearing arrangement* ceases to be *client money* for that *firm* if, as part of the default management process of that *authorised central counterparty* in respect of a default by the *firm*, it is *ported* by the *authorised central counterparty* in accordance with article 48 of *EMIR*.

7.11.36 R *Client money* which the *firm* places at an *authorised central counterparty* in connection with a *regulated clearing arrangement* ceases to be *client money* if, as part of the default management process of that *authorised central counterparty* in respect of a default by the *firm*, it is paid directly to the *client* by the *authorised central counterparty* in accordance with the procedure described in article 48(7) of *EMIR*.

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) 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) of the *EMIR L2 Regulation*.

7.11.38 R *Client money* received or held by the *firm* for a *sub-pool* ceases to be *client money* for that *firm* to the extent that such *client money* is transferred by the *firm* to an *authorised central counterparty* or a *clearing member* as a result of *porting*.

7.11.39 R A *firm* must not pay *client money* into a bank account of the *client* that has been opened without the consent of that *client*.

7.11.40 R When a *firm* draws a cheque or other payable order to discharge its fiduciary duty to the *client*, it must continue to treat the sum concerned as *client money* until the cheque or order is presented and paid by the bank.

Transfer of business

7.11.41 G A *firm* may transfer *client money* to a third party as part of transferring all or part of its business if, in respect of each *client* with an interest in the *client money* that is sought to be transferred, it:

- (1) obtains the consent or instruction of that *client* at the time of the transfer of business (see *CASS 7.11.34R(2)(a)*); or
- (2) complies with *CASS 7.11.42R* (see *CASS 7.11.34R(2)(c)*); or

- (3) complies with CASS 7.11.44R (see CASS 7.11.34R(2)(d)).
- 7.11.42 R Subject to CASS 7.11.44R, *money* ceases to be *client money* for a *firm* if:
- (1) it is transferred by the *firm* to another *person* as part of a transfer of business to that *person* where the *client money* relates to the business being transferred;
 - (2) it is transferred on terms which require the other *person* to return a *client's* transferred sums to the *client* as soon as practicable at the *client's* request;
 - (3) a written agreement between the *firm* and the relevant *client* provides that:
 - (a) the *firm* may transfer the *client's client money* to another *person*; and
 - (b)
 - (i) the sums transferred will be held by the *person* to whom they are transferred in accordance with the *client money rules* for the *clients*; or
 - (ii) if not held in accordance with (i), the *firm* will exercise all due skill, care and diligence in assessing whether the *person* to whom the *client money* is transferred will apply adequate measures to protect these sums; and
 - (4) the *firm* complies with the requirements in (3)(b)(ii) (if applicable).
- 7.11.43 G In considering how and whether to introduce the written agreement referred to in CASS 7.11.42R (3), *firms* should have regard to any relevant obligations to *clients*, including requirements under the *Unfair Terms Regulations*.

Transfer of business: de minimis sums

- 7.11.44 R
- (1) *Client money* belonging to those categories of *clients* set out in (2) and in respect of those amounts set out in (2) ceases to be *client money* of the *firm* if it is transferred by the *firm* to another *person*:
 - (a) as part of a transfer of business to that other *person* where these sums relate to the business being transferred; and
 - (b) on terms which require the other *person* to return a *client's* transferred sums as soon as practicable at the *client's* request.
 - (2)
 - (a) For *retail clients* the amount is £25.
 - (b) For all other *clients* the amount is £100.

- 7.11.45 G For the avoidance of doubt, sums transferred under CASS 7.11.44R do not, for the purposes of that *rule*, require the instruction or specific consent of each *client* at the time of the transfer or a written agreement as set out in CASS 7.11.42R (3).

Transfer of business: client notifications

- 7.11.46 R Where a *firm* transfers *client money* belonging to its *clients* under either or both of CASS 7.11.42R and CASS 7.11.44R, it must ensure that those *clients* are notified no later than seven *days* after the transfer taking place:
- (1) whether or not the sums will be held by the person to whom they have been transferred in accordance with the *client money rules* and, if not, how the sums being transferred will be held by that *person*;
 - (2) the extent to which the sums transferred will be protected under a compensation scheme; and
 - (3) that the *client* may opt to have the *client's* transferred sum returned to it as soon as practicable at the *client's* request.
- 7.11.47 R The *firm* must notify the *FCA* of its intention to effect any transfer of *client money* under either or both of CASS 7.11.42R and CASS 7.11.44R at least seven *days* before it transfers the *client money* in question.

Allocated but unclaimed client money

- 7.11.48 G The purpose of CASS 7.11.50R is to set out the requirements *firms* must comply with in order to cease to treat as *client money* any unclaimed balance which is allocated to an individual *client*.
- 7.11.49 G Before acting in accordance with CASS 7.11.50R to CASS 7.11.58G, a *firm* should consider whether its actions are permitted by law and consistent with the arrangements under which the *client money* is held. For the avoidance of doubt, these provisions relate to a *firm's* obligations as an *authorised person* and to the treatment of *client money* under the *client money rules*.
- 7.11.50 R A *firm* may pay away to a registered charity of its choice a *client money* balance which is allocated to a *client* and if it does so the released balance will cease to be *client money* under CASS 7.11.34R(10), provided:
- (1) this is permitted by law and consistent with the arrangements under which the *client money* is held;
 - (2) the *firm* held the balance concerned for at least six years following the last movement on the *client's* account (disregarding any payment or receipt of interest, charges or similar items);
 - (3) it can demonstrate that it has taken reasonable steps to trace the

client concerned and to return the balance; and

(4) the *firm* complies with CASS 7.11.54R.

7.11.51 G Where the *client money* balance held by a *firm* is, in aggregate, £100 or less for a *client* other than a *retail client* or, for a *retail client*, £25 or less, the *firm* may comply with CASS 7.11.57R instead of CASS 7.11.50R.

7.11.52 E (1) Taking reasonable steps in CASS 7.11.50R(3) includes following this course of conduct:

- (a) determining, as far as reasonably possible, the correct contact details for the relevant *client*;
- (b) writing to the *client* at the last known address either by post or by electronic mail to inform it of the *firm's* intention to no longer treat the *client money* balance as *client money* and to pay the sums concerned to charity if the *firm* does not receive instructions from the *client* within 28 days;
- (c) where the *client* has not responded after the 28 days referred to in (b), attempting to communicate the information set out in (b) to the *client* on at least one further occasion by any means other than that used in (b) including by post, electronic mail, telephone or media advertisement;
- (d) subject to (e) and (f), where the *client* has not responded within 28 days following the most recent communication, writing again to the *client* at the last known address either by post or by electronic mail to inform them that:
 - (i) as the *firm* did not receive a claim for the relevant *client money* balance, it will in 28 days pay the balance to a registered charity; and
 - (ii) an undertaking will be provided by the *firm* or a member of its *group* to pay to the *client* concerned a sum equal to the balance paid away to charity in the event of the *client* seeking to claim the balance in future;
- (e) if the *firm* has carried out the steps in (b) or (c) and in response has received positive confirmation in writing that the *client* is no longer at a particular address, the *firm* should not use that address for the purposes of (d);
- (f) if, after carrying out the steps in (a), (b) and (c), the *firm* has obtained positive confirmation that none of the contact details it holds for the relevant *client* are accurate or, if utilised, the communication is unlikely to reach the *client*, the *firm* does not have to comply with (d); and

- (g) waiting a further 28 *days* following the most recent communication under this *rule* before paying the balance to a registered charity.
 - (2) Compliance with (1) may be relied on as tending to establish compliance with CASS 7.11.50R.
 - (3) Contravention of (1) may be relied on as tending to establish contravention of CASS 7.11.50R.
- 7.11.53 G For the purpose of CASS 7.11.52R(1)(a), a *firm* may use any available means to determine the correct contact details for the relevant *client*, including telephoning the *client*, searching internal records, media advertising, searching public records, mortality screening, using credit reference agencies or tracing agents.
- 7.11.54 R (1) Where a *firm* wishes to release a balance allocated to an individual *client* under CASS 7.11.50R it must comply with either (a) or (b) and, in either case, (2):
- (a) the *firm* must unconditionally undertake to pay to the *client* concerned a sum equal to the balance paid away to charity in the event of the *client* seeking to claim the balance in future; or
 - (b) the *firm* must ensure that an unconditional undertaking in the terms set out in (a) is made by a member of its *group* and there is suitable information available for relevant *clients* to identify the member of the *group* granting the undertaking.
- (2) The undertakings in this *rule* must be:
- (a) authorised by the *firm's governing body* where (1)(a) applies or by the *governing body* of the *group* member where (1)(b) applies;
 - (b) legally enforceable by any *person* who had a legally enforceable claim to the balance in question at the time it was released by the *firm*, or by an assign or successor in title to such claim; and
 - (c) retained by the *firm*, and where (1)(b) applies, by the *group* member indefinitely.
- 7.11.55 R (1) If a *firm* pays away *client money* under CASS 7.11.50R(4) it must make and retain, or where the *firm* already has such records, retain:
- (a) records of all balances released from *client bank* accounts under CASS 7.11.50R (including details of the amounts and the identity of the *client* to whom the *money* was allocated);

- (b) all relevant documentation (including charity receipts); and
 - (c) details of the communications the *firm* had or attempted to make with the *client* concerned pursuant to CASS 7.11.50R(3).
- (2) The records in (1) must be retained indefinitely.
 - (2) If a member of the *firm's group* has provided an undertaking under CASS 7.11.54R(2) then the records in (1) must be readily accessible to that *group* member.

De minimis amounts of unclaimed client money

- 7.11.56 G The purpose of CASS 7.11.57R is to allow a *firm* to pay away to charity *client money* balances of (i) £25 or less for *retail clients* or (ii) £100 or less for other *clients* when those balances remain unclaimed. If a *firm* follows this process, the *money* will cease to be *client money* (see CASS 7.11.34R(10)).
- 7.11.57 R A *firm* may pay away to a registered charity of its choice a *client money* balance which is allocated to a *client* and if it does so the released balance will cease to be *client money* under CASS 7.11.34R(10), provided:
- (1) the balance in question is (i) for a *retail client*, in aggregate, £25 or less, or (ii) for a *professional client*, in aggregate, £100 or less;
 - (2) the *firm* held the balance concerned for at least six years following the last movement on the *client's* account (disregarding any payment or receipt of interest, charges or similar items);
 - (3) the *firm* has made at least one attempt to contact the *client* to return the balance using the most up-to-date contact details the *firm* has for the *client*, and the *client* has not responded to such communication within 28 days of the communication having been made; and
 - (4) the *firm* makes and/or retains records of all balances released from *client bank* accounts in accordance with this *rule*. Such records must include the information in CASS 7.11.55R (1)(a) and (b).

Costs associated with paying away allocated but unclaimed client money

- 7.11.58 G Any costs associated with the *firm* ceasing to treat unclaimed *client money* balances as *client money* pursuant to CASS 7.11.50R to CASS 7.11.57R should be paid for from the *firm's* own funds, including:
- (1) any costs associated with the *firm* carrying out the steps in CASS 7.11.50R(3), CASS 7.11.51 or CASS 7.11.57R(3); and
 - (2) the cost of any insurance purchased by a *firm* or the relevant

member of its *group* to cover any legally enforceable claim in respect of the *client money* paid away.

7.12 Organisational requirements: client money

Requirement to protect client money

- 7.12.1 R A *firm* must, when holding *client money*, make adequate arrangements to safeguard the *client's* rights and prevent the use of *client money* for its own account.

[**Note:** article 13(8) of *MiFID*]

Requirement to have adequate organisational arrangements

- 7.12.2 R A *firm* must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of *client money*, or of rights in connection with *client money*, as a result of misuse of *client money*, fraud, poor administration, inadequate record-keeping or negligence.

[**Note:** article 16(1)(f) of the *MiFID implementing Directive*]

- 7.12.3 G The risk of loss or diminution of rights in connection with *client money* can arise where a *firm's* organisational arrangements give rise to the possibility that *client money* held by the *firm* may be paid for the account of a *client* whose *money* is yet to be received by the *firm*. Consistent with the requirement to hold *client money* as trustee (see *CASS 7.17.5G*), a *firm* should ensure its organisational arrangements are adequate to minimise such a risk. This may include, for example, allowing for sufficient periods of time for payments of *client money* to the *firm* to become available for use (including automated payments, credit card payments and payments by cheque), and setting up safeguards to ensure that payments out of *client bank accounts* do not take effect before the relevant amount of *client money* has become available for use by the *firm*.

7.13 Segregation of client money

Application and purpose

- 7.13.1 G The segregation of *client money* from a *firm's* own *money* is an important safeguard for its protection.
- 7.13.2 R Where a *firm* establishes one or more *sub-pools*, the provisions of *CASS 7.13* (Segregation of client money) shall be read as applying separately to the *firm's* general pool and each *sub-pool* in line with *CASS 7.19.3R* and *CASS 7.19.12R*.

Depositing client money

- 7.13.3 R A *firm*, on receiving any *client money*, must promptly place this *money* into one or more accounts opened with any of the following:
- (1) a central bank;
 - (2) a *CRD credit institution*;
 - (3) a bank authorised in a third country;
 - (4) a *qualifying money market fund*.

[**Note:** article 18(1) of the *MiFID implementing Directive*]

- 7.13.4 G A *firm* should ensure that any *money* other than *client money* that is deposited in a *client bank account* is promptly paid out of that account unless such *money* is a minimum sum required to open the account, or to keep the account open.

Approaches for the segregation of client money

- 7.13.5 G The two approaches that a *firm* can adopt in discharging its obligations under this section are:
- (1) the 'normal approach'; or
 - (2) the 'alternative approach' (see *CASS 7.13.54G* to *CASS 7.13.69G*).

The normal approach

- 7.13.6 R Unless otherwise permitted by any other *rule* in *CASS 7.13*, a *firm* using the normal approach must ensure that all *client money* it receives is paid directly into a *client bank account* at an institution referred to in *CASS 7.13.3R*(1) to (3), rather than being first received into the *firm's* own account and then segregated.
- 7.13.7 G *Firms* should ensure that *clients* and third parties make transfers and payments of any *money* which will be *client money* directly into the *firm's* *client bank accounts*.

Selection, appointment and review of third parties

- 7.13.8 R A *firm* that does not deposit *client money* with a central bank must exercise all due skill, care and diligence in the selection, appointment and periodic review of the *CRD credit institution*, bank or *qualifying money market fund* where the *money* is deposited and the arrangements for the holding of this *money*.

[**Note:** article 18(3) of the *MiFID implementing Directive*]

- 7.13.9 G *Firms* should ensure that their consideration of a *CRD credit institution*, bank or *qualifying money market fund* under CASS 7.13.8R focuses on the specific legal entity in question and not simply that *person's* group as a whole.
- 7.13.10 R When a *firm* makes the selection, appointment and conducts the periodic review of a *CRD credit institution*, a bank or a *qualifying money market fund*, it must take into account:
- (1) the expertise and market reputation of the third party; and
 - (2) any legal requirements or market practices related to the holding of *client money* that could adversely affect *clients'* rights.
- [**Note:** article 18(3) of the *MiFID implementing Directive*]
- 7.13.11 G In complying with CASS 7.13.8R and CASS 7.13.10R, a *firm* should consider, as appropriate, together with any other relevant matters:
- (1) the capital of the *CRD credit institution* or bank;
 - (2) the amount of *client money* placed, as a proportion of the *CRD credit institution* or bank's capital and deposits, and, in the case of a *qualifying money market fund*, compared to any limit the fund may place on the volume of redemptions in any period;
 - (3) the extent to which *client money* that the *firm* deposits or holds with any *CRD credit institution* or bank incorporated outside the *UK* would be protected under a deposit protection scheme in the relevant jurisdiction;
 - (4) the credit-worthiness of the *CRD credit institution* or bank; and
 - (5) to the extent that the information is available, the level of risk in the investment and loan activities undertaken by the *CRD credit institution* or bank and *affiliated companies*.

Client bank accounts

- 7.13.12 R A *firm* must take the necessary steps to ensure that *client money* deposited, in accordance with CASS 7.13.3R, in a central bank, a *credit institution*, a bank authorised in a third country or a *qualifying money market fund* is held in an account or accounts identified separately from any accounts used to hold *money* belonging to the *firm*.
- [**Note:** article 16(1)(e) of the *MiFID implementing Directive*]
- 7.13.13 R
- (1) An account which the *firm* uses to deposit *client money* under CASS 7.13.3R(1) to (3) must be a *client bank account*.
 - (2) Each *client bank account* used by a *firm* must be held on terms under which:

- (a) the relevant bank's contractual counterparty is the *firm* that is subject to the requirement under CASS 7.13.3R; and
- (b) unless the *firm* has agreed terms that comply with CASS 7.13.13R(3), the *firm* is able to make withdrawals of *client money* promptly and, in any event, within one *business day* of a request for withdrawal.

Transitional provision CASS TP 1.1.10AR applies to (2).

- (3) *Firms* may use *client bank accounts* held on terms under which withdrawals are, without exception, prohibited until the expiry of a fixed term or a notice period of a maximum of 30 days.
 - (4) Paragraphs (2)(b) and (3) do not apply in respect of *client money* received by a *firm* in its capacity as a *trustee firm*.
- 7.13.14 G CASS 7.13.13R(2)(b) and (3) do not prevent a *firm* from depositing *client money* on terms under which a withdrawal may be made before the expiry of a fixed term or a notice period (whatever the duration), including where such withdrawal would incur a penalty charge to the *firm*.
- 7.13.15 G CASS 7.13.13R does not prevent a *firm* from depositing *client money* in overnight money market deposits which are clearly identified as being *client money* (for example, in the *client bank account* acknowledgment letter).
- 7.13.16 G *Firms* are reminded of their obligations under CASS 7.18 (Acknowledgment letters) for *client bank accounts*. *Firms* should also ensure that *client bank accounts* meet the requirements in the relevant *Glossary* definitions, including regarding the titles given to the accounts.
- 7.13.17 G A *firm* may open one or more *client bank accounts* in the form of a *general client bank account*, a *designated client bank account* or a *designated client fund account* (see CASS 7A.2.1G (Failure of the authorised firm: primary pooling event)). The requirements of CASS 7.13.13R (2) and (3) apply for each type of *client bank account*.
- 7.13.18 G A *designated client bank account* may be used for a *client* only where that *client* has consented to the use of that account. If a *firm* deposits *client money* into a *designated client bank account* then, in the event of a *secondary pooling event* in respect of the relevant bank, the account will not be pooled with any *general client bank account* or *designated client fund account*.
- 7.13.19 G A *designated client fund account* may be used for a *client* only where that *client* has consented to the use of that account and all other *designated client fund accounts* which may be pooled with it. For example, a *client* who consents to the use of bank A and bank B should have his *money* held in a different *designated client fund account* at bank B from a *client* who has consented to the use of banks B and C. If a *firm* deposits *client money* into a *designated client fund account* then, in the event of a *secondary pooling*

event in respect of the relevant bank, the account will not be pooled with any *general client bank account* or *designated client bank account*.

Diversification of client money

- 7.13.20 R Notwithstanding the requirement at CASS 7.13.22R a *firm* must limit the funds that it deposits or holds with a relevant group entity or combination of such entities so that the value of those funds do not at any point in time exceed 20 per cent of the total of all the *client money* held by the *firm* in its *client bank accounts*.
- 7.13.21 R For the purpose of CASS 7.13.20R an entity is a relevant group entity if it is:
- (1) a *CRD credit institution* or a bank authorised in a third country; and
 - (2) a member of the same *group* as that *firm*.
- 7.13.22 R Subject to the requirement at CASS 7.13.20R, and in accordance with *Principle 10* and CASS 7.12.1R, a *firm* must:
- (1) periodically assess whether it is appropriate to diversify (or further diversify) the third parties with which it deposits some or all of the *client money* that the *firm* holds; and
 - (2) whenever it concludes that it is appropriate to do so, it must make adjustments accordingly to the third parties it uses and to the amounts of *client money* deposited with them.
- 7.13.23 G In complying with the requirement in CASS 7.13.22R to periodically assess whether diversification (or further diversification) is appropriate, a *firm* should have regard to:
- (1) whether it would be appropriate to deposit *client money* in *client bank accounts* opened at a number of different third parties;
 - (2) whether it would be appropriate to limit the amount of *client money* the *firm* holds with third parties that are in the same *group* as each other;
 - (3) whether risks arising from the *firm's* business models create any need for diversification (or further diversification);
 - (4) the market conditions at the time of the assessment; and
 - (5) the outcome of any due diligence carried out in accordance with CASS 7.13.8R and CASS 7.13.10R.
- 7.13.24 G The *rules* in SUP 16.14 provide that CASS *large firms* and CASS *medium firms* must report to the *FCA* in relation to the identity of the entities with which they deposit *client money* and the amounts of *client money* deposited with those entities. The *FCA* will use that information to monitor compliance with the diversification *rule* in CASS 7.13.20R.

- 7.13.25 R (1) A *firm* must make a record of the grounds upon which it satisfies itself as to the appropriateness of its selection and appointment of a bank or a *qualifying money market fund* under CASS 7.13.8R. The *firm* must make the record on the date it makes the selection or appointment and must keep it from that date until five years after the *firm* ceases to use that particular *person* for the purposes of depositing *client money* under CASS 7.13.3R.
- (2) A *firm* must make a record of each periodic review of its selection and appointment of a bank or a *qualifying money market fund* that it conducts under CASS 7.13.8R, its considerations and conclusions. The *firm* must make the record on the date it completes the review and must keep it from that date until five years after the *firm* ceases to use that particular *person* for the purposes of depositing *client money* under CASS 7.13.3R.
- (3) A *firm* must make a record of each periodic review that it conducts under CASS 7.13.22R, its considerations and conclusions. The *firm* must make the record on the date it completes out the review and must keep it for five years from that date.

Qualifying money market funds

- 7.13.26 R Where a *firm* deposits *client money* with a *qualifying money market fund*, the *firm's* holding of those units in that fund will be subject to any applicable requirements of the *custody rules*.
- [**Note:** recital 23 to the *MiFID implementing Directive*]
- 7.13.27 G A *firm* that places *client money* in a *qualifying money market fund* should ensure that it has the *permissions* required to invest in and hold units in that fund and must comply with the *rules* that are relevant for those activities.
- 7.13.28 R A *firm* must give a *client* the right to oppose the placement of his *money* in a *qualifying money market fund*.
- [**Note:** article 18(3) of the *MiFID implementing Directive*]
- 7.13.29 G If a *firm* that intends to place *client money* in a *qualifying money market fund* is subject to the requirement to disclose information before providing services, it should, in compliance with that obligation, notify the *client* that:
- (1) *money* held for that *client* will be held in a *qualifying money market fund*; and
 - (2) as a result, the *money* will not be held in accordance with the *client money rules*; and
 - (3) if it is the case, that the *units* will be held as the *client's safe custody assets* in accordance with the *custody rules*.

Segregation in different currency

- 7.13.30 R A *firm* may segregate *client money* in a different currency from that in which it was received or in which the *firm* is liable to the relevant *client*. If it does so the *firm* must ensure that the amount held is adjusted each *day* to an amount at least equal to the original currency amount (or the currency in which the *firm* has its liability to its *clients*, if different), translated at the previous day's closing spot exchange rate.

Mixed remittance

- 7.13.31 R Except in the circumstances described in CASS 7.13.72R(1)(a), where a *firm* using the normal approach receives a *mixed remittance* it should:
- (1) in accordance with CASS 7.13.6R, take necessary steps to ensure the *mixed remittance* is paid directly into a *client bank account*; and
 - (2) promptly and, in any event no later than one *business day* after the payment of the *mixed remittance* into the *client bank account* has cleared, pay the *money* that is not *client money* out of the *client bank account*.

Physical receipts of client money

- 7.13.32 R Where a *firm* receives *client money* in the form of cash, a cheque or other payable order, it must:
- (1) pay the *money* in accordance with CASS 7.13.6R, promptly, and no later than on the *business day* after it receives the *money* into a *client bank account*, unless either:
 - (a) the *money* is received by a business line for which the *firm* uses the alternative approach, in which case the *money* must be paid into the *firm's* own bank account promptly, and no later than on the *business day* after it receives the *money*; or
 - (b) the *firm* is unable to meet the requirement in (1) because of restrictions under the *regulatory system* or law regarding the receipt and processing of *money*, in which case the *money* must be paid in accordance with CASS 7.13.6R as soon as possible;
 - (2) if the *firm* holds the *money* in the meantime before paying it in accordance with CASS 7.13.6R (or in the case of (1)(a), into its own bank account), hold it in a secure location in accordance with *Principle 10*; and
 - (3) in any case, record the receipt of the *money* in the *firm's* books and records in accordance with CASS 7.15 (Records, accounts and reconciliations).

- 7.13.33 R Where a *firm* receives *client money* in the form of a cheque that is dated with a future date, unless the *firm* returns the cheque it must:
- (1) pay the *money* in accordance with CASS 7.13.6R, promptly, and no later than the date on the cheque if the date is a *business day* or the next *business day* after the date on the cheque;
 - (2) in the meantime, hold it in a secure location in accordance with *Principle 10*; and
 - (3) record the receipt of the *money* in the *firm's* books and records in accordance with CASS 7.15 (Records, accounts and reconciliations).

Appointed representatives, tied agents, field representatives and other agents

- 7.13.34 R A *firm* must ensure that *client money* received by its *appointed representatives, tied agents, field representatives* or other agents is:
- (1) received directly into a *client bank account* of the *firm*, where this would have been required if such *client money* had been received by the *firm* otherwise than through its *appointed representatives, tied agents, field representatives* or other agents (see CASS 7.13.6R and CASS 7.13.7G); or
 - (2) if it is received in the form of a cheque or other payable order:
 - (a) paid into a *client bank account* of the *firm* promptly and, in any event, no later than the next *business day* after receipt; or
 - (b) forwarded to the *firm* or, in the case of a *field representative*, forwarded to a specified business address of the *firm*, to ensure that the *money* arrives at the specified business address promptly and, in any event, no later than the close of the third *business day*.

- 7.13.35 G Under CASS 7.13.34R(2)(b), *client money* received on *business day* one should be forwarded to the *firm* or specified business address of the *firm* promptly and, in any event, no later than the next *business day* after receipt (*business day* two) in order for it to reach that *firm* or specified business address by the close of the third *business day*. Procedures requiring the *client money* in the form of a cheque to be sent to the *firm* or the specified business address of the *firm* by first class post and, in any event, no later than the next *business day* after receipt, would fulfil CASS 7.13.34R (2)(b).

Allocation of client money receipts

- 7.13.36 R (1) A *firm* must allocate any *client money* it receives to an individual *client* promptly and, in any case, no later than ten *business days* following the receipt (or where subsequent to the receipt of *money*

it has identified that the *money*, or part of it, is *client money* under CASS 7.13.37R, no later than ten *business days* following that identification).

- (2) Pending a *firm's* allocation of a *client money* receipt to an individual *client* under (1), it must record the received *client money* in its books and records as “unallocated client money”.

- 7.13.37 R If a *firm* receives money (either in a *client bank account* or an account of its own) which it is unable to immediately identify as *client money* or its own *money*, it must:
- (1) take all necessary steps to identify the *money* as either *client money* or its own *money*;
 - (2) if it considers it reasonably prudent to do so, given the risk that *client money* may not be adequately protected if it is not treated as such, treat the entire balance of *money* as *client money* and record the *money* in its books and records as “unidentified client money” while it performs the necessary steps under (1).

- 7.13.38 G If a *firm* is unable to identify *money* that it has received as either *client money* or its own *money* under CASS 7.13.37R, it should consider whether it would be appropriate to return the *money* to the person who sent it or to the source from where it was received, for example, the banking institution).

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 is liable to pay money to a *client* should 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*.

- 7.13.40 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*.

Prudent segregation

- 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* is *client money* for the purposes of the *client money rules* and the *client money distribution rules*.

- 7.13.42 G A *firm* must make and retain an up-to-date record of all payments made under CASS 7.13.41R. (See further CASS 7.13.50R to 7.13.53R: the prudent segregation record.)
- 7.13.43 R If a *firm* intends to pay its own *money* into a *client bank account* under CASS 7.13.41R it must establish a written policy that is approved by its *governing body* (and retain such policy for a period of at least five years after the date it ceases to retain such *money* in a *client bank account* under CASS 7.13.41R) detailing:
- (1) the specific anticipated risks in relation to which it would be prudent for the *firm* to make such payments into a *client bank account*;
 - (2) why the *firm* considers that the use of such a payment is a reasonable means of protecting *client money* against each of the risks set out in the policy; and
 - (3) the method that the *firm* will use to calculate the amount required to address each risk set out in the policy.
- 7.13.44 R The *firm* may amend its written policy to reflect changes in the specific anticipated risks in relation to which it would be prudent for the *firm* to make payments into a *client bank account* under CASS 7.13.41R.
- 7.13.45 R The *firm's* written policy must not conflict with the *client money rules* or the *client money distribution rules*. If there is a conflict, the *client money rules* and the *client money distribution rules* will prevail.
- 7.13.46 G In the event the *firm* faces a risk not contemplated under its current policy it will not be prevented from prudently segregating *money* as *client money* in accordance with these *rules* but the policy must be created or amended, as applicable, as soon as reasonably practicable.
- 7.13.47 G Examples of the types of risks that a *firm* may wish to provide protection for under CASS 7.13.41R include systems failures and business that is conducted on non-*business days* where the *firm* would be unable to pay any anticipated *shortfall* into its *client bank accounts*.
- 7.13.48 R To the extent that the *firm* no longer considers it prudent to retain *money* in its *client bank account* pursuant to CASS 7.13.41R in order to ensure that *client money* is protected, the *firm* may cease to treat that *money* as *client money*.
- 7.13.49 R Any *money* that the *firm* ceases to treat as *client money* pursuant to CASS 7.13.48R must be withdrawn from its *client bank account* as an excess under CASS 7.15.29R as part of its next reconciliation.

Prudent segregation record

- 7.13.50 R A *firm* must create and keep up-to-date records so that the amount of *money*

paid into *client bank accounts* and retained as *client money* pursuant to CASS 7.13.41R or withdrawn pursuant to CASS 7.13.49R, and the reasons for such payment, retention and withdrawal can be easily ascertained (the *prudent segregation record*).

- 7.13.51 R The *prudent segregation record* must record:
- (1) the outcome of the *firm's* calculation of its *prudent segregation*;
 - (2) the amounts paid into or withdrawn from a *client bank account* pursuant to CASS 7.13.41R or CASS 7.13.49R;
 - (3) why each payment or withdrawal is made;
 - (4) in respect of the *firm's* written policy required by CASS 7.13.43R the *firm* must record, as applicable, either:
 - (a) that the payment or withdrawal is made in accordance with that policy; or
 - (b) that the policy will be created or amended to include the reasons for this payment or withdrawal;
 - (5) that the *money* was paid by the *firm* in accordance with CASS 7.13.41R or withdrawn by the *firm* in accordance with CASS 7.13.49R; and
 - (6) the up-to-date total amount of *client money* held pursuant to CASS 7.13.41R.
- 7.13.52 G *Firms* are reminded that payments and records made in accordance with CASS 7.13.51R should not be used as a substitute for a *firm* keeping accurate and timely records in accordance with CASS 7.15 (Records, accounts and reconciliations) and requirements under SYSC 4.1.1R (General requirements) and SYSC 6.1.1R (Compliance).
- 7.13.53 R The *prudent segregation record* must be retained for five years after the *firm* ceases to retain *money* as *client money* pursuant to CASS 7.13.41R.

The alternative approach to client money segregation

- 7.13.54 G (1) In certain circumstances, use of the normal approach for a particular business line of a *firm* could lead to significant operational risks to *client money* protection. These may include a business line under which *clients'* transactions are complex, numerous, closely related to the *firm's* proprietary business and/or involve a number of currencies and time zones. In such circumstances, subject to meeting the relevant criteria and fulfilling the relevant notification and audit requirements, a *firm* may use the alternative approach to segregating *client money* for that business line.

- (2) Under the alternative approach, *client money* is received into and paid out of a *firm's* own bank account. A *firm* that adopts the alternative approach to segregating *client money* should (in line with CASS 7.15.16R(2)) carry out an *internal client money reconciliation* on each *business day* ('T0') and calculate how much *money* it either needs to withdraw from, or place in from its own bank account or its *client bank account* as a result of any discrepancy arising between its *client money requirement* and its *client money resource* as at the close of business on the previous *business day* ('T-1').
- (3) The *alternative approach mandatory prudent segregation* required under CASS 7.13.65R is designed to address the risks that:
- (a) *client money* in a *firm's* own bank account may not be available to be pooled for distribution to *clients* on the occurrence of a *primary pooling event*; and
 - (b) at the time of a *primary pooling event* the *firm* may not have segregated in its *client bank account* a sufficient amount of *client money* to meet its *client money requirement*.
- 7.13.55 R A *firm* that wishes to adopt the alternative approach for a particular business line must first establish, and document in writing, its reasons for concluding, that:
- (1) adopting the normal approach would lead to greater operational risks to *client money* protection compared to the alternative approach;
 - (2) adopting the alternative approach (including complying with the requirements for *alternative approach mandatory prudent segregation* under CASS 7.13.65R), would not result in undue operational risk to *client money* protection; and
 - (3) the *firm* has systems and controls that are adequate to enable it to operate the alternative approach effectively and in compliance with *Principle 10* (Clients' assets).
- 7.13.56 R A *firm* must retain any documents created under CASS 7.13.55R in relation to a particular business line for a period of at least five years after the date it ceases to use the alternative approach in connection with that business line.
- 7.13.57 R At least three *months* before adopting the alternative approach for a particular business line, a *firm* must:
- (1) inform the *FCA* in writing that it intends to adopt the alternative approach for that particular business line; and
 - (2) if requested by the *FCA*, make any documents it created under

CASS 7.13.54R available to the *FCA* for inspection.

- 7.13.58 R (1) In addition to the requirement under CASS 7.13.57R, before adopting the alternative approach, a *firm* must send a written report to the *FCA* prepared by an independent auditor of the *firm* in line with a *reasonable assurance engagement*, stating the matters set out in (2).
- (2) The written report in (1) must state whether, in the auditor's opinion:
- (a) the *firm's* systems and controls are suitably designed to enable it to comply with CASS 7.13.62R to CASS 7.13.65R; and
- (b) the *firm's* calculation of its *alternative approach mandatory prudent segregation* amount under CASS 7.13.65R is suitably designed to enable the *firm* to comply with CASS 7.13.65R.
- 7.13.59 R (1) A *firm* that uses the alternative approach must review, at least on an annual basis and with no more than one year between each review, whether its reasons for adopting the alternative approach for a particular business line, as documented under CASS 7.13.55R, continue to be valid.
- (2) If, following the review in (1), a *firm* finds that its reasons for adopting the alternative approach are no longer valid for a particular business line, it must stop using the alternative approach for that business line as soon as reasonably practicable, and in any event within six months of the conclusion of its review in (1).
- 7.13.60 R A *firm* that uses the alternative approach must not materially change how it will calculate and maintain the *alternative approach mandatory prudent segregation* amount under CASS 7.13.65R unless:
- (1) an auditor of the *firm* has prepared a report that complies with the requirements in CASS 7.13.58R(2)(b) in respect of the *firm's* proposed changes; and
- (2) the *firm* provides a copy of the report prepared by the auditor under (a) to the *FCA* before implementing the change.
- 7.13.61 G A *firm* is reminded that, under SUP 3.4.2R, it must take reasonable steps to ensure that its auditor has the required skill, resources and experience to perform its function.
- 7.13.62 R A *firm* that uses the alternative approach for a particular business line must, on each *business day* ('T0'):
- (1) receive any *money* from and pay any *money* to (or, in either case,

on behalf of) *clients* into and out of its own bank accounts;

- (2) perform the necessary reconciliations of records and accounts required under CASS 7.15 (Records, accounts and reconciliations);
- (3) adjust the balances held in its *client bank account* (by effecting transfers between its own bank account and its *client bank account*) to address any difference arising between its *client money requirement* and its *client money resource* as at the close of business on the previous *business day* ('T-1'), so that the correct amount reflected in the reconciliations under (2) is segregated in its *client bank account*; and
- (4) subject to CASS 7.13.63R below, keep segregated in its *client bank account* the balance held under (3) until it has performed a reconciliation on the following *business day* ('T+1') and as a result of that reconciliation is undertaking further adjustments under (3).

7.13.63 R During the period between the adjustment in CASS 7.13.62R(3) and the completion of the next reconciliations in CASS 7.13.62R(2), a *firm* that uses the alternative approach for a particular business line may:

- (1) increase the balance held in its *client bank account* by making intra-day transfers (during T0) from its own bank account to its *client bank account* before the completion of the internal *client money* reconciliation under CASS 7.13.62R(2) (that is expected sometime later on T0) only if:
 - (a) the *firm* reasonably expects that the *client money requirement* for the previous *business day* (T-1) will increase above the *client money resource* currently (during T0) held in its *client bank account*; and
 - (b) such reasonable expectations are based on the working calculation of the *client money requirement* relating to the previous *business day* (T-1) that the *firm* has already determined on that *business day* (during T0) (as part of the process of completing its internal *client money* reconciliation); or
- (2) decrease the balance held in its *client bank account* by making intra-day transfers (during T0) from its *client bank account* to its own bank account before the completion of the internal *client money* reconciliation under CASS 7.13.62R (2) (that is expected sometime later on T0) only if:
 - (a) the *firm* reasonably expects that the *client money requirement* for the previous *business day* (T-1) will decrease below the *client money resource* currently held (during T0) in its *client bank account*; and

- (b) such reasonable expectations are based on the working calculation of the *client money requirement* relating to the previous *business day* (T-1) that the *firm* has already determined on that *business day* (during T0) (as part of the process of completing its *internal client money reconciliation*).

However, in doing so, a *firm* must act prudently and should take appropriate steps to manage the risk of not having segregated an amount that appropriately reflects its actual *client money requirement* at any given time.

- 7.13.64 G It is anticipated that CASS 7.13.63R may be used by *firms* which maintain *client bank accounts* in a number of different time zones and making adjustments to the balances of those *client bank accounts* is dependent on meeting cut off times for money transfers in those time zones.
- 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*.
- (2) The amount required to be segregated under this *rule* must be an amount that a *firm* reasonably determines would be sufficient, at the time it makes the determination, to protect *client money* against the risk that at any time in the following three months the following categories of *client money* may not have been fully segregated in its *client bank account* or may not be (or become) available for pooling under CASS 7A.2.4R(1), were a *primary pooling event* to occur:
- (a) *client money* that is received and held by the *firm* in its own bank account during the period between:
- (i) the *firm's* adjustment of *client bank account* balances under CASS 7.13.62R(3) on a particular *business day*; and
- (ii) the *firm's* subsequent adjustments under CASS 7.13.62R(3) on the following *business day*; and
- (b) *money* received and held by the *firm* in its own bank account which the *firm* does not initially identify as part of its *client money requirement*, but which subsequently does become part of its *client money requirement*;

with the effect that the *firm's alternative approach mandatory prudent segregation* under this *rule* will reduce, as far as possible,

any *shortfall* that might have been produced as a result of (a) or (b) on the occurrence of a *primary pooling event*.

- (3) (a) Subject to (c), in reaching its determination under (2) of the amount of *money* that would be sufficient to address the risks referred to in (2) for the forthcoming three months, a *firm* must take into account the following in respect of each business line for which it uses the alternative approach, and for at least the previous three months:
- (i) the *firm's client money requirement* over the course of that prior period (excluding any amount that was required to be segregated under this *rule* during that prior period for the purposes of *alternative approach mandatory prudent segregation*);
 - (ii) the daily adjustment payments that the *firm* made into its *client bank account* under CASS 7.13.62R(3) during that prior period; and
 - (iii) the amount of *money* received by the *firm* in its own bank account which it did not initially identify as part of its *client money requirement*, but which subsequently, and during that prior period, became part of its *client money requirement*;
- as shown in its internal records.
- (b) In reaching its determination under (2) a *firm* must also take into account, but at all times having regard to the requirement under (2), any impact that particular events, the seasonal nature of each relevant business line, or any other aspect of those business lines may have on:
- (i) the *firm's client money requirement* during the forthcoming three months for which the amount of *alternative approach mandatory prudent segregation* required under this *rule* is being determined;
 - (ii) the daily adjustment payments that the *firm* is likely to make into its *client bank account* under CASS 7.13.62R(3) in that same period; and
 - (iii) the amount of unidentified receipts of *money* that the *firm* is likely to receive into its own bank account and which will subsequently, in that same period, become part of its *client money requirement*.
- (c) If, at the time of its determination under (2), the *firm* has not

been trading for three months in a business line for which it is using the alternative approach, then it must use the records that are available to it and must also factor in reasonable forecasts, as required under (b), to establish a three-month reference period.

- (4) (a) A *firm* must, at regular intervals that are at least quarterly, repeat and complete the combined process of:
- (i) determining the amount that it is required to segregate for the purposes of *alternative approach mandatory prudent segregation* under (2) and (3);
 - (ii) making necessary adjustments to its records to reflect any changes to its *client money requirement* (in accordance with CASS 7.16.16R(3) and CASS 7.16.17R(2)); and
 - (iii) paying any additional amounts of its own *money* into its *client bank account* to increase the *firm's alternative approach mandatory prudent segregation* or withdrawing any excess amounts from its *client bank account* to decrease the *firm's alternative approach mandatory prudent segregation* after it has adjusted its records under (ii).
- (b) The combined process of (a)(i) to (iii) must take no longer than ten *business days*.
- (c) To the extent that a *firm's* compliance with (a)(i) and (ii) results in there being an excess in the *firm's client bank account*, the *firm* may cease to treat that *money* as *client money*.
- (5) A *firm* must ensure that the individual responsible for CASS oversight under CASS 1A.3.1R, CASS 1A.3.1AR or CASS 1A.3.1CR (as appropriate) reviews the adequacy of the amount of the *firm's alternative approach mandatory prudent segregation* maintained under this *rule* at least annually.

Alternative approach mandatory prudent segregation record

- 7.13.66 R A *firm* must create and keep up-to-date records so that any amount of *money* that is, pursuant to CASS 7.13.65R:
- (1) paid into a *client bank account* and retained as *client money*; or
 - (2) withdrawn from a *client bank account*;
- can be easily ascertained (the *alternative approach mandatory prudent*

segregation record).

- 7.13.67 R The alternative *approach mandatory prudent segregation record* under CASS 7.13.66R must record:
- (1) the date of the first determination under CASS 7.13.65R(2) and each subsequent review undertaken under CASS 7.13.65R(4), and the total amount that the *firm* determined was required to be segregated under CASS 7.13.65R(2) as at that date;
 - (2) the date of any payment of the *firm's* own money into a *client bank account*, or withdrawal of any excess from a *client bank account* under CASS 7.13.65R, and for each such occasion:
 - (a) the amount of the payment or withdrawal;
 - (b) the fact that the *money* was paid or withdrawn by the *firm* in accordance with CASS 7.13.65R; and
 - (c) as at that date, the total amount actually segregated by the *firm* under CASS 7.13.65R.

- 7.13.68 R The *alternative approach mandatory prudent segregation record* must be retained for five years after the *firm* ceases to segregate any *money* in accordance with CASS 7.13.65R.

- 7.13.69 G Nothing in CASS 7.13.54G to CASS 7.13.68R prevents a *firm* from also making use of the *prudent segregation* rule in CASS 7.13.41R.

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

- 7.13.70 G CASS 7.13.72R sets out the circumstances under which a *firm*, that would otherwise be required to comply with the requirement in CASS 7.13.6R to receive *client money* directly into a *client bank account*, must receive *client money* into its own bank account.

- 7.13.71 R A *firm* that is also a *clearing member* that is using the normal approach in connection with *regulated clearing arrangements* must use reasonable endeavours to ensure it is not required under its arrangements with an *authorised central counterparty* to receive *mixed remittances* from or pay *mixed remittances* to the *authorised central counterparty* through a single bank account.

- 7.13.72 R
- (1) If, notwithstanding its reasonable endeavours in accordance with CASS 7.13.71R, the *firm* is required under its arrangements with an *authorised central counterparty* to:
 - (a) receive *mixed remittances* into a single bank account and pay *mixed remittances* to the *authorised central counterparty* from that bank account; or

- (b) pay *mixed remittances* to the *authorised central counterparty* using a single bank account;

it must comply, as applicable, with (2) and CASS 7.13.73R.

- (2) (a) In either or both of the circumstances described in (1), the *firm* must pay any *mixed remittances* from its own bank account.
- (b) Where, in the circumstances described in (1)(a) *mixed remittances* from an *authorised central counterparty* are received into a *firm's* own account it must transfer the *client money* element of the *mixed remittance* to its *client bank account* promptly and, in any event, no later than the next *business day* after receipt.

- 7.13.73 R (1) Where the circumstances described in CASS 7.13.72(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*.
- (2) The amount required to be segregated under this *rule* must be an amount that a *firm* reasonably determines would be sufficient, at the time it makes the determination, to protect *client money* against the risk that at any time in the following three months *client money* received from the *authorised central counterparty* and held by the *firm* in its own bank account following receipt of these monies under CASS 7.13.72R(1)(a) and until their transfer in accordance with CASS 7.13.72R(2)(b) may not have been fully segregated in its *client bank account* or may not be (or become) available for pooling under CASS 7A.2.4R(1), were a *primary pooling event* to occur with the effect that the *firm's clearing arrangement mandatory prudent segregation* under this *rule* will reduce, as far as possible, any *shortfall* that might have been produced as a result of this risk on the occurrence of a *primary pooling event*.
- (3) (a) Subject to (c), in reaching its determination under (2) of the amount of *money* that would be sufficient to address the risks referred to in (2) for the forthcoming three months, a *firm* must take into account the following for at least the previous three months:
- (i) the *firm's client money requirement* over the course of that prior period (excluding any amount that was required to be segregated under this *rule* during that prior period for the purposes of *clearing arrangement mandatory prudent segregation*); and

- (ii) the payments that the *firm* made into its *client bank account* under CASS 7.13.72R(2)(b) during that prior period;

as shown in its internal records.

- (b) In reaching its determination under (2) a *firm* must also take into account, at all times having regard to the requirement under (2), any impact that particular events, the seasonal nature of each relevant business line, or any other aspect of those business line(s) may have on:
 - (i) the *firm's client money requirement* during the forthcoming three months for which the amount of *clearing arrangement mandatory prudent segregation* required under this *rule* is being determined; and
 - (ii) the payments that the *firm* is likely to make into its *client bank account* under CASS 7.13.72R(2)(b).
- (c) If, at the time of its determination under (2), the *firm* has not been trading for three months in a business line for which it is using the normal approach in connection with *regulated clearing arrangements*, then it must use the records that are available to it and must also factor in reasonable forecasts, as required under (b), to make up a three-month reference period.
- (4) (a) A *firm* must, at regular intervals that are at least quarterly, repeat and complete the combined process of:
 - (i) determining the amount that it is required to segregate for the purposes of *clearing arrangement mandatory prudent segregation* under (2) and (3);
 - (ii) making necessary adjustments to its records to reflect any changes to its *client money requirement* in accordance with CASS 7.16.16R(3) and CASS 7.16.17R(1); and
 - (iii) paying any additional amounts of its own *money* into its *client bank account* to increase the *firm's clearing arrangement mandatory prudent segregation* or withdrawing any excess amounts from its *client bank account* to decrease the *firm's clearing arrangement mandatory prudent segregation* after it has adjusted its records under (ii).
- (b) The combined process of (a)(i) to (iii) must take no longer

than ten *business days*.

- (c) To the extent that a *firm's* compliance with (a)(i) and (ii) results in there being an excess in the *firm's client bank account*, the *firm* may cease to treat that *money* as *client money*.
- (5) A *firm* must ensure that the individual responsible for CASS oversight under CASS 1A.3.1R, CASS 1A.3.1AR or CASS 1A.3.1CR (as appropriate) reviews the adequacy of the amount of the *firm's clearing arrangement mandatory prudent segregation* maintained under this *rule* at least annually.

Clearing arrangement mandatory prudent segregation record

- 7.13.74 R A *firm* must create and keep up-to-date records so that any amount of *money* that is, pursuant to CASS 7.13.73R:
- (1) paid into a *client bank account* and retained as *client money*; or
 - (2) withdrawn from a *client bank account*;
- can be easily ascertained (the *clearing arrangement mandatory prudent segregation record*).
- 7.13.75 R The *clearing arrangement mandatory prudent segregation record* under CASS 7.13.74R must record:
- (1) the date of the first determination under CASS 7.13.73R(2) and each subsequent review undertaken under CASS 7.13.73R(4), and the total amount that the *firm* determined was required to be segregated under CASS 7.13.73R(2) as at that date;
 - (2) the date of any payment of the *firm's own money* into a *client bank account*, or withdrawal of any excess from a *client bank account* under CASS 7.13.73R(4)(a)(iii), and for each such occasion:
 - (a) the amount of the payment or withdrawal;
 - (b) the fact that the *money* was paid or withdrawn by the *firm* in accordance with CASS 7.13.73R; and
 - (c) as at that date, the total amount actually segregated by the *firm* under CASS 7.13.73R.
- 7.13.76 R The *clearing arrangement mandatory prudent segregation record* must be retained for five years after the *firm* ceases to segregate any *money* in accordance with CASS 7.13.73R.
- 7.13.77 G Nothing in CASS 7.13.73R to CASS 7.13.76R prevents a *firm* from making use of the prudent segregation rule in CASS 7.13.41R.

7.13.78 G The obligation to use reasonable endeavours referred to in CASS 7.13.71R is a continuing obligation. *Firms* should assess, at least on an annual basis, whether it is possible for payments of *client money* between the *firm* and the *authorised central counterparties* to be made separately from house monies and for such payments to be received into and made from its *client bank accounts*.

7.13.79 G Where a *firm* operates a *sub-pool* in accordance with CASS 7.19 (Clearing member client money sub-pools), the references to *client bank accounts* in CASS 7.13.70G to CASS 7.13.78G should be read as *client bank accounts* pertaining to the relevant *sub-pool*.

7.14 Client money held by a third party

7.14.1 G This section sets out the requirements a *firm* must comply with when it allows another *person* to hold *client money*, other than under CASS 7.13.3R, without discharging its fiduciary duty to that *client*. Such circumstances arise when, for example, a *firm* passes *client money* to a *clearing house* in the form of margin for the *firm's* obligations to the *clearing house* that are referable to transactions undertaken by the *firm* for the relevant clients. They may also arise when a *firm* passes *client money* to an *intermediate broker* for *contingent liability investments* in the form of initial or variation margin on behalf of a *client*. In these circumstances, the *firm* remains responsible for that *client equity balance* held at the *intermediate broker* until the contract is terminated and all of that *client's* positions at that *broker* closed. Similarly, this section applies where a *firm* allows a broker to hold *client money* in respect of the *firm's client's non-margined transactions*, again without the *firm* discharging its fiduciary duty to that *client*. In all cases, if a *firm* wishes to discharge itself from its fiduciary duty, it should do so in accordance with the *rule* regarding the discharge of a *firm's* fiduciary duty to the *client* (CASS 7.11.34R).

7.14.2 R A *firm* may allow another *person*, such as an exchange, a *clearing house* or an *intermediate broker*, to hold *client money*, but only if:

- (1) the *firm* allows that *person* to hold the *client money*:
 - (a) for the purpose of one or more transactions for a *client* through or with that *person*; or
 - (b) to meet a *client's* obligation to provide collateral for a transaction (for example, an *initial margin* requirement for a *contingent liability investment*); and
- (2) in the case of a *retail client*, that *client* has been notified that the *firm* may allow the other *person* to hold its *client money*.

7.14.3 G *Client money* that a *firm* allows another person to hold under CASS 7.14.2R:

- (1) should only be held for transactions which are likely to occur (and for which the other *person* needs to receive *client money*) or have recently settled (and such that the other *person* has received *client money*); and
- (2) should be recorded in *client transaction accounts* by that other *person*.

7.14.4 G Apart from *client money* held by a *firm* in an *individual client account* or an *omnibus client account* at an *authorised central counterparty*, a *firm* should not hold excess *client money* in its *client transaction accounts*.

Client money arising from, or in connection with, safe custody assets

7.14.5 G (1) *Money* arising from, or in connection with, the holding of a *safe custody assets* by a *firm* which is due to *clients* should, unless treated otherwise under the *client money rules*, be treated as *client money* by the *firm*.

(2) *Firms* are reminded of the *guidance* in CASS 6.1.2G.

7.14.6 R If a *firm* has deposited *safe custody assets* with a third party under CASS 6.3 and *client money* arises from, or in connection with, those *safe custody assets* then the *firm* must ensure that the third party either deposits the money in a *client bank account* of the *firm* or records it in a *client transaction account* for the benefit of the *firm clients* as appropriate.

7.14.7 G *Firms* are reminded of the *guidance* in CASS 7.14.4G which is applicable to *client transaction accounts*.

7.14.8 G If the third party holding the *safe custody assets* under CASS 7.14.6R is a bank with which the *firm* is permitted to deposit *client money* under CASS 7.13.3R, then the *client bank account* referred to in CASS 7.14.6R may be an account with that bank.

7.14.9 G *Firms* are reminded of the requirements under CASS 7.18 for *acknowledgement letters*, which must be complied with before using *client bank accounts* and *client transaction accounts*.

7.15 Records, accounts and reconciliations

- 7.15.1 G (1) This section sets out the requirements a *firm* must meet when keeping records and accounts of the *client money* it holds.
- (2) Where a *firm* establishes one or more *sub-pools*, the provisions of CASS 7.15 (Records, accounts and reconciliations) shall be read as applying separately to the *firm's general pool* and each *sub-pool* in line with CASS 7.19.3R and CASS 7.19.4R.

- 7.15.2 R A *firm* must keep such records and accounts as are necessary to enable it, at any time and without delay, to distinguish *client money* held for one *client* from *client money* held for any other *client*, and from its own *money*.

[**Note:** article 16(1)(a) of the *MiFID implementing Directive*]

- 7.15.3 R A *firm* must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the *client money* held for *clients*.

[**Note:** article 16(1)(b) of the *MiFID implementing Directive*]

- 7.15.4 G The requirements in CASS 7.15.2R to CASS 7.15.3R are for a *firm* to keep internal records and accounts of *client money*. Therefore, any records falling under those requirements should be maintained by the *firm* and should be separate to any records the *firm* may have obtained from any third parties, such as those with or through whom it may have deposited, or otherwise allowed to hold, *client money*.

Record keeping

- 7.15.5 R (1) A *firm* must maintain records so that it is able to promptly determine the total amount of *client money* it should be holding for each of its *clients*.
- (2) A *firm* must ensure that its records are sufficient to show and explain its transactions and commitments for its *client money*.
- (3) Unless otherwise stated, a *firm* must ensure that any record made under the this chapter is retained for a period of five years starting from the later of:
- (a) the date it was created; and
 - (b) (if it has been modified since the date it was created), the date it was most recently modified.
- 7.15.6 G Unless required sooner under another *rule* in this chapter, in complying with CASS 7.15.5R(1) a *firm* should ensure it is able to determine the total amount of *client money* it should be holding for each *client* within two *business days* of having taken a decision to do so or at the request of the *FCA*.
- 7.15.7 R For each *internal client money reconciliation* and *external client money reconciliation* the *firm* conducts, it must ensure that it records:
- (1) the date it carried out the relevant process;
 - (2) the actions the *firm* took in carrying out the relevant process; and
 - (3) the outcome of its calculation of its *client money requirement* and

client money resource.

Policies and procedures

- 7.15.8 G *Firms* are reminded that they must, under SYSC 6.1.1R, establish, implement and maintain adequate policies and procedures sufficient to ensure compliance of the *firm* with the *rules* under this chapter. This should include, for example, establishing and maintaining policies and procedures concerning:
- (1) the frequency and method of the reconciliations the *firm* is required to carry out under this section;
 - (2) the resolution of reconciliation discrepancies under this section; and
 - (3) the frequency at which the *firm* is required to review its arrangements in compliance with this chapter.

Receipts of client money

- 7.15.9 R A *firm* must maintain appropriate records that account for all receipts of *client money* in the form of cash, cheque or other payable order that are not yet deposited in a *client bank account* (see CASS 7.13.32R and CASS 7.13.33R).
- 7.15.10 G *Firms* following one of the *standard methods of internal client money reconciliation* in CASS 7.16 are also reminded that they must, as part of their *internal client money reconciliation*, take into account all receipts of *client money* in the form of cash, cheque or other payable order that are not yet deposited in a *client bank account* (see CASS 7.13.32R and CASS 7.13.33R).

Payments made to discharge fiduciary duty

- 7.15.11 R If a *firm* draws a cheque, or other payable order, to discharge its fiduciary duty to its *clients*, it must continue to record its obligation to its *clients* until the cheque, or other payable order, is presented and paid by the bank.

Internal client money reconciliations

- 7.15.12 R An *internal client money reconciliation* requires a *firm* to carry out a reconciliation of its internal records and accounts of the amount of *client money* that the *firm* holds for each *client* with its internal records and accounts of the *client money* the *firm* should hold in *client bank accounts* or has placed in *client transaction accounts*.
- 7.15.13 R In carrying out an *internal client money reconciliation*, a *firm* must use the values contained in its internal records and ledgers (for example, its cash book or other internal accounting records) rather than the values contained in the records it has obtained from banks and other third parties with whom it has placed *client money* (for example, bank statements).

- 7.15.14 G An *internal client money reconciliation* should:
- (1) be one of the steps a *firm* takes to arrange adequate protection for *clients'* assets when the *firm* is responsible for them (see *Principle 10* (Clients' assets), as it relates to *client money*);
 - (2) be one of the steps a *firm* takes to satisfy its obligations under CASS 7.12.2R and CASS 7.15.3R and, where relevant, SYSC 4.1.1R(1) and SYSC 6.1.1R, to ensure the accuracy of the *firm's* records and accounts;
 - (3) for the normal approach to segregating *client money* (CASS 7.13.6R), check whether the amount of *client money* recorded in the *firm's* records as being segregated in *client bank accounts* meets the *firm's* obligations to its *clients* under the *client money rules* on a daily basis; and
 - (4) for the alternative approach to segregating *client money* (CASS 7.13.62R), calculate the amount of *client money* to be segregated in *client bank accounts* which meets the *firm's* obligations to its *clients* under the *client money rules* on a daily basis.
- 7.15.15 R (1) A *firm* must perform an *internal client money reconciliation*:
- (a) each *business day*; and
 - (b) based on the records of the *firm* as at the close of business on the previous *business day*.
- (2) When performing an *internal client money reconciliation*, a *firm* must, subject to (3), follow one of the *standard methods of internal client money reconciliation* in CASS 7.16.
- (3) A *firm* proposing to follow a *non-standard method of internal client money reconciliation* must comply with the requirements in CASS 7.15.17R to CASS 7.15.19G.
- 7.15.16 R (1) A *firm* which has adopted the normal approach to segregating *client money* (see CASS 7.13.6R) must use the *internal client money reconciliation* to check whether its *client money resource*, as at the close of business on the previous *business day*, was equal to its *client money requirement* at the close of business on that previous day.
- (2) A *firm* that adopts the alternative approach to segregating *client money* (see CASS 7.13.54G) must use the *internal client money reconciliation* to ensure that its *client money resource* as at the close of business on any *day* it carries out an *internal client money reconciliation* is equal to its *client money requirement* at the close of business on the previous day.

Non-standard method of internal client money reconciliation

- 7.15.17 R A *non-standard method of internal client money reconciliation* is a method of *internal client money reconciliation* which does not meet the requirements in CASS 7.16 (The standard methods of internal client money reconciliation).
- 7.15.18 R (1) Before using a *non-standard method of internal client money reconciliation*, a firm must:
- (a) establish and document in writing its reasons for concluding that the method of *internal client money reconciliation* it proposes to use will:
 - (i) (for the normal approach to segregating *client money*) check whether the amount of *client money* recorded in the firm's records as being segregated in *client bank accounts* meets the firm's obligation to its *clients* under the *client money rules* on a daily basis; or
 - (ii) (for the alternative approach to segregating *client money*) calculate the amount of *client money* to be segregated in *client bank accounts* which meets the firm's obligations to its *clients* under the *client money rules* on a daily basis;
 - (b) notify the FCA of its intentions to use a *non-standard method of internal client money reconciliation*; and
 - (c) send a written report to the FCA prepared by an independent auditor of the firm in line with a *reasonable assurance engagement* and stating the matters set out in (2).
- (2) The written report in (1)(c) must state whether in the auditor's opinion:
- (a) the method of *internal client money reconciliation* which the firm will use is suitably designed to enable it to (as applicable):
 - (i) (for the normal approach to segregating *client money*) check whether the amount of *client money* recorded in the firm's records as being segregated in *client bank accounts* meets the firm's obligation to its *clients* under the *client money rules* on a daily basis; or
 - (ii) (for the alternative approach to segregating *client money*) calculate the amount of *client money* to be segregated in *client bank accounts* which meets the firm's obligations to its *clients* under the *client money rules* on a daily basis; and
 - (b) the firm's systems and controls are suitably designed to

enable it to carry out the method of *internal client money reconciliation* the *firm* will use.

- (3) A *firm* using a *non-standard method of internal client money reconciliation* must not materially change its method of undertaking *internal client money reconciliations* unless:
- (a) the *firm* has established and documented in writing its reasons for concluding that the changed methodology will meet the requirements in (1)(a)(i) and (ii), as applicable;
 - (b) an auditor of the *firm* has prepared a report that complies with the requirements in (1)(c) and (2) in respect of the *firm's* proposed changes; and
 - (c) the *firm* provides a copy of the report prepared by the auditor under (2) to the *FCA* before implementing the change .

- 7.15.19 G A *firm* is reminded that, under *SUP 3.4.2R*, it must take reasonable steps to ensure that its auditor has the required skill, resources and experience to perform its function.

External client money reconciliations

- 7.15.20 R A *firm* must conduct, on a regular basis, reconciliations between its internal records and accounts and those of any third parties which hold *client money*.

[**Note:** article 16(1)(c) of the *MiFID implementing Directive*]

- 7.15.21 G The purpose of an *external client money reconciliation* is to ensure the accuracy of a *firm's* internal records and accounts against those of any third parties by whom *client money* is held.

Frequency of external client money reconciliations

- 7.15.22 R A *firm* must perform an *external client money reconciliation*:
- (1) as regularly as is necessary but without allowing more than one month to pass between each *external client money reconciliation*; and
 - (2) as soon as reasonably practicable after the date to which the *external client money reconciliation* relates.
- 7.15.23 R When determining the frequency at which it will undertake *external client money reconciliations*, a *firm* must have regard to:
- (1) the frequency, number and value of transactions which the *firm* undertakes in respect of *client money*; and
 - (2) the risks to which the *client money* is exposed, such as the nature, volume and complexity of the *firm's* business and where and with

whom *client money* is held.

- 7.15.24 R (1) A *firm* must make and retain records sufficient to show and explain any decision it has taken under CASS 7.15.23R when determining the frequency of its *external client money reconciliation*. Subject to (2), any such records must be retained indefinitely.
- (2) If any decision under CASS 7.15.23R is superseded by a subsequent decision under that *rule* then the record of that earlier decision retained in accordance with (1) need only be retained for a further period of five years from the subsequent decision.
- 7.15.25 G In most circumstances, *firms* which undertake transactions on a daily basis should conduct an *external client money reconciliation* each *business day*.
- 7.15.26 R (1) Subject to (3), a *firm* must review the frequency it conducts its *external client money reconciliations* at least annually to ensure that it continues to comply with CASS 7.15.22R and has given due consideration to the matters in CASS 7.15.23R.
- (2) For each review a *firm* undertakes under (1), it must record the date and the actions it took in reviewing the frequency of its *external client money reconciliations*.
- (3) A *firm* need not carry out a review under (1) if it is conducting *external client money reconciliations* each *business day*.

Method of external client money reconciliations

- 7.15.27 R An *external client money reconciliation* requires a *firm* to:
- (1) compare:
- (a) the balance, currency by currency, on each *client bank account* recorded by the *firm*, as set out in the most recent statement or other form of confirmation issued by the bank with which those accounts are held; and
- (b) the balance, currency by currency, on each *client transaction account* as recorded by the *firm*, as set out in the most recent statement or other form of confirmation issued by the *person* with whom the account is held; and
- (2) promptly identify and resolve any discrepancies between those balances under CASS 7.15.31R and CASS 7.15.32R.
- 7.15.28 R A *firm* must ensure it includes the following items within its *external client money reconciliation*:
- (1) any *client's approved collateral* a *firm* holds which secures an individual negative *client equity balance* (see CASS 7.16.32R); and

- (2) any of its own *approved collateral* a firm holds which is used to meet the total *margin transaction requirement* in CASS 7.16.33R.

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 ensure that:
- (1) any *shortfall* is paid into a *client bank account* by the close of business on the day that the reconciliation is performed; or
- (2) any excess is withdrawn from a *client bank account* within the same time period.
- 7.15.30 G Where the discrepancy identified under CASS 7.15.29R has arisen as a result of a breach of the *client money segregation requirements*, the *firm* should ensure it takes sufficient steps to avoid a reoccurrence of that breach (see *Principle 10* (Clients' assets), as it relates to *client money*, CASS 7.15.3R and, where relevant, SYSC 4.1.1R(1) and SYSC 6.1.1R).
- 7.15.31 R If any discrepancy is identified by an *external client money reconciliation*, the *firm* must investigate the reason for the discrepancy and take all reasonable steps to correct it without undue delay, unless the discrepancy arises solely as a result of timing differences between the accounting systems of the party providing the statement or confirmation and that of the *firm*.
- 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 pay its own *money* into a relevant account.

Notification requirements

- 7.15.33 R A *firm* must inform the *FCA* in writing without delay if:
- (1) its internal records and accounts of *client money* are materially out of date, inaccurate or invalid so that the *firm* is no longer able to comply with the requirements in CASS 7.15.2R, CASS 7.15.3R or CASS 7.15.5R(1);
- (2) it will be unable to, or materially fails to, pay any *shortfall* into a *client bank account* or withdraw any excess from a *client bank account* so that the *firm* is unable to comply with CASS 7.15.29R after having carried out an *internal client money reconciliation*;

- (3) it will be unable to, or materially fails to, identify and resolve any discrepancies under CASS 7.15.31R to CASS 7.15.32R after having carried out an *external client money reconciliation*;
- (4) it will be unable to, or materially fails to, conduct an *internal client money reconciliation* in compliance with CASS 7.15.12R and CASS 7.15.15R;
- (5) it will be unable to, or materially fails to, conduct an *external client money reconciliation* in compliance with CASS 7.15.20R to CASS 7.15.28R; and
- (6) it becomes aware that, at any time in the preceding 12 months, the amount of *client money* segregated in its *client bank accounts* materially differed from the total aggregate amount of *client money* the *firm* was required to segregate in *client bank accounts* under the *client money segregation requirements*.

Annual audit of compliance with the client money rules

- 7.15.34 G *Firms* are reminded that the auditor of the *firm* has to confirm in the report submitted to the *FCA* under SUP 3.10 (Duties of auditors: notification and report on client assets) that the *firm* has maintained systems adequate to enable it to comply with the *client money rules*.

7.16 The standard methods of internal client money reconciliation

- 7.16.1 G (1) *Firms* are required to carry out an *internal client money reconciliation* each *business day* (CASS 7.15.12R and CASS 7.15.15R). This section sets out methods of reconciliation that are appropriate for these purposes (the *standard method of internal client money reconciliation*).
- (2) Where a *firm* establishes one or more *sub-pools*, the provisions of CASS 7.16 (The standard methods of internal client money reconciliation) shall be read as applying to the *firm's general pool* and each *sub-pool* individually, in line with CASS 7.19.3R and CASS 7.19.4R.
- 7.16.2 G (1) A *non-standard method of internal client money reconciliation* is a method of *internal client money reconciliation* which does not meet the requirements of this section.
- (2) Where a *firm* uses a *non-standard method of internal client money reconciliation* it is reminded that it must comply with the requirements in CASS 7.15.18R.
- 7.16.3 G Regardless of whether a *firm* is following one of the *standard methods of internal client money reconciliation* or a *non-standard method of internal*

client money reconciliation, it is reminded that it must maintain its records so that it is able to promptly calculate the total amount of *client money* it should be holding for each *client* (see CASS 7.15.5R(1)).

- 7.16.4 G *Firms* are reminded that the *internal client money reconciliation* should achieve the purposes set out in CASS 7.15.14G.
- 7.16.5 G (1) A *firm* that adopts the normal approach to segregating *client money* (CASS 7.13.6R) will be using the methods in this section to check whether it has correctly segregated *client money* in its *client bank accounts*.
- (2) A *firm* that adopts the alternative approach to segregating *client money* (CASS 7.13.54G) will be using the methods in this section to calculate how much *money* it needs to withdraw from, or place in, *client bank accounts* as a result of any discrepancy arising between its *client money requirement* and its *client money resource* at the close of business on the previous *business day*.
- 7.16.6 G Unless otherwise stated, *firms* are reminded that they are required to receive all *client money* receipts directly into a *client bank account* (see CASS 7.13.6R).
- 7.16.7 G A *firm* that receives *client money* in the form of cash, a cheque or other payable order is reminded that it must pay that *money* (eg, into a *client bank account*) no later than on the *business day* after it receives the *money* (see CASS 7.13.32R). Once deposited into a *client bank account*, that receipt of *client money* should form part of the *firm's client money resource* (see CASS 7.16.8R). In calculating its *client money requirement*, a *firm* will need to take into account any *client money* received as cash, cheques or payment orders but not yet deposited into a *client bank account* (see CASS 7.16.25R(3) and CASS 7.16.26G).

Client money resource

- 7.16.8 R The *client money resource* is the aggregate balance on the *firm's client bank accounts*.
- 7.16.9 G (1) A *firm* should ensure that the amount it reflects in its *internal client money reconciliation* as its *client money resource* is equal to the aggregate balance on its *client bank accounts*. For example, if:
- (a) a *firm* holds *client money* received as cash, cheques or payment orders but not yet deposited in a *client bank account* (in accordance with CASS 7.13.32R); and
- (b) that *firm* records all receipts from *clients*, whether or not yet deposited with a bank, in its cashbook (see CASS 7.16.26G(1)(a));

its *client money resource* should not include the cash, cheques or payment orders received but not yet deposited in a *client bank*

account.

- (2) The *guidance* in (1) is consistent with a *firm's* obligations to maintain its internal records in an accurate way, particularly their correspondence to the *client money* held for *clients*.

Client money requirement

- 7.16.10 R Subject to CASS 7.16.12R, the *client money requirement* must be calculated by one, but not both, of the following of two methods:
- (1) the *individual client balance method* (CASS 7.16.16R); or
 - (2) the *net negative add-back method* (CASS 7.16.17R).
- 7.16.11 R The *net negative add-back method* may only be used, under this section, by a CASS 7 *asset management firm* or a CASS 7 *loan-based crowdfunding firm* and only if such *firms* do not undertake any *marginated transactions* for, or on behalf of, their *clients*.
- 7.16.12 R A CASS 7 *loan-based crowdfunding firm* must not use the *individual client balance method* under this section.
- 7.16.13 G
- (1) The *client money requirement* should represent the total amount of *client money* a *firm* is required to have segregated in *client bank accounts* under the *client money rules*.
 - (2) CASS 7.16.11R does not prevent a *firm* from adopting a *net negative add-back method* as part of a *non-standard method of internal client money reconciliation*.
 - (3) CASS 7.16.12R does not prevent a CASS *loan-based crowdfunding firm* from adopting the *individual client balance method* as part of a *non-standard method of internal client money reconciliation*.
 - (4) If a *firm* uses the *individual client balance method* in respect of some of its business lines and the *net negative add-back method* in respect of others it will be conducting a *non-standard method of internal client money reconciliation*.
- 7.16.14 G
- (1) The *individual client balance method* (CASS 7.16.16R) may be applied by any *firm* except a CASS 7 *loan-based crowdfunding firm*. This method requires a *firm* to calculate the total amount of *client money* it should be segregating in *client bank accounts* by reference to how much the *firm* should be holding in total (ie, across all its *client bank accounts* and businesses) for each of its individual *clients* for:
 - (a) *non-marginated transactions* (CASS 7.16.16R(1) and CASS 7.16.21R);

- (b) *marginised transactions* (CASS 7.16.16R(2) and CASS 7.16.32R); and
 - (c) certain other matters (CASS 7.16.16R(3) and CASS 7.16.25R).
- (2)
- (a) CASS 7.16.22E is an *evidential provision* which sets out a method *firms* should use for calculating how much they should be holding in total for each individual *client* for *non-marginised transactions*.
 - (b) The calculation in CASS 7.16.22E permits a *firm* to calculate either one *individual client balance* across all its products for each *client* or a number of *individual client balances* per *client* equal to the number of products operated by the *firm* for each client (see CASS 7.16.22E(1)).
 - (c) The calculation referred to in (2)(b) may also be applied by different types of *firms* and, as a result, each *firm* will need to apply the calculation in way which recognises the business model under which that *firm* operates.

- 7.16.15 G The *net negative add-back method* (CASS 7.16.17R) is available to CASS 7 *asset management firms* and CASS 7 *loan-based crowdfunding firms*, many of whom may operate internal ledger systems on a bank account by bank account, not *client-by-client*, basis. This method allows a *firm* to calculate the total amount of *client money* it is required to have segregated in *client bank accounts* by reference to:
- (1) the balances in each *client bank account* (see CASS 7.16.17R(1) and CASS 7.16.18G(2));
 - (2) whether any individual *client's* net position in a specific *client bank account* is negative (see CASS 7.16.17R(2) and CASS 7.16.18G(2)); and
 - (3) certain other matters (see CASS 7.16.17R(2) and CASS 7.16.25R).

Client money requirement calculation: individual client balance method

- 7.16.16 R Subject to CASS 7.16.25R and CASS 7.16.37R, under this method the *client money requirement* must be calculated by taking the sum of, for all *clients* and across all products and accounts:
- (1) the *individual client balances* calculated under CASS 7.16.21R, excluding:
 - (a) *individual client balances* which are negative (ie, debtors); and
 - (b) *clients' equity balances*;

- (2) the total *margin*ed transaction requirement (calculated under CASS 7.16.32R); and
- (3) any amounts that have been segregated as *client money* according to the *firm's* records under any of the following: CASS 7.13.51R(1) (*prudent segregation record*), CASS 7.13.66R (*alternative approach mandatory prudent segregation record*) and/ CASS 7.13.74R (*clearing arrangement mandatory prudent segregation record*).

Client money requirement calculation: net negative add-back method

- 7.16.17 R Subject to CASS 7.16.25R, under this method the *client money requirement* must be calculated by taking the sum of, for each *client bank account*:
- (1) the amount which the *firm's* internal records show as held on that account; and
 - (2) an amount that offsets each negative net amount which the *firm's* internal records show attributed to that account for an individual *client*.
- 7.16.18 G (1) A *firm* which utilises the *net negative add-back method* is reminded that it must do so in a way which allows it to maintain its records so that, at any time, the *firm* is able to promptly determine the total amount of *client money* it should be holding for each *client* (see CASS 7.15.5R(1)).
- (2) For the purposes of CASS 7.16.17R, a *firm* should be able to readily use the figures previously recorded in its internal records and ledgers (for example, its cashbook or other internal accounting records) as at the close of business on the previous *business day* without undertaking any additional steps to determine the balances in the *firm's client bank accounts*.
- 7.16.19 G A *firm* which utilises the *net negative add-back method* may:
- (1) calculate its *client money requirement* and *client money resource* on a bank account by bank account basis;
 - (2) for the purposes of CASS 7.16.17R, a *firm* should take into account any amounts that have been segregated as *client money* according to the *firm's* records under either or both CASS 7.13.50R (*prudent segregation record*) and CASS 7.13.66R (*alternative approach mandatory prudent segregation record*).

Non-margin

ed transactions (eg, securities): individual client balance

- 7.16.20 G The sum of positive *individual client balances* for each *client* should represent the total amount of all *money* the *firm* holds, has received or is obligated to have received or be holding as *client money* in a *client bank account* for that *client* for *non-margin*ed transactions.

7.16.21 R A *firm* must calculate a *client's individual client balances* in a way which captures the total amount of all *money* the *firm* should be holding as *client money* in a *client bank account* for that *client* for *non-margined transactions* under the *client money rules*.

7.16.22 E (1) A *firm* may calculate either:

- (a) one *individual client balance* for each of its *clients*, based on the total of the *firm's* holdings for each *client*; or
- (b) a number of *individual client balances* per *client*, equal to the number of products the *firm* operates for each *client*.

(2) Each *individual client balance* for a *client* should be calculated in accordance with this table:

Individual client balance calculation			
	Free <i>money</i> (sums held for a <i>client</i> free of sale or purchase (eg, see (3)(a)) and		A
	sale proceeds due to the <i>client</i> :		
(a)	for <i>principal deals</i> when the <i>client</i> has delivered the <i>designated investments</i> ; and		B
(b)	for <i>agency deals</i> , when:		
	(i)	the sale proceeds have been received by the <i>firm</i> and the <i>client</i> has delivered the <i>designated investments</i> ; or	C1
	(ii)	the <i>firm</i> holds the <i>designated investments</i> for the <i>client</i> ; and	C2
	the cost of purchases:		
(c)	for <i>principal deals</i> , paid for by the <i>client</i> when the <i>firm</i> has not delivered the <i>designated investments</i> to the <i>client</i> ; and		D
(d)	for <i>agency deals</i> , paid for by the <i>client</i> when:		
	(i)	the <i>firm</i> has not remitted the <i>money</i> to, or to the order of, the counterparty; or	E1
	(ii)	the <i>designated investments</i> have been received by the <i>firm</i> but have not	E2

		been delivered to the <i>client</i> ;	
Less			
		<i>money</i> owed by the <i>client</i> for unpaid purchases by, or for, the <i>client</i> if delivery of those <i>designated investments</i> has been made to the <i>client</i> ; and	F
		proceeds remitted to the <i>client</i> for sales transactions by, or for, the <i>client</i> if the <i>client</i> has not delivered the <i>designated investments</i> .	G
<i>Individual client balance 'X' =</i> (A+B+C1+C2+D+E1+E2)-F-G			X

- (3) When calculating an *individual client balance* for each *client*, a *firm* should also:
- (a) ensure it includes:
- (i) *client money* consisting of dividends received and interest earned and allocated (see CASS 7.11.32R);
 - (ii) *client money* consisting of dividends (actual or payments in lieu), stock lending fees and other payments received and allocated (see CASS 6.1.2G);
 - (iii) *money* the *firm* appropriates and segregates as *client money* to cover an unresolved *shortfall* in *safe custody assets* it identifies in its internal records which is attributable to an individual *client* (see CASS 6.6.54R(2)); and
 - (iv) *money* the *firm* segregates as *client money* instead of an individual *client's safe custody asset* until such time as the relevant delivery versus payment transaction settles under CASS 6.1.12R(2); and
- (b) deduct any amounts due and payable by the *client* to the *firm* (see CASS 7.11.25R).
- (4) Compliance with (1), (2), (3) and (4) may be relied on as tending to establish compliance with CASS 7.16.21R.

- 7.16.23 R A *firm* must calculate an *individual client balance* using the contract value of any *client* purchases or sales, being the value to which the *client* would be contractually entitled to receive or contractually obligated to pay.
- 7.16.24 G If a *firm* calculates each *individual client balance* on a product-by-product basis under CASS 7.16.22E(1)(b), the result should be that the *firm* does not net *client* positions across all products and accounts.

Other requirements for calculating the client money requirement

- 7.16.25 R When calculating the *client money requirement* under either of the methods in CASS 7.16.10R, a *firm* must:
- (1) include any unallocated *client money* (see CASS 7.13.36R) and unidentified receipts of *money* it considers prudent to segregate as *client money* (see CASS 7.13.37R);
 - (2) include any money the *firm* appropriates and holds as *client money* to cover an unresolved *shortfall* in *safe custody assets* identified in its internal records which is not attributable, or cannot be attributed to, an individual *client* (see CASS 6.6.49R, CASS 6.6.50R and CASS 6.6.54R);
 - (3) take into account any *client money* received as cash, cheques or payment orders but not yet deposited into a *client bank account* under CASS 7.13.32R (see also CASS 7.15.9R);
 - (4) if it has drawn any cheques or other payable orders, to discharge its fiduciary duty to its *clients* and continue to treat the sum concerned as forming part of its *client money requirement* until the cheque or order is presented and paid by the bank (see CASS 7.11.40R); and
 - (5) ensure it has taken into account all *client money* the *firm* should be holding in connection with *clients' non-margined transactions*.
- 7.16.26 G (1) Under CASS 7.16.25R(3), where a *firm* holds *client money* received as cash, cheques or payment orders but not yet deposited in a *client bank account* under CASS 7.13.32R, it may:
- (a) include these balances when calculating its *client money requirement* (eg, where the *firm* records all receipts from *clients*, whether or not yet deposited with a bank, in its cashbook); or
 - (b) exclude these balances when calculating its *client money requirement* (eg, where the *firm* only records *client* receipts to its cashbook once deposited with a bank).
- (2) In line with (1)(a), the *firm* will need to ensure that, before finalising the calculation of its *client money requirement* within this section, it deducts these balances, to ensure that they do not give rise to a discrepancy between the *firm's client money requirement* and *client money resource* (see CASS 7.15.29R).
 - (3) In line with (1)(b), although the balances concerned do not form part of the *firm's client money requirement*, the *firm* must continue to account for all receipts of *client money* as cash, cheques or payment orders but not yet deposited in a *client bank account* in its records and accounts (see CASS 7.13.32R and CASS 7.15.9R).

- 7.16.27 G (1) In accordance with CASS 7.16.25R(5), where a *firm* has allowed another *person* to hold *client money* in connection with a *client's non-margined transaction* (eg, in a *client transaction account* under CASS 7.14 (Client money held by a third party), the *firm* should include these balances when calculating its *client money requirement*.
- (2) If a *firm* is utilising the *individual client balance method* (CASS 7.16.16R) to calculate its *client money requirement*, CASS 7.16.21R requires the *firm* to include the sums it holds for each *client* that are placed with another *person* in connection with a *client's non-margined transaction* when calculating a *client's individual client balance* (eg, see CASS 7.16.22E and items C1 and E2).
- (3) Under (1) and (2), the *firm* will need to ensure that, before finalising the calculation of its *client money requirement* within this section, it deducts the balances held for *clients' non-margined transactions in client transaction accounts*, to ensure that they do not give rise to a discrepancy between the *firm's client money requirement* and *client money resource* (see CASS 7.15.29R).
- (4) Under (1), (2) and (3), in determining the balances of *client money* a *firm* has allowed another *person* to hold in connection with a *client's non-margined transaction* or the balances held for *clients' non-margined transactions in client transaction accounts*, a *firm* should use the values contained in its internal records and ledgers (see CASS 7.15.13R).

Margined transactions (eg, derivatives): equity balances

- 7.16.28 R Subject to CASS 7.16.30R, a *client's equity balance* is the amount which the *firm* would be liable to pay to the *client* (or the *client* to the *firm*) under the *client money rules* for *margined transactions* if each of the open positions were liquidated at the closing or settlement prices published by the relevant exchange or other appropriate pricing source and the account with the *firm* were closed. This notional balance should include any unrealised losses or profits associated with that *client's* open positions, and any margin the *firm* has received from the *client* in connection with those positions.
- 7.16.29 R Subject to CASS 7.16.30R, a *firm's equity balance* is the amount which the *firm* would be liable to pay to the exchange, *clearing house*, *intermediate broker* or *OTC* counterparty (or vice-versa) for the *firm's margined transactions* if each of the open positions of those of the *firm's clients* that are entitled to protection under the *client money rules* were liquidated at the closing or settlement prices published by the relevant exchange or other appropriate pricing source and the *firm's client transaction accounts* with that exchange, *clearing house*, *intermediate broker* or *OTC* counterparty were closed. This notional balance should include any unrealised losses or profits associated with the open positions the *firm* holds for *clients* and any margin the *firm* holds for *clients* in the relevant *client transaction accounts*.

- 7.16.30 R The terms '*client's equity balance*' and '*firm's equity balance*' refer to cash values and do not include non-cash *collateral* or other *designated investments* (including *approved collateral*) the *firm* holds for a *margin*ed transaction.

Margin

ed transactions (eg, derivatives): margined transaction requirement

- 7.16.31 G The *margin*ed transaction requirement should represent the total amount of *client money* a *firm* is required under the *client money rules* to segregate in *client bank accounts* for *margin*ed transactions. The calculation in CASS 7.16.33R is designed to ensure that an amount of *client money* is held in *client bank accounts* which equals at least the difference between the equity the *firm* holds at exchanges, *clearing houses*, *intermediate brokers* and *OTC* counterparties for *margin*ed transactions for *clients* entitled to protection under the *client money rules*, and the amount due to *clients* under the *client money rules* for those same *margin*ed transactions. With this calculation, a *firm's margin*ed transaction requirement should represent, if positions were unwound, the *firm's* gross liabilities to *clients* entitled to protection under the *client money rules* for *margin*ed transactions.
- 7.16.32 R The total *margin*ed transaction requirement is:
- (1) the sum of each of the *client's equity balances* which are positive; less
 - (2) the proportion of any individual negative *client equity balance* which is secured by *client approved collateral*; and
 - (3) the net aggregate of the *firm's equity balance* (negative balances being deducted from positive balances) on *client transaction accounts* for *customers* with exchanges, *clearing houses*, *intermediate brokers* and *OTC* counterparties.
- 7.16.33 R
- (1) To meet the total *margin* transaction requirement, a *firm* may appropriate and use its own *approved collateral*, provided it meets the requirements in (2).
 - (2) The *firm* must hold the *approved collateral* in a way which ensures that, in accordance with CASS 7A.2.3AR, the *approved collateral* will be liquidated on the occurrence of a *primary pooling event* and the proceeds paid into a *client bank account*, and in so doing:
 - (a) ensure the *approved collateral* is clearly identifiable as separate from the *firm's* own property and is recorded by the *firm* in its records as being held for its *clients*;
 - (b) keep a record of the actions the *firm* has taken under this *rule* which includes a description of the terms on which the *firm* holds the *approved collateral*, identifies that the *approved collateral* is held for the benefit of its *clients* and specifies the *approved collateral* that the *firm* has appropriated for the

purposes of this *rule*; and

- (c) update the record made under (b) whenever the *firm* ceases to appropriate and use *approved collateral* under this rule.

7.16.34 G Where CASS 7.16.33R applies, the *firm* will be reducing the requirement arising from CASS 7.16.16R(2) and, as such, simultaneously reducing its overall *client money requirement* (ie, the amount of money the *firm* is required to segregate in *client bank accounts*).

7.16.35 R If a *firm's* total *marginied transaction requirement* is negative, the *firm* must treat it as zero for the purposes of calculating its *client money requirement*.

LME bond arrangements

7.16.36 R A *firm* with a *Part 30 exemption order* which also operates an *LME bond arrangement* for the benefit of US-resident investors must exclude the *client equity balances* for transactions undertaken on the *LME* on behalf of those US-resident investors from the calculation of the *marginied transaction requirement*, to the extent those transactions are provided for by an *LME bond arrangement*.

Reduced client money requirement option

- 7.16.37 R Where appropriate, a *firm* may:
- (1) when, in respect of a *client*, there is a positive *individual client balance* and a negative *client equity balance*, offset the credit against the debit and, therefore, have a reduced *individual client balance* in CASS 7.16.21R for that *client*; and
 - (2) when, in respect of a *client*, there is a negative *individual client balance* and a positive *client equity balance*, offset the credit against the debit and, therefore, have a reduced *client equity balance* (CASS 7.16.28R) for that *client*.
- 7.16.38 G The effect of CASS 7.16.37R is to allow a *firm* to offset, on a *client-by-client* basis, a negative amount with a positive amount arising out of the calculations in CASS 7.16.21R and CASS 7.16.28R and, therefore, reduce its overall *client money requirement*.

7.17 Statutory trust

7.17.1 G Section 137B(1) of the *Act* (Miscellaneous ancillary matters) provides that rules may make provision which result in *client money* being held by a *firm* on trust (England and Wales and Northern Ireland) or as agent (Scotland only). This section creates a fiduciary relationship between the *firm* and its *client* under which *client money* is in the legal ownership of the *firm* but remains in the beneficial ownership of the *client*. In the event of failure of the *firm*, costs relating to the distribution of *client money* may have to be

borne by the trust.

Requirement

- 7.17.2 R Subject to CASS 7.17.3R in respect of a *trustee firm*, a *firm* receives and holds *client money* as trustee on the following terms:
- (1) for the purposes of, and on the terms of, the *client money rules* and the *client money distribution rules*;
 - (2)
 - (a) where a *firm* maintains only a *general pool* of *client money*, subject to (4), for the *clients* (other than *clients* which are *insurance undertakings* when acting as such with respect to *client money* received in the course of *insurance mediation activity* and that was opted in to this chapter) for whom that *money* is held, according to their respective interests in it;
 - (b) where a *firm* has established one or more *pools* of *client money*, subject to (4):
 - (i) the *general pool* is held for all the *clients* of the *firm* for whom the *firm* receives or holds *client money* (other than *clients* which are *insurance undertakings* when acting in regard to *client money* received during *insurance mediation activity* and that was opted in to this chapter) according to their respective interests; and
 - (ii) each *sub-pool* is for the *clients* of the *firm* who are identified as beneficiaries of the *sub-pool* in question, in accordance with CASS 7.19.6R(2), according to their respective interests in it;
 - (3) after all valid claims in (2) have been met, for *clients* which are *insurance undertakings* with respect of *client money* received in the course of *insurance mediation activity* according to their respective interests in it;
 - (4) for the payment of the costs properly attributable to the distribution of the *client money* in (2) if such distribution takes place following the *failure* of the *firm*; and
 - (5) after all valid claims and costs under (2) to (4) have been met, for the *firm* itself.
- 7.17.3 R A *trustee firm* which is subject to the *client money rules* by virtue of CASS 7.10.1R(2) receives and holds *client money* as trustee on the terms in CASS 7.17.2R, subject to its obligations to hold *client money* as trustee under the relevant instrument of trust.
- 7.17.4 G If a *trustee firm* holds *client money*, the *firm* should follow the provisions in CASS 7.10.33R to CASS 7.10.40G.

- 7.17.5 G The statutory trust under CASS 7.17.2R does not permit a *firm*, in its capacity as trustee, to use *client money* to advance credit to the *firm's clients*, itself, or any other *person*. For example, if a *firm* wishes to undertake a transaction for a *client* in advance of receiving *client money* from that *client* to fund that transaction, it should not advance credit to that *client* or itself using other *clients' client money* (ie, it should not 'pre-fund' the transaction using other *clients' client money*).

7.18 Acknowledgment letters

Purpose

- 7.18.1 G The main purposes of an *acknowledgement letter* are:
- (1) to put the bank, exchange, *clearing house*, *intermediate broker*, *OTC* counterparty or other *person* (as the case may be) on notice of a *firm's clients' interests* in *client money* that has been deposited with, or has been allowed to be held by, such *person*;
 - (2) to ensure that the *client bank account* or *client transaction account* has been opened in the correct form (eg, whether the *client bank account* is being correctly opened as a *general client bank account*, a *designated client bank account* or a *designated client fund account*), and is distinguished from any account containing *money* that belongs to the *firm*; and
 - (3) to ensure that the bank, exchange, *clearing house*, *intermediate broker*, *OTC* counterparty or other *person* (as the case may be) understands and agrees that it will not have any recourse or right against *money* standing to the credit of the *client bank account* or *client transaction account*, in respect of any sum owed to such *person*, or to any other third *person*, on any other account.

Client bank account acknowledgment letters

- 7.18.2 R (1) For each *client bank account*, a *firm* must, in accordance with CASS 7.18.6R, complete and sign a *client bank account acknowledgement letter* clearly identifying the *client bank account*, and send it to the bank with whom the *client bank account* is, or will be, opened, requesting the bank to acknowledge and agree to the terms of the letter by countersigning it and returning it to the *firm*.
- (2) Subject to CASS 7.18.14R and CASS 7.18.15R, a *firm* must not hold or receive any *client money* in or into a *client bank account* unless it has received a duly countersigned *client bank account acknowledgement letter* from the relevant bank that has not been inappropriately redrafted (see CASS 7.18.8R) and clearly identifies the *client bank account*.

Client transaction account acknowledgement letters

- 7.18.3 R (1) This *rule* does not apply to a *firm* to which CASS 7.18.4R(1) applies.
- (2) For each *client transaction account*, a *firm* must, in accordance with CASS 7.18.6R, complete and sign a *client transaction account acknowledgement letter* clearly identifying the *client transaction account*. That letter must be sent to the *person* with whom the *client transaction account* is, or will be, opened, requesting such *person* to acknowledge and agree to the terms of the letter by countersigning it and returning it to the *firm*.
- (3) Subject to CASS 7.18.14R and CASS 7.18.15R, a *firm* must not allow the relevant *person* to hold any *client money* in a *client transaction account* maintained by that *person* for the *firm*, unless the *firm* has received a duly countersigned *client transaction account acknowledgement letter* from that *person* that has not been inappropriately redrafted (see CASS 7.18.8R) and that clearly identifies the *client transaction account*.

Authorised central counterparty acknowledgment letters

- 7.18.4 R (1) A *firm* which places *client money* at an *authorised central counterparty* in connection with a *regulated clearing arrangement* must, in accordance with CASS 7.18.6R, complete and sign an *authorised central counterparty acknowledgement letter* clearly identifying the relevant *client transaction account*. That letter must be sent to the *authorised central counterparty* with whom the *client transaction account* is, or will be, opened, requesting such *authorised central counterparty* to acknowledge receipt of the letter by countersigning it and returning it to the *firm*.
- (2) A *firm* which has complied with CASS 7.18.4R(1) may allow the *authorised central counterparty* to hold *client money* on the relevant *client transaction account*, whether or not the *authorised central counterparty* has countersigned and returned the *authorised central counterparty acknowledgement letter* it received from the *firm*.

Acknowledgement letters in general

- 7.18.5 G In drafting *acknowledgement letters* under CASS 7.18.2R, CASS 7.18.3R or CASS 7.18.4R, a *firm* is required to use the relevant template in CASS 7 Annex 2R, CASS 7 Annex 3R or CASS 7 Annex 4R, respectively.
- 7.18.6 R When completing an *acknowledgment letter* under CASS 7.18.2R(1), CASS 7.18.3R(1) or CASS 7.18.4R(1), a *firm*:
- (1) must not amend any of the *acknowledgement letter fixed text*;
- (2) subject to (3), must ensure the *acknowledgement letter variable text* is removed, included or amended as appropriate; and

- (3) must not amend any of the *acknowledgement letter variable text* in a way that would alter or otherwise change the meaning of the *acknowledgement letter fixed text*.
- 7.18.7 G CASS 7 Annex 5G contains *guidance* on using the template *acknowledgement letters*, including when and how *firms* should amend the *acknowledgement letter variable text* that is in square brackets.
- 7.18.8 R (1) If, on countersigning and returning the *acknowledgement letter* to a *firm*, the relevant *person* has also:
- (a) made amendments to any of the *acknowledgement letter fixed text*; or
 - (b) made amendments to any of the *acknowledgement letter variable text* in a way that would alter or otherwise change the meaning of the *acknowledgement letter fixed text*;
- the *acknowledgement letter* will have been inappropriately redrafted for the purposes of CASS 7.18.2R(2) or CASS 7.18.3R(3) (as applicable).
- (2) For the purposes of CASS 7.18.2R(2) or CASS 7.18.3R(3), amendments made to the *acknowledgement letter variable text* in the *acknowledgement letter* returned to a *firm* by the relevant *person*, will not have the result that the letter has been inappropriately redrafted if those amendments do not affect the meaning of the *acknowledgement letter fixed text*, have been specifically agreed with the *firm* and do not cause the *acknowledgement letter* to be inaccurate.
- 7.18.9 R A *firm* must use reasonable endeavours to ensure that any individual that has countersigned an *acknowledgement letter* that has been returned to the *firm* was authorised to countersign the letter on behalf of the relevant *person*.
- 7.18.10 R (1) A *firm* must retain each countersigned *client bank account acknowledgement letter* and *client transaction account acknowledgement letter* it receives, from the date of receipt until the expiry of five years from the date on which the last *client bank account* or *client transaction account* to which the *acknowledgement letter* relates is closed.
- (2) A *firm* must retain a copy of each *authorised central counterparty acknowledgement letter* it sends to an *authorised central counterparty* under CASS 7.18.4R(1), from the date it was sent until the expiry of five years from the date the last *client transaction account* to which the *acknowledgement letter* relates is closed.
- 7.18.11 R A *firm* must also retain any other documentation or evidence it believes is necessary to demonstrate that it has complied with each of the applicable requirements in this section (such as any evidence it has obtained to ensure that the individual that has countersigned an *acknowledgment letter* returned

to the *firm* was authorised to countersign the letter on behalf of the relevant *person*).

- 7.18.12 R (1) This rule applies to:
- (a) any countersigned *client bank account acknowledgement letter* or *client transaction account acknowledgement letter* received by a *firm* under CASS 7.18.2R(2) or CASS 7.18.3R(3) respectively; and
 - (b) any *authorised central counterparty acknowledgement letter* sent by a *firm* under CASS 7.18.4R(1), whether or not it has been countersigned by the relevant *authorised central counterparty* and received by the *firm*.
- (2) A *firm* must, periodically (at least annually, and whenever it is aware that something referred to in an *acknowledgement letter* has changed) review each of its *acknowledgement letters* to ensure that they all remain accurate.
- (3) Whenever a *firm* finds an inaccuracy in an *acknowledgement letter*, it must promptly draw up a replacement *acknowledgement letter* under CASS 7.18.2R, CASS 7.18.3R or CASS 7.18.4R, as applicable, and, if it is an *acknowledgement letter* required to be sent under CASS 7.18.2R or CASS 7.18.3R, ensure that the new *acknowledgement letter* is duly countersigned and returned by the relevant *person*.
- 7.18.13 G Under CASS 7.18.12R, a *firm* should draw up and send out a replacement *acknowledgement letter* whenever:
- (1) there has been a change in any of the parties' names or addresses as set out in the letter; or
 - (2) the *firm* becomes aware of an error or misspelling in the drafting of the letter.
- 7.18.14 R If a *firm's client bank account* or *client transaction account* is transferred to another *person*, the *firm* must promptly draw up a new *acknowledgement letter* under CASS 7.18.2R, CASS 7.18.3R or CASS 7.18.4R, as applicable, and, if it is an *acknowledgement letter* required to be sent under CASS 7.18.2R or CASS 7.18.3R, ensure that the new *acknowledgement letter* is duly countersigned and returned by the relevant *person* within 20 *business days* of the *firm* sending it to that *person*.
- 7.18.15 R If a *firm* opens a *client bank account* after a *primary pooling event*, the *firm* must:
- (1) promptly draw up and send out a new *acknowledgement letter* under CASS 7.18.2R;
 - (2) not hold or receive any *client money* in or into the *client bank account* unless it has sent the *acknowledgement letter* to the relevant *person*;

and

- (3) if the *firm* has not received a duly countersigned *acknowledgement letter* that has not been inappropriately redrafted (see CASS 7.18.8R) within 20 *business days* of the *firm* sending the *acknowledgement letter*, withdraw all *money* standing to the credit of the account and *deposit* it in a *client bank account* with another bank as soon as possible.

Amend the following as shown.

7.19 Clearing member client money sub-pools

...

7.19.4 R Where a *firm* establishes one or more *sub-pools*, CASS ~~7.6~~ 7.15 (Records, accounts and reconciliations) should be read as applying to the *firm* for its *general pool* and each *sub-pool* individually.

7.19.5 R A *firm* that establishes one or more *sub-pools* must establish and maintain adequate internal controls and records in accordance with CASS ~~7.6~~ 7.15 (Records, accounts and reconciliations) to conduct internal and external reconciliations for each *sub-pool* and the *general pool* individually.

7.19.14 R ~~A~~ Save to the extent permitted under CASS 7.13.70R a *firm* that receives *client money* to be credited in part to one *pool* and in part to a *sub-pool* must:

- (1) ...

...

7 Annex 2R Client bank account acknowledgment letter template

[*letterhead of firm* subject to CASS ~~7.8.1~~ 7.18.2R, including full name and address of firm]

[*name and address of bank*]

[*date*]

Client Money Acknowledgment Letter (pursuant to the rules of the Financial Conduct Authority)

...

7 Annex 3R Client transaction account acknowledgment letter template

[*letterhead of firm subject to CASS 7.8.2 7.18.3R, including full name and address of firm*]
 [*name and address of counterparty*]

[*date*]

Client Money Acknowledgment Letter (pursuant to the rules of the Financial Conduct Authority)

...

7 Annex 4R Authorised central counterparty acknowledgment letter template

[*letterhead of firm subject to CASS 7.8.3 7.18.4R, including full name and address of firm*]
 [*name and address of authorised central counterparty*]

[*date*]

Client Money Acknowledgment Letter (pursuant to the rules of the Financial Conduct Authority)

...

7 Annex 5G Guidance notes for acknowledgement letters (CASS 7.8 7.18)

...

3 Under *CASS 7.8.1 7.18.2R(2)* and *CASS 7.8.2 7.18.3R(3)*, *firms* are required to have in place a duly signed and countersigned *acknowledgment letter* for a *client bank account* or *client transaction account* (respectively) before they are allowed to hold or receive *client money* in or into the *client bank account*, or allow the relevant *person* to hold any *client money* on the *client transaction account* (respectively).

...

13 An *acknowledgment letter* that is signed or countersigned electronically should not, for that reason alone, result in a breach of the rules in *CASS 7.8 7.19*. However, where electronic signatures are used, a *firm* should consider whether, under *CASS 7.4.7 7.13.8R* and taking into account the governing law and choice of competent jurisdiction, it needs to ensure that the electronic signature and the certification by any person of such signature would be admissible as evidence in any legal proceedings in the relevant jurisdiction in relation to any question as to the authenticity or integrity of the letter.

...

20 If a *firm* does not, in any *client bank account acknowledgement letter* or *client transaction account acknowledgment letter*, utilise the governing law and choice of competent jurisdiction that is the same as either or both:

- (a) the law and the jurisdiction under which either the *firm* or the relevant counterparty are organised; or
- (b) that specified in the underlying agreement/s (eg, banking, custody or clearing services agreement) with the relevant counterparty;

then the *firm* should consider whether it is at risk of breaching either ~~CASS 7.8.5R(3)~~ 7.18.6R(3) or, in the case of a *client bank account acknowledgement letter*, ~~CASS 7.4.7~~ 7.13.8R.

21 The *FCA* recognises that some *firms* and their counterparties may wish to clarify through additional words in the governing law provision (see paragraph (l) of the template in *CASS 7 Annex 2R* and paragraph (k) of the template in *CASS 7 Annex 3R*) that they are agreeing that the substantive law of the governing jurisdiction shall apply and that their intention is that a court should not decide to apply the substantive provisions of some other law instead of the parties' chosen governing law (a 'renvoi'). Where this is the case *firms* are permitted to insert additional text that seeks to provide increased legal certainty in the space provided. There is no restriction as to what additional words may be used (for example additional words such as "*without regard to the principles of choice of law*" may be appropriate in the circumstances), but a *firm* should at all times have regard to the need to comply with ~~CASS 7.8.5~~ 7.18.6R(3). However, for the majority of *firms* the *FCA* does not expect additional wording for the governing law provision to be necessary. This is likely to be the case where only a court that is subject to 'Rome I' (Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008) is likely to accept jurisdiction over a dispute arising out of or in connection with the relevant *acknowledgement letter*.

Authorised signatories

22 A *firm* is required, under ~~CASS 7.8.8~~ 7.18.9R, to use reasonable endeavours to ensure that any individual that has countersigned an *acknowledgement letter* returned to the *firm* was authorised to countersign the letter on behalf of the relevant counterparty.

...

35 A *firm* should ensure that *client money* placed in a money market deposit is clearly identified as *client money* (see ~~CASS 7.4.11BG~~ 7.13.15G).

...

37 A *firm* which operates the alternative approach to *client money* segregation (see ~~CASS 7.4.18AR~~ 7.13.62R) might not make deposits of *client money* in a money market deposit from another *client bank account*. In these circumstances, the *firm* need only include in the body of the letter how the *firm* will notify the bank that a money market deposit placed with it consists of *client money*. For example, the relevant space in the

template letter in CASS 7 Annex 2R may set out that:

...

7A Client money distribution

...

7A.2 Primary pooling events

...

7A.2.2 R When the *firm* notified, or is in breach of its duty to notify, the *FCA*, in accordance with ~~CASS 7.6.16~~ 7.15.33 R (Notification requirements), that it is unable to identify and allocate in its records all valid claims arising as a result of a *secondary pooling event*.

...

7A.2.3A R If a *primary pooling event* occurs in circumstances where the *firm* had, before the *primary pooling event*, reduced its *margin*ed transaction requirement by utilising *approved collateral* under ~~CASS 7 Annex 1G paragraph 15~~ 7.16.33R, it must immediately liquidate this *approved collateral* and place the proceeds in a *client bank account*.

Pooling and distribution

7A.2.4 R ...

(2) the *firm* must distribute *client money* comprising the notional pool² in accordance with ~~CASS 7.7.2R~~ 7.17.2R, so that:

...

(3) ...

(a) any such remittance in respect of a *client transaction account* that is an *individual client account* must be distributed to the relevant *client* subject to ~~CASS 7.7.2R(4)~~ 7.17.2R(4);

...

in which case the amount of such remittance must be distributed to each such *client* in accordance with the information provided by the *authorised central counterparty*³ or *clearing member* subject to ~~CASS 7.7.2R(4)~~ 7.17.2R(4); and

...

7A.2.4A G ...

- (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 7.2.15R(8)~~ 7.11.34(8).
- 7A.2.5 R (-1)
- (a) ...
- (i) an authorised central counterparty to a clearing member other than the *firm* in connection with a *porting* arrangement in accordance with ~~CASS 7.2.15R(6)~~ 7.11.34R(6) in respect of that *client*;
- (ii) a *clearing member* to another *clearing member* or *firm* (other than the *firm*) in connection with a transfer in accordance ~~CASS 7.2.15R(8)~~ 7.11.34R(8);
- (b) ...
- (i) an *authorised central counterparty* directly to that *client*, in accordance with ~~CASS 7.2.15R(7)~~ 7.11.34R(7);
- (ii) a *clearing member* directly to an *indirect client* in accordance ~~CASS 7.2.15R(9)~~ 7.11.34R(9); and

...

7A.3 Secondary Pooling events

Failure of a bank, intermediate broke, settlement agent or OTC counterparty:
secondary pooling events

- 7A.3.1 R A *secondary pooling event* occurs on the *failure* of a third party to which *client money* held by the *firm* has been transferred under ~~CASS 7.4.1R(1)~~ 7.13.3R(1) to ~~CASS 7.4.1R(3)~~ 7.13.3R(3) (Depositing client money) or ~~CASS 7.5.2R~~ 7.14.2R (Transfer of client money to a third party).

...

- 7A.3.4 G When a bank *fails* and the *firm* decides not to make good the *shortfall* in the amount of *client money* held at that bank, a *secondary pooling event* will occur in accordance with ~~CASS 7A.3.6R~~. The *firm* would be expected to reflect the *shortfall* that arises at the *failed* bank 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 7.6~~ 7.15 (Records, accounts and reconciliations).

...

- 7A.3.8 R ...

- (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), for the purposes of reconciliations pursuant to ~~CASS 7.6.2R~~ 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.3.10 R ...

- (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), for the purposes of reconciliations pursuant to ~~CASS 7.6.2R~~ 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 ...

- (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), for the purposes of reconciliations pursuant to ~~CASS 7.6.2R~~ 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.3.17 R ...

- (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), for the purposes of reconciliations pursuant to ~~CASS 7.6.2R~~ 7.15.3R (Records and accounts), and where relevant SYSC 4.1.1R (General organisational requirements) and SYSC 6.1.1R (Compliance).

...

8 Mandates

...

8.2 Definition of mandate

- 8.2.1 R A *mandate* is any means that give a *firm* the ability to control a *client's* assets or liabilities, which meet the conditions in (1) to (5) (as applicable):

...

- (2) where those means are obtained in the course of, or in connection with, the firm's insurance mediation activity, they are in written form at the time they are obtained from the client;

...

~~Written~~ The form of a mandate

- 8.2.2 G A *mandate* can take any ~~written~~ form and need not state that it is a *mandate*. For example, it could take the form of: ~~a standalone document containing certain information or conferring a certain authority on the firm, a specific provision within a document or agreement that also relates to other matters, or a combination of provisions within a number of documents which together meet the conditions in CASS 8.2.1R.~~

- (1) a standalone document containing certain information conferring authority to control a client's assets or liabilities on the firm;
- (2) a specific provision within a document or agreement that also relates to other matters; or
- (3) an authority provided by a client orally.

Retention by the firm

- 8.2.3 G (1) If a *firm* receives information that puts it in the position described in CASS 8.2.1R(4) in order to effect transactions immediately on receiving that information, then such information could only amount to a *mandate* if the *firm* retained it (for example by not destroying the relevant document, electronic record or telephone recording):

...

...

...

- 8.2.5 G A *mandate* in relation to the type of instructions referred to in CASS 8.2.1R(4)(a) could include a direct debit instruction over a *client's* bank account in favour of the *firm*. The fact that the instruction was given by the client in the form of a paperless direct debit would not prevent it from being a mandate.

- 8.2.6 G A *mandate* in relation to the type of instructions referred to in CASS 8.2.1R(4)(d) could include ~~written information that sets out~~ the *client's* credit card details.

...

8.3 Records and internal controls

...

- 8.3.2 R The records and *internal controls* required by CASS 8.3.1R must include:
- (1) an up-to-date list of each *mandate* that the *firm* has obtained, including a record of any conditions placed by the *client* or the *firm's* management on the use of the *mandate* and, where a *mandate* was received in non-written form in the course of, or in connection with, its *designated investment business*, the details required under CASS 8.3.2CR;
 - ...
 - (3) *internal controls* to ensure that each transaction entered into under each *mandate* that the *firm* has is carried out in accordance with any conditions placed by the *client* or the *firm's* management on the use of the *mandate*;
 - ...

A firm's list of mandates

- 8.3.2A R (1) A firm's up-to-date list of *mandates* under CASS 8.3.2R(1) must be maintained in a medium that allows the storage of information in a way accessible for future reference by the *FCA* or by an auditor preparing a report under SUP 3.10.4R.
- (2) It must be possible for any corrections or other amendments, and the contents of the list prior to such corrections and amendments, to be easily ascertained.
- 8.3.2B G A firm may use version control to comply with CASS 8.3.2AR(2).
- 8.3.2C R An entry in a firm's list of *mandates* under CASS 8.3.2R(1) that relates to a *mandate* that was received in non-written form (eg, in a telephone call) in the course of, or in connection with, its *designated investment business* must, as well as the information referred to at CASS 8.3.2R(1), include the following details:
- (1) the nature of the *mandate* (eg, debit card details);
 - (2) the purpose of the *mandate* (eg, collecting insurance premiums);
 - (3) how the *mandate* was obtained (eg, by telephone);
 - (4) the name of the relevant *client*; and
 - (5) the date on which the *mandate* was obtained.

- 8.3.2D G If a firm receives information through a telephone call in the course of, or in connection with, its *designated investment business* that amounts to a *mandate* as a result of the *firm* retaining a recording of the call (see CASS 8.2.3G), the requirements at CASS 8.3.2R(1) apply, regardless of whether or not the *firm* intends to use the *mandate* in the future. The *firm* will meet the requirements of CASS 8.3.2R(1) if the *firm's* list of *mandates* is updated with the details of the *mandate* that the *firm* obtained as a result of the call.
- 8.3.2E G A *firm* should not reproduce information meeting the conditions under CASS 8.2.1R as a separate record (eg, by including such information in its list of *mandates* under CASS 8.3.2R(1)) unless the *firm* considers this necessary, as this creates additional risk of misuse. Making a record of the details concerning the *mandate* described in CASS 8.3.2CR would be appropriate.
- 8.3.2F G When keeping its list of *mandates* under CASS 8.3.2R(1) up to date:
- (1) a *firm* should create a new entry in the list each time the *firm* obtains a new *mandate*;
 - (2) if, for an existing entry on its list, a *firm* obtains the same information meeting the conditions in CASS 8.2.1R again (eg, in a written confirmation following a paperless direct debit), the additional *mandate* is not a new *mandate* and the *firm* should not create another entry on the list; but
 - (3) the *firm* should, for every entry on its list, identify each of the locations in which it has retained the information that meets the conditions in CASS 8.2.1R (eg, a *client's* debit card details retained in a telephone recording and also the *firm's* written log of the call, or two separate documents containing the same information).

Retention of records

- 8.3.2G R A *firm* must retain the records required under CASS 8.3.1R in relation to a particular *mandate* for the following period after it ceases to have the *mandate* (eg, because the *firm* has destroyed the relevant document, electronic record or telephone recording), as applicable:
- (1) subject to (2), a minimum of one year;
 - (2) a minimum of five years, where the relevant *mandate* was held by the *firm* in the course of, or in connection with, its *MiFID business*.
- 8.3.2H G Where a *firm* has an obligation under CASS 8.3.2GR to retain records after it ceases to have a particular *mandate*, it may keep the *mandate* on the *firm's* list under CASS 8.3.2R(1) for the relevant period, but the list should be updated to reflect the fact that it ceased to have the relevant *mandate* at the relevant date.

...

9 Prime brokerage information to clients

9.1 Application

9.1.1 R This chapter applies ~~to a firm~~ as follows:

- (1) CASS 9.2 and CASS 9.3 apply to a prime brokerage firm to which CASS 6 (Custody rules) applies; and
- (2) ~~which is a prime brokerage firm~~ subject to (3) and (4), CASS 9.4 and CASS 9.5 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 do not apply to a firm which only arranges safeguarding and administration of assets;
- (4) for a firm to which CASS 7 (Client money rules) applies as well as either or both of CASS 5 (Client money: insurance mediation activity) and CASS 11 (Debt management client money chapter) ,this chapter does not apply to client money that a firm holds in accordance with CASS 5 or CASS 11.

...

Insert the following section after CASS 9.4. The text is all new and is not underlined.

9.5 Reporting to clients on request

- 9.5.1 G *Firms* are reminded that, under COBS 16.4, they are required to send to each of their *clients* at least once a year a statement in a *durable medium* of those *designated investments* and/or *client money* they hold for that *client*. A *firm* which *manages investments* may provide this statement in its *periodic statement*, as required under COBS 16.3.
- 9.5.2 G *Firms* are reminded that the requirements in COBS 16.4 only set out the minimum frequency at which *firms* must report to their *clients* on their holdings of *designated investments* and/or *client money*. *Firms* may choose to report to their *clients* more frequently.
- 9.5.3 G Subject to CASS 9.5.6R, CASS 9.5.4R and CASS 9.5.5R require *firms* to comply with a *client's* request for information on the *custody assets* and/or *client money* the *firm* holds for a *client* under CASS 6 and/or CASS 7, and such request may be made by a *client* at any time.
- 9.5.4 R When a *firm* receives a request, made by a *client* or on a *client's* behalf, for a statement of the *custody assets* and/or *client money* that the *firm* holds for that *client*, the *firm* must provide the *client* with the statement requested in a *durable medium*.

- 9.5.5 R When a *firm* receives a request, made by a *client* or on a *client's* behalf, for a copy of any statement of *custody assets* and/or *client money* previously provided to that *client*, the *firm* must provide the *client* with the copy of the statement requested in a *durable medium* and within five *business days* following the receipt of the request.
- 9.5.6 R Any charge agreed between the *firm* and the *client* for providing the statements in CASS 9.5.4R and CASS 9.5.5R must reasonably correspond to the *firm's* actual costs.
- 9.5.7 G Any statement provided to a *client* under CASS 9.5.4R or CASS 9.5.5R may, although it is not required to, be in the same form as the statement a *firm* is required to provide to a *client* under COBS 16.4 or, if appropriate, COBS 16.3.
- 9.5.8 G Consistent with the *fair, clear and not misleading rule*, a *firm* should ensure that, in any statements of *custody assets* and/or *client money* it provides to its *clients*, it is clear from the statement which assets and/or monies the *firm* reports as holding for the *client* are, or are not, protected under CASS 6 and/or CASS 7 (eg, if the statement also includes information regarding assets and/or monies which are held by the *firm* for that *client* which are not subject to the *custody rules* and/or *client money rules*).
- 9.5.9 G *Firms* are reminded that under CASS 3.2.4G *firms* that enter into arrangements with retail *clients* covered by CASS 3 (Collateral) should, when appropriate, identify in any statement of *custody assets* sent to the *client* under COBS 16.4 (Statements of client designated investments or client money) or this section the details of the assets which form the basis of that collateral arrangement.

Amend the following as shown.

10 CASS resolution pack

10.1 Application, purpose and general provisions

...

General provisions

...

- 10.1.9 E (1) For the purpose of CASS 10.1.7R, the following documents and records should be retrievable immediately:

...

- (c) any written notification or ~~trust acknowledgement letters~~

acknowledgement letters referred to in CASS 10.2.1R(5);

- (d) the most recent ~~internal reconciliations relating to safe custody assets~~ internal custody records checks referred to in CASS 10.3.1R(3);
- (e) the most recent ~~external reconciliations relating to safe custody assets~~ external custody reconciliations referred to in CASS 10.3.1R(5);
- (f) the most recent ~~internal reconciliations relating to client money~~ internal client money reconciliations referred to in CASS 10.3.1R(7) and (7A); and
- (g) the most recent ~~external reconciliations relating to client money~~ external client money reconciliations referred to in CASS 10.3.1R(9).

...

...

10.2 Core content requirements

10.2.1 R A *firm* must include within its *CASS resolution pack*:

...

- (2) a document which identifies the institutions the *firm* has appointed (including through an *appointed representative, tied agent, field representative* or other agent):

- (a) in the case of *client money*, for the placement of *money* in accordance with ~~CASS 7.4.1R~~ 7.13.3R or to hold ~~or control~~ *client money* in accordance with ~~CASS 7.5.2R~~ 7.14.2R; and

...

...

- (5) for each institution identified in CASS 10.2.1R(2), a copy of each executed agreement, including any side letters or other agreements used to clarify or modify the terms of the executed agreement, between that institution and the *firm* that relates to the holding of *client money* or *safe custody assets* including any written notification or ~~trust acknowledgement letters~~ acknowledgement letters sent or received pursuant to CASS 7.8 7.18;

...

- 10.2.2 G For the purpose of CASS 10.2.1R(4), examples of individuals within the *firm* who are critical or important to the performance of operational functions include:
- (1) those necessary to carry out both internal and external *client money* and *safe custody asset* reconciliations and record checks; and
 - ...

...

10.3 Existing records forming part of the CASS resolution pack

- 10.3.1 R A *firm* must include, as applicable, within its *CASS resolution pack* the records required under:
- (1) ~~CASS 6.3.1R (4)~~ 6.3.2AR (safe custody assets: appropriateness of the firm's selection of a third party);
 - ...
 - (3) ~~CASS 6.6.2R and CASS 6.6.3R (safe custody assets held for each client), including internal reconciliations carried out pursuant to CASS 6.5.2R as explained in the guidance at CASS 6.5.4G;~~
 - (4) ~~CASS 6.5.2AR~~ 6.6.6R (client agreements: firm's right to use);
 - (4A) CASS 6.6.8R (internal custody record checks, physical asset reconciliations and external custody reconciliations);
 - (5) ~~CASS 6.5.6R~~ 6.6.34R (Reconciliations with external records External custody reconciliations);
 - (5A) SYSC 6.1.1R (policy and procedures for carrying out record checks and reconciliations);
 - (6) ~~CASS 7.4.10R~~ 7.13.25R (client money: appropriateness of the firm's selection of a third party);
 - (7) ~~CASS 7.6.1R~~ 7.15.2R, CASS 7.15.3R and CASS 7.15.5R (client money held for each client), ~~including internal reconciliations carried out pursuant to CASS 7.6.2R as explained in the guidance at CASS 7.6.6G;~~
 - (7A) CASS 7.15.7R (internal client money reconciliations and external client money reconciliations);
 - (8) ~~CASS 7.6.6ER and CASS 7.6.8R (method of internal reconciliation of client money balances);~~

(9) ~~CASS 7.6.9R (Reconciliations with external records);~~

...

(11) COBS 8.1.4R (retail and professional client agreements);

...

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
...					
10 A	CASS <u>7.4.11AR(2)</u> <u>7.13.13R(2)</u>	...			
...					

Insert the following new rows in the appropriate numerical position in **Schedule 1 (Record Keeping Requirements)**. The new text is not underlined.

Sch 1.3G

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
...				
CASS 6.1.8AR(2)	Client's communication to <i>firm</i> of wish to terminate TTCA	Client's communication of wish to terminate TTCA	When communication made	Five years (from date of communication)
CASS 6.1.8AR(4)	<i>Firm's</i> response to <i>client's</i> wish to terminate TTCA	<i>Firm's</i> response to <i>client's</i> wish to terminate TTCA	When notification given	Five years (from date of notification)

CASS 6.3.2AR(2)	A <i>firm's</i> periodic review into the selection and appointment of a third party under CASS 6.3.1R	Date of review, actions taken by the <i>firm</i> in reviewing the selection and appointment of a third party under CASS 6.3.1R, and grounds upon which the <i>firm</i> continues to be satisfied of appropriateness of its selection of that third party to hold <i>safe custody assets</i> belonging to <i>clients</i>	On the date of the review	Five years (from the date the <i>firm</i> ceases to use the third party to hold <i>safe custody assets</i> belonging to <i>clients</i>)
CASS 6.6.4R	<i>Client specific safe custody asset record</i>	<i>Client specific safe custody asset record</i>	Maintain up to date	Five years (from the date the record was made)
CASS 6.6.8R	<i>Internal custody record checks, physical asset reconciliations and external custody reconciliations</i> conducted carried out by the firm.	Date and actions the <i>firm</i> took when carrying out the relevant process; a list of the discrepancies the <i>firm</i> identified and the actions the <i>firm</i> took to resolve those discrepancies	Immediate	Not specified (see default provision CASS 6.6.7R)
CASS 6.6.16R	<i>Aggregate safe custody asset record</i>	All the <i>safe custody assets</i> the <i>firm</i> holds for its <i>clients</i> , including those deposited with third parties under CASS 6.3 and any	Maintain up to date if the <i>firm</i> wishes to use the <i>internal custody reconciliation method</i>	Not specified (see default provision CASS 6.6.7R)

		<i>physical safe custody assets</i>		
CASS 6.6.30R	<i>Rolling stock method for physical asset reconciliations</i>	<i>Firm's reasons for concluding that this method is adequately designed to mitigate risk of records being manipulated or falsified</i>	Before using this method	Five years (from the date the <i>firm</i> ceases to use this method)
CASS 6.6.45R	Frequency of the <i>firm's internal record custody checks, physical asset reconciliations and external custody reconciliations</i>	Sufficient to show and explain decision taken under CASS 6.6.44R when determining frequency	Immediate	(1) Subject to (2), indefinitely. (2) For any decision which is superseded by a subsequent decision, five years from the subsequent decision (with (1) applying to the subsequent decision).
CASS 6.6.46R(2)	Review of frequency if the <i>firm's internal record custody checks, physical asset reconciliations and external custody reconciliations</i>	Date of each review and the actions the <i>firm</i> took in reviewing the frequency at which it conducts the relevant process	Immediate	Not specified (see default provision CASS 6.6.7R)
CASS 6.6.54R(2)(a)	Actions taken by the <i>firm</i> to resolve <i>shortfall</i> under this rule	Actions taken, description of <i>shortfall</i> , identity of affected <i>client(s)</i> , applicable <i>assets</i> appropriated to cover the <i>shortfall</i> . Update when discrepancy resolved.	Maintain up to date	Not specified (see default provision CASS 6.6.7R)

CASS 6.6.54R(2)(b)	Actions taken by the <i>firm</i> to resolve <i>shortfall</i> under this rule	Actions taken, description of <i>shortfall</i> , identity of affected <i>client(s)</i> , amount of <i>money</i> appropriated to cover the <i>shortfall</i> . Update when discrepancy resolved.	Maintain up to date	Not specified (see default provision CASS 6.6.7R)
CASS 7.11.9R(2)	<i>Client's</i> communication to <i>firm</i> of wish to terminate TTCA	<i>Client's</i> communication of wish to terminate TTCA	When communication made	Five years (from date of communication)
CASS 7.11.9R(4)	<i>Firm's</i> response to <i>client's</i> wish to terminate TTCA	<i>Firm's</i> response to <i>client's</i> wish to terminate TTCA	When notification given	Five years (from date of notification)
CASS 7.11.20R	<i>Client's</i> agreement to <i>firm's</i> use of the delivery versus payment exemption under CASS 7.11.14R	Written evidence of <i>client's</i> agreement	Immediate	Until the <i>firm</i> ceases to use this exemption
CASS 7.11.24R	<i>Client's</i> agreement to <i>firm's</i> use of the delivery versus payment exemption under CASS 7.11.21R	Written evidence of <i>client's</i> agreement	Immediate	Until the <i>firm</i> ceases to use this exemption
CASS 7.13.25R(2)	<i>Firm's</i> periodic review into	Date of each review, actions the <i>firm</i> took in	Date of review	Five years (from date of review)

	selection and appointment of third party under CASS 7.13.8R.	reviewing the selection and appoint of a third party under CASS 7.13.8R, and the grounds upon which the <i>firm</i> continues to be satisfied of appropriateness of its selection of that third party to hold <i>client money</i>		
CASS 7.13.25R(3)	<i>Firm's</i> periodic review under CASS 7.13.22R.	Fact of review, its considerations and conclusions	Date of review	Five years (from date of review)
CASS 7.13.36R	Unallocated <i>client money</i>	Fact that the balance treated as unallocated <i>client money</i>	When firm is unable to immediately identify <i>money</i> as <i>client money</i> or its own <i>money</i> and it treats the balance as <i>client money</i>	Pending <i>firm's</i> allocation of the <i>client money</i> concerned to an individual <i>client</i>
CASS 7.13.50R; CASS 7.13.51R	Prudent segregation record	Details of <i>money</i> segregated under CASS 7.13.41R required by these rules	Maintain up to date	Five years (after the firm ceases to retain <i>money</i> as <i>client money</i> under CASS 7.13.41R)
CASS 7.13.66R; CASS 7.13.67R	Alternative approach <i>mandatory prudent segregation record</i>	Details of <i>money</i> segregated under CASS 7.13.65R required by these rules	Maintain up to date	Five years (after the firm ceases to retain <i>money</i> as <i>client money</i> under CASS 7.13.65R)

CASS 7.13.74R; CASS 7.13.75R	<i>Clearing arrangement mandatory prudent segregation record</i>	Details of <i>money</i> segregated under CASS 7.13.73R(3)(a) required by these rules	Maintain up to date	Five years (after the firm ceases to retain <i>money</i> as <i>client money</i> under CASS 7.13.73R(3)(a))
CASS 7.15.5R(1)	Total amount of <i>client money</i> the <i>firm</i> should be holding for each <i>client</i>	Total amount of <i>client money</i> the <i>firm</i> should be holding for each <i>client</i>	Maintain up to date	Not specified (see default provision CASS 7.15.5R(3))
CASS 7.15.5R(2)	Transactions and commitments for <i>client money</i>	Sufficient to show and explain transactions and commitments	Maintain up to date	Not specified (see default provision CASS 7.15.5R(3))
CASS 7.15.7R	<i>Internal client money reconciliations and external client money reconciliations</i> conducted carried out by the <i>firm</i>	Date, actions the <i>firm</i> took in carrying out the relevant process, and the outcome of its calculation of its <i>client money requirement</i> and <i>client money resource</i> . Fact of each reconciliation and review of the <i>firm's</i> arrangements for complying with CASS 7.15.5R to CASS 7.15.8R.	Immediate	Not specified (see default provision CASS 7.15.5R(3))
CASS 7.15.9R	Receipts of <i>client money</i>	Appropriate to account for all receipts of <i>client money</i> in the form of cash, cheque or	Maintain up to date	Not specified (see default provision CASS 7.15.5R(3))

		other payable order not yet deposited in a <i>client bank account</i>		
CASS 7.15.24R	Frequency of the <i>firm's external client money reconciliations</i>	Sufficient to show and explain decision taken under CASS 7.15.232R when determining frequency	Immediate	(1) Subject to (2), indefinitely. (2) For any decision which is superseded by a subsequent decision, five years from the subsequent decision (with (1) applying to the subsequent decision).
CASS 7.15.26R(2)	Review of frequency of the <i>firm's external client money reconciliations</i>	Date of each review and the actions the <i>firm</i> took in reviewing the frequency at which it carries out the <i>external client money reconciliations</i>	Not specified	Not specified (see default provision CASS 7.15.5R(3))

Amend the following as shown:

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
CASS 6.3.1R(4) <u>6.3.2AR(1)</u>	...			
CASS 6.5.1R <u>6.6.2R</u>	...			
CASS 6.5.2R <u>6.6.3R</u>	...			
CASS 7.1.3R (2) 7.11.3R(3)				
CASS 7.1.15CR <u>7.10.31R</u>	...			

CASS 7.1.15G 7.10.35R	...			
CASS 7.1.15JR 7. 10.38R	...			
CASS 7.2.23R 7.11.55R				
CASS 7.2.25R(4) 7.11.57R(4)				
CASS 7.4.10R 7.13.25R(1)	...			
CASS 7.6.1R 7.15.2R	...			
CASS 7.6.2R 7.15.3R	...			
CASS 7.6.6AR (1)(a) 7.15.18R(1)(a)	...			
CASS 8.3.1R	Adequate records and internal controls in respect of the <i>firm's</i> use of <i>mandates</i> (see CASS 8.3.2R (1) to CASS 8.3.2R (5) to CASS 8.3.2CR	Up-to-date list of <i>firm's mandates</i> , and any conditions regarding the use of <i>mandates</i> , all transactions entered into, details of procedures and <i>internal controls</i> for giving and receiving of instructions under <i>mandates</i> , important <i>client</i> documents held by the <i>firm</i> , and, in relation to <u>non-written</u>	...	Not specified <u>One year after the <i>firm</i> ceases to have the <i>mandate</i> or, if the <i>mandate</i> was held in the course of or in connection with the <i>firm's</i> MiFID business, five years after the same date</u>

		<u>mandates, the further details required by CASS 8.3.2CR</u>		
...				

Insert the following new rows in the appropriate numerical position in **Schedule 2 (Notification Requirements)**. The new text is not underlined.

Sch 2.1G

...

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
CASS 6.6.57R(3)	Inability or material failure to take the steps required under CASS 6.6.54R for the treatment of <i>shortfalls</i>	The fact that the <i>firm</i> is unable or has materially failed to comply and the reasons for that	Inability or material failure to comply with the requirement	Without delay
CASS 6.6.57R(4)	Inability or material failure to conduct an <i>internal custody record check</i> under CASS 6.6.11R to CASS 6.6.19R	The fact that the <i>firm</i> is unable or has materially failed to comply and the reasons for that	Inability or material failure to comply with the requirement	Without delay
CASS 6.6.57R(5)	Inability or material failure to conduct a <i>physical asset reconciliation</i> in compliance with CASS 6.6.22R to CASS 6.6.30R	The fact that the <i>firm</i> is unable or has materially failed to comply and the reasons for that	Inability or material failure to comply with the requirement	Without delay
CASS 6.6.57R(6)	Inability or material failure to conduct an <i>external custody record check</i> in	The fact that the <i>firm</i> is unable or has materially failed to	Inability or material failure to comply with the	Without delay

	compliance with CASS 6.6.34R to CASS 6.6.37R.	comply	requirement	
CASS 7.15.33R(1)	Inability to comply with CASS 7.15.2R, CASS 7.15.3R or CASS 7.15.5R(1), due to materially out of date, inaccurate or invalid internal records and accounts	The fact that the <i>firm</i> is unable to comply and the reasons for that	<i>Firm's</i> records and accounts are materially out of date, inaccurate or invalid internal so that it is unable to comply	Without delay
CASS 7.15.33R(2)	Inability to comply with CASS 7.15.29R after having carried out an <i>internal client money reconciliation</i>	The fact that the <i>firm</i> is unable to comply and the reasons for that	<i>Firm's</i> records and accounts are materially out of date, inaccurate or invalid internal so that it is unable to comply	Without delay
CASS 7.15.33R(3)	Inability or material failure to identify and correct any discrepancies under CASS 7.15.31R to CASS 7.15.32R after having carried out an <i>external client money reconciliation</i>	The fact that the <i>firm</i> is unable to comply and the reasons for that	Inability or material failure to comply	Without delay
CASS 7.15.33R(4)	Inability or material failure to conduct an <i>internal client money reconciliation</i> under CASS 7.15.12R and	The fact that the <i>firm</i> is unable to comply and the reasons for that	Inability or material failure to comply	Without delay

	CASS 7.15.15R			
CASS 7.15.33R(5)	Inability or material failure to conduct an <i>external client money reconciliation</i> under CASS 7.15.20R to CASS 7.15.28R	The fact that the <i>firm</i> is unable to comply and the reasons for that	Inability or material failure to comply	Without delay
CASS 7.15.33R(6)	Amount of <i>client money</i> segregated in <i>client bank accounts</i> materially differing from <i>client money segregation requirements</i> during preceding 12 months	The fact of the material difference and the reasons for that		Without delay

Amend the following as shown and re-order numerically as appropriate.

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
CASS 6.5.13R (1) 6.57R (1)	Non-compliance or inability, in any material respect, Inability to comply with the requirements in CASS 6.5.1R 6.6.2R to CASS 6.6.4R (Records, and accounts and reconciliations); CASS 6.5.2R (Records and accounts, including internal reconciliations) or CASS 6.5.6R (Reconciliations with external	The fact that the <i>firm</i> has not complied or is unable, in any material respect, to comply with the requirements and the reasons for that	Non-compliance or inability, in any material respect, to comply with the requirements	Without delay

	records)			
CASS 6.5.13R (1A) 6.57R (2)	Non-compliance or material inability to comply with the requirements in CASS 6.5.1R 6.6.2R (Records, and accounts and reconciliations) and/or articles 89(1)(b) or 89(1)(c) (Safekeeping duties with regard to assets held in custody) of the AIFMD level 2 regulation	The fact that the <i>firm</i> has not complied or is materially unable to comply with the requirements and the reasons for that	Non-compliance or material inability to comply with the requirement	Without delay
CASS 6.5.13R (2)	Non-compliance or inability, in any material respect, to comply with the requirements in CASS 6.5.10R (Reconciliation discrepancies)	The fact that the <i>firm</i> has not complied or is unable, in any material respect, to comply with the requirements and the reasons for that	Non-compliance or inability, in any material respect, to comply with the requirements	Without delay
...				
CASS 7.2.17G 7.12.42R	...			
CASS 7.4.17DR 7.13.57R
CASS 7.6.6AR(1)(b) 7.15.18R(1)(b)
CASS 7.6.16R(1)	Non-compliance or inability, in any material	The fact that the <i>firm</i> has not complied	Non-compliance or inability,	Without delay

	<p>respect, to comply with the requirements in CASS 7.6.1R (Records and accounts), CASS 7.6.2R (Records and accounts, including internal reconciliations) or CASS 7.6.9R (Reconciliations with external records)</p>	<p>or is unable, in any material respect, to comply with the requirements and the reasons for that</p>	<p>in any material respect, to comply with the requirements</p>	
--	---	--	---	--

Annex D

Amendments to the Supervision manual (SUP)

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

This section comes into force on 1 June 2015

3 Auditors

...

3.10 Duties of auditors: notification and report on client assets

...

Application

3.10.2 R An auditor of an *authorised professional firm* need not report under this section in relation to that *firm's* compliance with the *client money rules* in the *client money chapter* or the *debt management client money rules* if:

...

(2) that *firm* is subject to the rules of its *designated professional body* as specified in *CASS 7.1.15R(2)* 7.10.28R(2) or *CASS 11.1.6R(2)* with respect to its *regulated activities*.

...

6 Applications to vary and cancel Part A permission and to impose, vary or cancel requirements

...

6.4 Applications for cancellation of permission

...

6.4.22 G In deciding whether to cancel a *firm's Part 4A permission*, the relevant regulator will take into account all relevant factors in relation to business carried on under that permission, including whether:

...

(2) the *firm* has complied with, *CASS 5.5.80R* and *CASS 7.2.15R*

7.11.34R (Client money: discharge of fiduciary duty) and ~~CASS 7.2.19R~~ 7.11.50R (Client money: allocated but unclaimed client money) if it has ceased to hold client money; these rules apply to both repayment and transfer to a third party;

...

6 Annex 4.2AG

1	A <i>firm</i> must comply with CASS 5.5.80R and CASS 7.2.15R <u>7.11.34R</u> (Client money: discharge of fiduciary duty) and CASS 7.2.19R <u>7.11.50R</u> (Allocated but unclaimed <i>client money</i>) if it is ceasing to hold <i>client money</i> . A <i>firm</i> must also cease to hold or control <i>custody assets</i> in accordance with instructions received from <i>clients</i> and <i>COBS</i> 6.1.7R (Information concerning safeguarding of designated investments belonging to clients and client money). These <i>rules</i> apply to both repayment and transfer to a third party.
---	--

12 Appointed representatives

...

12.6 Continuing obligations of firms with appointed representatives or EEA tied agents

...

12.6.5A G When complying with the *MiFID client money segregation requirements*, *firms'* attention is drawn to ~~the guidance in CASS 7.4.24G to CASS 7.4.27G~~ 7.13.34R and CASS 7.13.35R .

...

16 Annex 29R

Client Money and Asset Return

Section 1 - Firm Information

This section should be completed by all firms

- 1 Name of CASS audit firm
- 2 Name of CASS audit firm (if other was selected above)
- 3 Did the firm hold client money during the reporting period?
- 4 Did the firm ~~hold safeguard and administer~~ safe custody assets during the reporting period?
- 5 Was the firm subject to the CFTC Part 30 Exemption Order during the reporting period?

Alternative Approach to client money segregation

- 6 Did the firm operate the alternative approach during the reporting period? ~~(CASS 7.4.14G – 7.4.16G)~~
- 7 Has ~~the firm received the auditor assurances required for its use of the alternative approach and provided these to the FCA~~ been signed off by the firm's auditors (as detailed in CASS 7.4.14G – 7.4.16G)?

Overview of firm's activities subject to CASS

Please complete the table below with all business types undertaken for segregated clients

	A	B	C	D
8	Type of business activity	Number of clients	Balance of client money as at reporting period end date	Value of safe custody assets as at reporting period end date
	Total			

Section 2 - Balances

This section should be completed by all firms

- 9 Highest client money balance held during the reporting period
- 10 Lowest client money balance held during the reporting period
- 11 Highest value of safe custody assets held during the reporting period
- 12 Lowest value of safe custody assets held during the reporting period

A

Section 3 - Segregation of client money

This section should only be completed if the answer to question 3A is "Yes"

	A	B	C	D	E
13	Type	Institution where client money held	Client money balances	Country of incorporation of the institution	Is this a group entity
		Total			

Section 4 - Client money requirement and resources

This section should only be completed if the answer to question 3A is "Yes"

14	Client money requirement	A	<input type="text"/>
	of which:		
15	Unallocated to individual clients but identified as client money		<input type="text"/>
16	Unidentified receipts of client money in client money bank accounts treated as client money		<input type="text"/>
17	Uncleared payments e.g. unrepresented cheques sent to clients		<input type="text"/>
18	Excess cash in segregated accounts Prudent segregation of client money		<input type="text"/>
19	Client money resource		<input type="text"/>
20	Surplus Excess (+)/ deficit shortfall (-) of client money resource against client money requirement		<input type="text"/>
21	Adjustments made to withdraw an excess or rectify a deficit shortfall identified as a result of an internal <u>client money</u> reconciliation		<input type="text"/>

Section 5 - Client money reconciliations

This section should only be completed if the answer to question 3A is "Yes"

		A	
		Frequency	
22	Client money Internal <u>client money</u> reconciliation		<input type="text"/>
23	Client money External <u>client money</u> reconciliation		<input type="text"/>
24	Client money unreconciled <u>unresolved</u> items		

A	B	C	D
6-29 days	30-59 days	60-90 days	90+ days

Section 6 - Segregation of safe custody assets

This section should only be completed if the answer to question 4A is "Yes"

	A	G	B	C	D	E	F
25	How registered?	Where <u>How</u> held?	Name of institution where <u>safe</u> custody assets held/ <u>registered</u>	Number of lines of stock	Value of safe custody assets as at reporting period end date	Country of incorporation of the institution	Is this a group entity
				Total			

Section 7 - Safe custody assets record checks and reconciliations

This section should only be completed if the answer to question 4A is "Yes"

	A	B	C
26	Safe custody assets <u>unreconciled</u> <u>unresolved</u> items	30 days	60 days
			90 days

	A	B	C
27	<u>Method</u> Record check/reconciliation	Frequency	Type of safe custody asset
	"Internal reconciliation"		
	"Internal system evaluation"		
	"Physical reconciliation - total count"		
	"Physical reconciliation - rolling stock"		
	"External reconciliation"		
	"External reconciliation to CREST"		

Section 8 - Record Keeping and Breaches

Record Keeping

This section should only be completed if the answer to question 3A is "Yes"

	A	B	C	D	E	F
	Number of accounts held at beginning of the reporting period	Number of new accounts opened during the reporting period	Number of accounts closed during the reporting period	Total number of accounts at the end of the reporting period	Number of trust status letters and/or acknowledgment letters in place that cover these accounts at the end of the reporting period covered by an acknowledgment letter	Explanation of difference discrepancies
28 Client bank accounts						
29 Client transaction accounts						
30 Total						

Notifiable CASS Breaches

This section should be completed by all firms

- 31 ~~Did any of the circumstances referred to in CASS 6.6.57R arise the firm fail to comply with requirements set out in CASS 6.5.1R, CASS 6.5.2R, CASS 6.5.6R and CASS 6.5.10R?~~ A
- 32 ~~If yes, was a notification made to the FCA did the firm comply with the notification requirements?~~
- 33 ~~Did any of the circumstances referred to in CASS 7.15.33R arise the firm fail to comply with requirements in any of CASS 7.6.1R, 7.6.2R, 7.6.9R, 7.6.13R to 7.6.15?~~
- 34 ~~If yes, was a notification made to the FCA did the firm comply with the notification requirements?~~

Section 9 - Outsourcing and Offshoring

This section should only be completed by firms who outsource and/or offshore

	A	B	C	D
35	Who do you outsource and/or offshore your client money and/or custody asset operations to? (name of entity)	What function of your CASS operations do you outsource and/or offshore?	Location of service provider	Significant changes being made or planned to existing arrangements

16 Annex 29AG**Guidance notes for the data item in SUP 16 Annex 29R****Client Money and Asset Return (CMAR)**

This annex contains *guidance* on the *CMAR* and is therefore addressed only to a *firm* which is subject to *SUP* 16.14.

General

...

A *firm* should include in any amount of *client money* that it reports any *client money* which it has allowed another *person* to hold or control in accordance with *CASS* ~~7.5.2R~~ 7.14.2R (for example, an exchange, *clearing house* ~~or~~, *intermediate broker* or *OTC counterparty*).

Reporting Period period

The reporting period for the *CMAR* is the calendar month for which a *CMAR* is required to be completed in accordance with *SUP* 16.14.3R, including the first *day* and the last *day* of that month. For example, the January reporting period will be 1 January ~~+~~ to 31 January ~~+~~, regardless of whether or not any *day* in January is a *business day*.

...

Reporting ~~Client Money Balances~~ client money balances using internal client money reconciliations

The *guidance* in this annex assumes that a *firm* uses one of the standard ~~method~~ methods of internal client money reconciliation. *Firms* that use a ~~different method of internal reconciliation~~ non-standard method of internal client money reconciliation in accordance with *CASS* ~~7.6.7R~~ 7.15.17R should read the *guidance* in this annex in so far as it is consistent with that ~~different~~ non-standard method.

Where this *data item* requires a *firm* to report any *client money* balances, unless otherwise specified the *firm* should report on the basis of balances used for its ~~internal reconciliation~~ internal client money reconciliation carried out on the first *business day* following the reporting period in question. This means using the values contained in the *firm's* internal accounting records and ledgers, for example its cash book or other internal accounting records, rather than the values contained in statements the records it has obtained received from its banks and other third parties with whom it has placed client money (for example, bank statements).

Currency

...

Section 1 Firm information

...

2 Name of *CASS* audit firm (if 'Other' was selected above)

If a *firm* selects 'Other' in (1), it should enter the name of ~~its~~ the auditor that provides its client assets report (see *SUP* 3.10).

...

- 4 Did the *firm* ~~hold safeguard and administer~~ *safe custody assets* during the reporting period?

A *firm* should state “Yes” or “No”.

A *firm* should state “Yes” if, during the reporting period:

- (a) it held *financial instruments* belonging to a *client* in the course of its *MiFID business*; or
 (b) it was *safeguarding and administering investments* in the course of its business that is not *MiFID business*.

A *firm* should not take into account *safe custody assets* in respect of which it was merely *arranging safeguarding and administration of assets* in accordance with CASS 6 during the reporting period.

- 5 Was the *firm* subject to ~~a CFTC~~ the CFTC’s Part 30 exemption order during the reporting period?

A *firm* should state “Yes” or “No”. *Handbook* provisions dealing with the ~~CFTC CFTC’s Part 30 exemption order~~ are set out in CASS 7.4.32G to CASS 7.4.35R 12.

- 6 Did the *firm* operate the alternative approach during the reporting period (~~see CASS 7.4.14G to CASS 7.4.19G~~) (see CASS 7.13.54G to CASS 7.13.69G)?

A *firm* should state “Yes” or “No”. *Handbook* provisions dealing with the alternative approach to *client money segregation* are set out in CASS 7.4.14G 7.14.54G to CASS 7.4.19G 7.14.69G.

- 7 Has the *firm* received the auditor assurances required for its use of the alternative approach and provided these to the FCA ~~alternative approach been signed off by the firm’s auditor?~~

A *firm* should state “Yes” or “No”.

~~CASS 7.4.15R provides that a firm that does not operate the normal approach must first send a written confirmation to the FCA from the firm’s auditor that the firm has in place systems and controls which are adequate to enable it to operate another approach effectively.~~

Pursuant to CASS 7.13.58R before adopting the *alternative approach*, a *firm* must first send a written report to the FCA prepared by an independent auditor of the *firm* in line with a *reasonable assurance engagement*, stating the matters set out in CASS 7.13.58R(2).

...

- 8C Balance of *client money*

In relation to each of the investment activities or services identified, a *firm* should report in this data field the total amount of *client money* that it held belonging to *clients* in respect of the activity or service in question.

A *firm* should report *client money* balances on the basis of balances used in the ~~internal reconciliation~~ *internal client money reconciliation* that the *firm* carried out on the first *business day* following the reporting period in question.

...

Section 2 Balances

...

In relation to data fields 9 to 12, a *firm* should determine the lowest and highest figures by reference to the data that it has recorded ~~from internal reconciliations~~ in the internal records and accounts the *firm* holds that relate to the reporting period in question.

Section 3 Segregation of client money

13A Type

A *firm* should identify the types of institution with which it has placed *client money*. ~~CASS 7.4.1R~~ 7.13.3R identifies the type of institution with which a *firm* must promptly place into one or more accounts *client money* that it receives. ~~CASS 7.5.2R~~ 7.14.2R identifies a ~~limited number of~~ the circumstances in which a *firm* may allow another *person*, such as an exchange, a *clearing house* ~~or~~, an *intermediate broker* or an OTC counterparty, to hold or control *client money*.

For each institution with which it has placed *client money*, the *firm* should identify in this data field whether the *client money* was:

- (a) deposited with a CRD credit institution;
- (b) placed with a clearing house;
- (c) placed with an exchange;
- (d) placed with an intermediate broker;
- (e) placed in a qualifying money market fund;
- (f) deposited with a bank authorised in a third country; and
- (g) deposited with a central bank.

In relation to any *client money* a *firm* has placed with an OTC counterparty and/or any other *person*, the *firm* should selection option (d).

...

13C Client money balances

A *firm* should report the total amount of *client money* which it has placed with each institution identified in 13B.

A *firm* should report *client money* balances on the basis of balances used in the ~~internal reconciliation~~ internal client money reconciliation that the *firm* carried out on the first *business day* following the reporting period in question.

A *firm* should include in the *client money* balance the aggregate balance of any allocated but unclaimed *client money* which a the *firm* continues to treat as ~~*client money*~~ *client money* such. For example, *client money* balances held in respect of *clients* whom the *firm* is no longer able to contact.

The balance shown in that row may also include any balance that is included in data field 17.

...

13E Group entity

A *firm* should indicate in this data field whether each institution with which it has placed *client money* is or is not a relevant group entity within the meaning of CASS ~~7.4.9BR~~ 7.13.21R. A *firm* should note that the definition in CASS ~~7.4.9BR~~ 7.13.21R is specific to CASS and the entities which comprise it may not be the same as those which comprise the *firm's group*.

Section 4 Client money requirement and resource

14 *Client money requirement*

In relation to a *firm* that follows one of the standard ~~method~~ methods of internal client money reconciliation, that *firm* should report its *client money requirement*, calculated in accordance with CASS 7.16.10R ~~7.16 Annex 1G paragraph 6~~.

A *firm* should report its *client money requirement* on the basis of the ~~internal reconciliation~~ internal client money reconciliation that the *firm* carried out on the first *business day* following the reporting period in question.

A *firm* should include in the *client money requirement* the aggregate balance of any allocated but unclaimed client money which a the firm continues to treat as such-client money. For example, *client money* balances held in respect of *clients* whom the *firm* is no longer able to contact.

...

15 Unallocated to individual *clients* but identified as *client money*

A *firm* should report the amount of ~~unallocated~~ *client money* that it holds that it has recorded in its internal records and accounts as “unallocated client money” in accordance with CASS 7.13.36R(2). A *firm* should not include balances for this data field that it is reporting in data field 16.

16 Unidentified receipts segregated as client money in *client bank accounts*

A *firm* should report the amount of *client money* that it has recorded in its internal records and accounts as “unallocated client money” in accordance with CASS 7.13.36R(2). A *firm* should not include balances for this data field that it is reporting in data field 15. is held in that firm's client bank accounts and client transaction accounts which is the subject of enquiry by that *firm* to determine whether that *money* is *client money*.

17 Uncleared payments e.g. ~~unpresented cheques sent to clients~~

...

18 ~~Excess cash in segregated accounts~~ Prudent segregation of *client money* and the alternative approach mandatory prudent segregation

A ~~In this data field,~~ a *firm* should report: (i) the amount of *client money* that it holds in *client bank accounts* ~~and *client transaction accounts* which the *firm* included in its *client money requirement*~~ as a result of the *firm's* application of CASS 7.4.18BR (Alternative approach buffer) ~~and CASS 7.4.21R~~ 7.13.41R (Prudent segregation), and (ii) if applicable, the amount of *client money* that it holds in *client bank accounts* as a result of the requirement set out in CASS 7.13.65R (mandatory prudent segregation). A *firm* should not include balances for this data field that it is reporting in data fields 15-17.

19 *Client money resource*

A *firm* should report its *client money resource* on the basis of the *client money resource* used in the ~~internal reconciliation~~ internal *client money reconciliation* that the *firm* carried out on the first *business day* following the reporting period in question (which should be the same ~~internal reconciliation~~ internal *client money reconciliation* used by the *firm* to report its *client money requirement* in data field 14).

A *firm* should include in the *client money resource* resource the aggregate balance of any allocated but unclaimed *money* which a *firm* continues to treat as *client money*. For example, *client money* balances held in respect of *clients* whom the *firm* is no longer able to contact.

20 ~~Surplus~~ Excess (+)/ deficit- shortfall (-) of *client money resource* resource against *client money requirement*

A *firm* should report in this data field the amount by which its *client money resource* resource ~~exceeds~~ is greater than its *client money requirement* requirement (to be reported in the *data item* as a positive amount), or as the case may be, the amount by which its *client money requirement* requirement ~~exceeds~~ is greater than its *client money resource* resource (to be reported in the *data item* as a negative amount).

Where a ~~an surplus excess~~ or ~~deficit~~ shortfall does not exist following a *firm's* ~~internal~~ internal *client money reconciliation*, the *firm* should report '0' for this data field.

21 Adjustments made to withdraw an excess or rectify a ~~deficit~~ shortfall identified as a result of an ~~internal reconciliation~~ internal *client money reconciliation*.

A *firm* should report the amount of *money* that it added to correct a ~~deficit~~ shortfall or, as the case may be, that it withdrew reflecting an excess ~~a surplus~~.

In relation to data fields 14 to ~~20~~ 21, a *firm* should report by reference to the results of its ~~internal reconciliation~~ internal *client money reconciliation* carried out on the first *business day* following the reporting period in question.

Data fields 15-18 relate to *client money* balances identified in a *firm's* internal ~~accounting records and ledgers~~, for example its cash book or other internal accounting records, that form part of the *client money requirement* ~~requirement~~ reported in data field 14. ~~Data fields 15-18 will not equal the *client money requirement* reported in data field 14 unless the balances reported for data fields 15-18 include all balances that are allocated to individual *clients*.~~

Section 5 Client money reconciliations

22 ~~Internal client~~ *Client money* ~~internal reconciliation~~ *reconciliation*

A *firm* should identify in this data field the frequency with which it performs ~~internal reconciliations~~ *internal client money reconciliations*.

23 ~~External client~~ *Client money* ~~external reconciliation~~ *reconciliation*

A *firm* should identify in this data field the frequency with which it performs ~~external reconciliations~~ *external client money reconciliations*.

24 *Client money* ~~unreconciled~~ *unresolved* items

A *firm* should identify in this data field the number of ~~unreconciled~~ *unresolved* *client money* items and allocate each item to one of the specified time bands according to the length of time for which it has remained ~~unreconciled~~ *unresolved*.

For the purposes of this data field, the number of ~~unreconciled~~ *unresolved* *client money* items includes: (a) the number of individual unresolved discrepancies identified as part of a *firm's* internal *client money reconciliations* (see CASS 7.15.12R); and (b) the number of individual unresolved discrepancies identified as part of a *firm's* external *client money reconciliations* (see CASS 7.15.29R), but not those unresolved discrepancies that have arisen solely as a result of timing differences between the accounting systems of third party providing the statement or confirmation and that of the firm. In both cases, only include those items which have remained unresolved for period of six calendar *days* or more ~~refers to the number of individual discrepancies/breaks identified as part of a *firm's* internal and external reconciliations which have remained unresolved for period of 6 calendar *days* or more. For the purposes of this data field unreconciled items should include any unresolved differences that have not yet been allocated to individual clients and any unidentified *client money* balances, but should not include items that were in fact reconciled by taking into account timing differences between a *firm's* own accounting records (e.g. cash book entries) and *client bank account* statements.~~

For the purposes of this data field, the number of unresolved items should also include any individual items recorded in a *firm's* internal records and accounts as "unallocated client money" in accordance with CASS 7.13.36R(2) which have remained unresolved for period of six calendar days or more.

...

Section 6 Segregation of safe custody assets

In order to complete this section a *firm* will need to group the *safe custody assets* it held at the reporting period end date by the method of registration used (25A), the means by which the assets were held (25G) and the name of the institution with which the assets were deposited or registered (25B). Each group of *safe custody assets* so identified should be reported as a separate row.

When reporting dematerialised *safe custody assets* a *firm* holds in a *collective investment scheme*, a *firm* has the option to report the holdings in either one of the following ways:

- (1) per *fund* manager (ie, for every *fund* manager with whom the *firm* has holdings registered) it should use a new row to report the relevant holdings; or
- (2) on an aggregate basis by reference to each variance of data fields 25A, 25E and 25F (where relevant, ie, for each variance, such as holdings based in different countries and/or different methods of legal title registration), the *firm* should use a new row. For example, an asset held in one country in the name of a nominee company should be in a different row from an asset held in the same country in the name of a *client*, and also from an asset held in another country in the name of the same nominee company.

Annex 1 to this guidance sets out an example of reporting under either of these options.

25A How registered?

...

25B Name of institution where *safe custody assets* held/registered

...

In relation to any dematerialised *safe custody assets* which a *firm* held as the sole *custodian* the *firm* should report the name of the central securities depository where the *safe custody assets* were deposited registered, for example CREST, Euroclear UK & Ireland, etc. and should select “deposited with any other third party” when completing data field 25G.

In relation to any dematerialised *safe custody assets* a *firm* holds in a *collective investment scheme*, a *firm* should report, either:

- (a) the name of the fund manager who retains the regulatory responsibility for maintaining the legal register for those *safe custody assets*, if the *firm* is reporting by fund manager (for example, in respect of a UK OEIC, the ACD); or
- (b) the term “collective investment scheme” if the *firm* is reporting on an aggregate basis.

25C Number of lines of stock

...

For the purpose of this data field, a *firm* should treat each stock which bears its own CUSIP or ISIN number, or any individual *collective investment scheme* as a separate line of stock.

25D Value of *safe custody assets* as at reporting period end date

As at the reporting period end date, a *firm* should calculate the total value of the *safe custody assets* reported on each row and enter that value in the data field.

25E Country of incorporation of the institution

In relation to each institution identified in 25B, a *firm* should report the name of the country in which that institution is incorporated using the appropriate two letter ISO code.

In relation to dematerialised *safe custody assets* a *firm* holds in a *collective investment scheme*, the *firm* should report the country of incorporation of the relevant *fund manager* who has retained regulatory responsibility for registering units in the *collective investment scheme*. This means that a *firm* will need to have at least one row per country of incorporation of relevant *fund managers* regardless of whether the *firm* is reporting per *fund manager* or on an aggregate basis.

25F Group entity?

A *firm* should indicate in this data field whether each institution with which it placed *safe custody assets* is or is not a member of that *firm's group*. In relation to any dematerialised *safe custody assets* a *firm* holds in a *collective investment scheme*, the *firm* should treat the *fund manager* of that scheme as the relevant institution.

25G ~~Where~~ How held?

For each group of *safe custody assets* that a *firm* (in carrying on the *regulated activity* of *safeguarding and administering investments*) held at the reporting period end date, the *firm* should identify in this data field how ~~whether~~ the *safe custody assets* were held.:

- (a) ~~held in the *firm's* physical possession (for example any non-dematerialised assets such as bearer notes);~~
- (b) ~~deposited with a third party *custodian* (this may include any third party that has responsibility to the *firm* for the *safe custody assets*, such as a sub-custodian or a *fund manager*);~~
- (c) ~~deposited with a third party exchange;~~
- (d) ~~deposited with a third party *clearing house*;~~
- (e) ~~deposited with a third party intermediary; or~~
- (f) ~~deposited with any other third party (where none of the above options adequately describe how the *safe custody assets* are held).~~

	<u>If the <i>safe custody assets</i> were:</u>	<u>Choose the following option from the drop down box in the form:</u>
(a)	<u>held in the <i>firm's</i> physical possession (for example, any non-dematerialised assets such as bearer notes);</u>	<u>Firm physical;</u>
(b)	<u>deposited with a third party <i>custodian</i> (this may include any third party that has responsibility to the <i>firm</i> for the <i>safe custody assets</i>, such as a sub-custodian);</u>	<u>3rd party custodian</u>
(c)	<u>deposited with a third party exchange and/or <i>clearing house</i>;</u>	<u>Exchange/Clearing House</u>
(d)	<u>deposited with a third party intermediary; or</u>	<u>Intermediary</u>
(e)	<u>deposited/registered with any other third party (where none of the above options adequately describes how the <i>safe custody assets</i> are held).</u>	<u>Other</u>

In relation to any dematerialised *safe custody assets* which a *firm* held as the sole *custodian* the *firm* should select “Other” ~~option (f)~~ and report the name of the central securities depository where the *safe custody assets* were ~~deposited~~ registered, for example CREST, Euroclear UK & Ireland, etc. when completing data field 25B.

In relation to any dematerialised *safe custody assets* a *firm* holds in a *collective investment scheme*, the *firm* should select “Other”.

Section 7 Safe Custody Assets Reconciliations custody assets records checks and reconciliations

26 *Safe custody assets* ~~unreconciled~~ unresolved items

A *firm* should identify in this data field the number of ~~unreconciled~~ unresolved *safe custody assets* items and allocate each item to one of the specified time bands according to the length of time for which it has remained ~~unreconciled~~ unresolved.

For the purposes of this data field, the number of ~~unreconciled~~ unresolved safe custody assets items refers to the number of individual discrepancies (‘‘eg, custody record breaks’’) identified as part of a *firm’s* ~~external reconciliation~~ external custody reconciliation which have remained unresolved for a specific period of time.

CASS 6.6.48G provides that a discrepancy should not be considered to be resolved until is fully investigated and any associated *shortfall* is made good.

In relation to the 30-day field, a *firm* should report items which have remained ~~unreconciled~~ unresolved for at least 30 *days* but no more than 59 *days*.

In relation to the 60-day field, a *firm* should report items which have remained ~~unreconciled~~ unresolved for at least 60 *days*, but no more than 60 89 *days*.

In relation to the 90-day field, a *firm* should report items which have remained ~~unreconciled~~ unresolved for at least 90 *days*.

27A Method of custody record check/reconciliation

~~In relation to each type of *safe custody asset* identified in 27C, a *firm* should report the method of internal reconciliation that it applied to that type of asset. CASS 6.5.2R to CASS 6.5.5R set out rules and guidance in relation to internal reconciliation methods.~~

In relation to each type of *safe custody asset* identified in 27C, a *firm* should report:

(a) the method of *internal custody records checks* that it utilised in respect of that type of asset during the reporting period, by selecting either:

(i) ‘‘internal reconciliation’’ where it performed its *internal custody record checks* using the *internal custody reconciliation method*; or

(ii) ‘‘internal system evaluation’’ where it performed its *internal custody record checks* using the *internal system evaluation method*.

CASS 6.6.10G to 6.6.20G sets out rules and guidance in relation to *internal custody records checks*, and the available methods;

(b) (if applicable) the method of *physical asset reconciliation* that it utilised in respect of all *physical safe custody assets* it held during the reporting period, by selecting either:

(i) ‘‘physical reconciliation - total count’’ where it performed its *physical asset reconciliations* using the *total count method*; or

(ii) ‘‘physical reconciliation - rolling stock’’ where it performed its *physical asset reconciliations* under the *rolling stock method*.

CASS 6.6.21G to 6.6.32G set out rules and guidance in relation to *physical asset reconciliations*, and the available methods; and

(c) (if applicable) the method of *external custody reconciliation* that it utilised in respect of that type of asset during the reporting period, by selecting either:

(i) ‘‘External reconciliation to CREST’’ where it performed an *external custody reconciliation* with Euroclear UK & Ireland for *safe custody assets* held in the *CREST* system; or

(ii) “external reconciliation”, where it performed an *external custody reconciliation* with any other third party.

CASS 6.6.33G to 6.6.43G set out rules and guidance in relation to external custody checks, and the available methods.

27B Frequency

In relation to each custody record check/reconciliation type method identified in 27A, a *firm* should report the frequency with which it conducted ~~internal reconciliations~~ the custody record check/reconciliation for its safe custody assets during the reporting period using that record check/reconciliation method.

27C Type of *safe custody asset*

A *firm* should report the different types of *safe custody asset* (e.g. shares) that it held and may do so using its own description of an asset type.

Section 8 Record keeping and ~~branches~~ notification requirements

...

28F Explanation of ~~discrepancies~~ difference

A *firm* should provide a brief explanation for any difference between the number of *client bank accounts* reported for 28D and the number of ~~trust/acknowledgement letters~~ *client bank accounts* reported in 28E which were covered by a *client bank account acknowledgement letter* to cover these accounts reported for 28E in accordance with (see CASS 7.8.1R 7.18.2R).

...

29F Explanation of ~~discrepancies~~ difference

A *firm* should provide a brief explanation where there is a difference between the number of *client transaction accounts* reported for 29D and the number of ~~trust/acknowledgement letters~~ *client transaction accounts* reported in 29E which were covered by a *client transaction account acknowledgement letter* and/or *authorised central counterparty acknowledgement letter* to cover these accounts reported for 29E (see in accordance with CASS 7.8.2R 7.18.3R and/or CASS 7.8.3R 7.18.4R).

31 Did any of the circumstances referred to in CASS 6.6.57R arise? ~~the firm fail to comply with the requirements set out in CASS 6.5.1R, CASS 6.5.2R, CASS 6.5.6R and CASS 6.5.10R?~~

~~A *firm* should indicate whether, at any point during the reporting period, it failed to comply with any of the requirements set out in CASS 6.5.1R, CASS 6.5.2R and CASS 6.5.6R.~~

~~If a *firm*, having carried out a reconciliation during the reporting period, failed to comply with CASS 6.5.10R, it should also record that fact in this data field.~~

~~CASS 6.5.10R provides that a *firm* must promptly correct any discrepancies which are revealed in the reconciliations envisaged by CASS 6.5 and make good, or provide the equivalent of, any unreconciled *shortfall* for which there are reasonable grounds for concluding that the *firm* is responsible.~~

~~A *firm* should indicate whether at any point during the reporting period one of the situations referred to in CASS 6.6.57R arose, in which the *firm* was obligated to notify the FCA.~~

~~Some of the notification requirements in CASS 6.6.57R only apply where a *firm* materially fails to comply with a *rule* (ie, a breach of the *rule* having occurred), while others apply where the *firm* was unable to comply with a *rule* (ie, a *firm* had not yet breached the relevant *rule* but became aware that it would, in the future, either continuously or for a specified period, be unable to comply with the specified *rule*). Therefore, a *firm* should base its response only on those breaches that would be notifiable.~~

- 32 ~~If yes, was a notification made to the FCA did the *firm* comply with the notification requirements?~~

~~If in data field 31 the *firm* has answered “Yes”, acknowledged a failure to comply with any of the specified *rules*, it should confirm in this data field whether a notification all notifications was were made to the FCA in accordance with CASS 6.5.13R 6.6.57R.~~

~~Where the *firm*’s response to data field 31 relates to multiple instances of non-compliance, it should only answer “Yes” in this data field if all instances were notified.~~

- 33 ~~Did any of the circumstances referred to in CASS 7.15.33R arise? Did the *firm* fail to comply with any of the requirements set out in CASS 7.6.1R, CASS 7.6.2R, CASS 7.6.9R and CASS 7.6.13R to CASS 7.6.15R?~~

~~A *firm* should indicate whether, at any point during the reporting period it failed to comply with any of the requirements set out in CASS 7.6.1R, CASS 7.6.2R and CASS 7.6.9R.~~

~~If a *firm*, having carried out a reconciliation during the reporting period, failed to comply with one or more of the obligations found in CASS 7.6.13R to CASS 7.6.15R, it should also record that fact in this data field.~~

~~CASS 7.6.13R to CASS 7.6.15R set out requirements which apply to a *firm* in relation to internal and external reconciliation discrepancies.~~

~~A *firm* should indicate whether at any point during the reporting period one of the situations referred to in CASS 7.15.33R arose, in which the *firm* was required to notify the FCA.~~

~~Some of the notification requirements in CASS 7.15.33R only apply where a *firm* materially fails to comply with a *rule* (ie, a breach of the *rule* having occurred), while others apply where the *firm* was unable to comply with a *rule* (ie, a *firm* had not yet~~

breached the relevant *rule* but became aware that it would, in the future, either continuously or for a specified period, be unable to comply with the specified *rule*). Therefore, a *firm* should base its response only on those breaches that would be notifiable.

34 If yes, ~~was a notification made to the FCA~~ did the *firm* comply with the notification requirements?

If in data field 33 the *firm* has answered “Yes”, ~~acknowledged a failure to comply with any of the specified *rules*~~, it should confirm in this data field whether a ~~notification~~ all notifications ~~was~~ were made to the FCA in accordance with CASS ~~7.6.16R~~ 7.15.33R.

~~Where the *firm*'s response to data field 33 covers multiple instances of non-compliance, it should only answer “Yes” in this data field if all instances were notified.~~

~~In relation to data fields 31 and 33, a *firm* should answer “Yes” if it failed to comply with any of the *rules* specified in those data fields at any point during the reporting period in question, whether or not it is in compliance at the end of the reporting period.~~

~~A *firm*'s responses to data fields 31 and 33 should only include relate to unresolved breaches that occurred within the particular a previous CMAR reporting period if those breaches would have required further notification under CASS 6.6.57R in question and not to any breach that may have occurred in a previous reporting period, even if the breach remains unresolved.~~

~~A *firm* should answer “N/A” as appropriate to data fields 31 and 33 if it did not hold *client money* or *safe custody assets* during the reporting period.~~

~~In relation to data fields 32 and 34, a *firm* should only answer “Yes” if the *firm* has acknowledged any breaches in data fields 31 or 33, and all such breaches were notified as required within the reporting period in question.~~

~~CASS 6.5.13R and CASS 7.6.16R require that the FCA be informed without delay of any of the matters in respect of which notification is required by those *rules*. Submission of the CMAR within the time limit specified in SUP 16.14.3R does not discharge the obligations in those *rules* and a *firm* remains obliged to notify the FCA as soon as it becomes aware that any of the circumstances described in those *rules* has arisen.~~

~~A *firm* should answer “N/A” as appropriate to data fields 32 and 34 if the *firm* has answered either “No” or “N/A” for data fields 31 and 33 respectively.~~

CASS 6.6.57R and CASS 7.15.33R require that the FCA be informed without delay of any of the matters in respect of which notification is required by those *rules*. Submission of the CMAR within the time limit specified in SUP 16.14.3R does not discharge the obligations in those *rules* and a *firm* remains obliged to notify the FCA as soon as it becomes aware that any of the circumstances described in those *rules* has arisen.

...

Annex 1**Options for reporting dematerialised safe custody assets a firm holds in a collective investment scheme in fields 25A-G****Option 1 – reporting holdings per fund manager**

Table 1 shows an example of some of the possible permutations of reporting this way. In Table 1:

- With respect to Fund Manager X, for the purposes of completing fields 25A-G of the CMAR, the reporting firm needs to complete one line. This is because in relation to its holdings in all 3 collective investment schemes (reported in 25C) the units are registered in the name of a nominee company controlled by the firm. Fund Manager X is incorporated in Guernsey and it is a member of the firm’s group. The same applies with respect to Fund Manager Y.
- With respect to Fund Manager Z, for the purposes of completing fields 25A-G of the CMAR, the reporting firm needs to complete two separate lines. This is because in relation to the firm’s holdings in 1 collective investment scheme (reported in 25C) the units are registered in the name of a nominee company which is controlled by the firm and in relation to the firm’s holdings in the other 3 collective investment schemes the units are registered in the name of a nominee company which is controlled by an affiliated company. Fund Manager Z is incorporated in the Cayman Islands and it is a member of the firm’s group.

Table 1

<u>A</u>	<u>G</u>	<u>B</u>	<u>C</u>	<u>D</u>	<u>E</u>	<u>F</u>
<u>How registered?</u>	<u>How held /registered</u>	<u>Institution where safe custody assets held/registered</u>	<u>Number of lines of stock</u>	<u>Value of safe custody assets as at reporting period end date</u>	<u>Country of incorporation of the institution</u>	<u>Is this a group entity</u>
<u>Nominee company which is controlled by the firm</u>	<u>Other</u>	<u>Fund Manager X</u>	<u>3</u>	<u>£600m</u>	<u>Guernsey</u>	<u>Yes</u>
<u>Nominee company which is controlled by the firm</u>	<u>Other</u>	<u>Fund Manager Y</u>	<u>5</u>	<u>£350m</u>	<u>Guernsey</u>	<u>Yes</u>

<u>Nominee company which is controlled by the firm</u>	<u>Other</u>	<u>Fund Manager Z</u>	<u>1</u>	<u>£90m</u>	<u>Cayman Islands</u>	<u>Yes</u>
<u>Nominee company which is controlled by an affiliated company</u>	<u>Other</u>	<u>Fund Manager Z</u>	<u>3</u>	<u>£400m</u>	<u>Cayman Islands</u>	<u>Yes</u>
<u>Nominee company which is controlled by an affiliated company</u>	<u>Other</u>	<u>Fund Manager XX</u>	<u>5</u>	<u>£250m</u>	<u>Cayman Islands</u>	<u>Yes</u>

Option 2 – reporting on an aggregate basis

Table 2 shows an example of some of the possible permutations of reporting this way. In Table 2:

- Line (i) reports all the firm’s holdings in collective investment schemes in relation to which the units are registered in the name of a nominee company which is controlled by the firm and the relevant fund manager is incorporated in Guernsey and is a group entity.
- Line (ii) reports all the firm’s holdings in collective investment schemes in relation to which the units are registered in the name of a nominee company which is controlled by the firm and the relevant fund manager is incorporated in the Cayman Islands and is a group entity.
- Line (iii) reports all the firm’s holdings in collective investment schemes in relation to which the units are registered in the name of a nominee company which is controlled by an affiliated firm and the relevant fund manager is incorporated in the Cayman Islands and is a group entity.

Table 2

<u>A</u>	<u>G</u>	<u>B</u>	<u>C</u>	<u>D</u>	<u>E</u>	<u>F</u>
<u>How registered?</u>	<u>How held / registered</u>	<u>Institution where safe custody assets</u>	<u>Number of lines of stock</u>	<u>Value of safe custody</u>	<u>Country of incorporation of the</u>	<u>Is this a group</u>

		<u>held/registered</u>		<u>assets as at reporting period end date</u>	<u>institution</u>	<u>entity</u>	
<u>(i)</u>	<u>Nominee company which is controlled by the firm</u>	<u>Other</u>	<u>collective investment scheme</u>	<u>8</u>	<u>£950m</u>	<u>Guernsey</u>	<u>Yes</u>
<u>(ii)</u>	<u>Nominee company which is controlled by the firm</u>	<u>Other</u>	<u>collective investment scheme</u>	<u>1</u>	<u>£90m</u>	<u>Cayman Islands</u>	<u>Yes</u>
<u>(iii)</u>	<u>Nominee company which is controlled by an affiliated company</u>	<u>Other</u>	<u>collective investment scheme</u>	<u>8</u>	<u>£650m</u>	<u>Cayman Islands</u>	<u>Yes</u>

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25 The North Colonnade Canary Wharf
London E14 5HS
Telephone: +44 (0)20 7066 1000
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