Financial Conduct Authority

Consultation Paper CP13/5**

# Review of the client assets regime for investment business

July 2013

We are asking for comments on this Consultation Paper by:

- 12 August 2013 – in relation to EMIR RTS proposals (chapter 8);
- 11 October 2013 – in relation to all other proposals (chapters 2 to 7, inclusive and 9).

You can send them to us using the form on our website at:
www.fca.org.uk/your-fca/documents/consultation-papers/cp13-05-response-form.

**Or in writing to:**

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You can download this Consultation Paper from our website: www.fca.org.uk. Or contact our order line for paper copies: 0845 608 2372.

# Abbreviations used in this paper

| | |
|---|---|
| **BCD** | Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast), referred to as the Banking Consolidation Directive |
| **CASS** | Client Assets sourcebook |
| **CBA** | Cost benefit analysis |
| **CCP** | Central counterparty |
| **CFTC** | U.S. Commodity Futures Trading Commission |
| **Client assets** | Client money and custody assets |
| **CMAR** | Client money and assets return |
| **CMP** | Client money pool |
| **COBS** | Conduct of business sourcebook |
| **CP** | Consultation Paper |
| **EMIR** | Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories, commonly referred to as the European Market Infrastructure Regulation |
| **ESMA** | European Securities and Markets Authority |
| **IOSCO** | International Organization of Securities Commissions |
| **IP** | Insolvency practitioner |
| **LBIE** | Lehman Brothers International (Europe) |
| **LBIE case** | Lehman Brothers International (Europe) (in administration), [2012] UKSC 6 |
| **MiFID** | Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, referred to as the Markets in Financial Instruments Directive |
| **Pritchards** | Pritchards Stockbrokers Limited |
| **PPE** | Primary pooling event |
| **PS** | Policy statement |
| **QMMF** | Qualifying money market fund |

| | |
|---|---|
| **RAO** | Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544), referred to as the Regulated Activities Order |
| **RTS on indirect clearing, EMIR RTS** | Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation EU No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP.<br>*This Consultation Paper is primarily concerned with Chapter II of these RTS, addressing the subject of indirect clearing.* |
| **SAR** | The Investment Bank Special Administration Regulations 2011 and The Investment Bank Special Administration (England and Wales) Rules 2011, referred to as the Special Administration Regime |
| **TTCA** | Title transfer collateral arrangements |
| **Unit** | The Client Assets Unit |
| **WSL** | Worldspreads Limited |

# 1. Overview

## Introduction

**1.1** This paper consults on material changes to the rules in relation to client money, custody assets and mandates. Some of these proposals are more significant than others. Individually each proposal is intended to address a particular risk identified in firms or clarify an existing requirement. Collectively these proposals aim to enhance the FCA's client assets regime to achieve better results for consumers (both wholesale and retail) and increase confidence in financial markets.

**1.2** Throughout this paper the term 'client assets' refers to both client money and custody assets.

## Who does this consultation affect?

**1.3** This consultation paper proposes changes to the client assets rules that are applicable to **firms that are subject to the client assets sourcebook** (CASS) because they hold client money, custody assets, collateral and/or mandates (or rely on exemptions contained within CASS) in relation to investment business.

**1.4** This consultation will also interest:

- **Auditors** in relation to the provision of client assets audit reports and auditors' reports on different or alternative approaches/methods permitted by CASS.
- **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 place client money.
- **Insolvency practitioners** and their advisers that would be responsible for distributing client assets if a firm that holds client assets starts insolvency proceedings.

**1.5** The proposals in this Consultation Paper will not apply to general insurance intermediaries that only hold client money in accordance with CASS 5.[1]

1 Please refer to the FSA's CP12/20 for proposed changes to the CASS 5 regime.

## Is this of interest to consumers?

**1.6** These proposals, if made, would affect what steps firms take to protect consumers' assets (both retail and wholesale). However, these proposals should not directly affect what consumers experience from firms, except in the following instances:

- Distribution of client money proposals (Chapter 2) would change a client's recovery of their money (both in terms of speed and balance recovered) in the event of insolvency of a firm with whom they had placed money.
- Disclosure proposals (Chapter 6) would enhance the information provided to consumers (both retail and wholesale) about how their money and assets are held by a firm.
- Multiple pools proposals (Chapter 2) would allow clients of clearing member firms (likely to be mostly wholesale consumers) to agree for money provided as margin to be held in separate pooling arrangements to facilitate porting of client money (alongside positions) in the event of insolvency of the clearing member firm.

**1.7** We welcome feedback from consumers and consumer groups on the proposals contained in this CP.

## Context

**1.8** The client assets regime applies to around 1,500 firms regulated by the FCA that are permitted to safeguard and administer assets and/or hold client money, collectively holding in excess of £10tn of custody assets[2] and in excess of £100bn of client money[3] in relation to investment business. The protection of client assets is fundamental to consumers' rights and the trust they place with firms that are often acting as their agents, fiduciaries and/or counterparties. It is at the heart of ensuring a well-functioning and robust market place.

**1.9** Our increased focus on the protection of client assets has been well publicised and in 2010 we launched the Client Assets Unit (the Unit), which brings together specialist risk, supervision and policy functions.

**1.10** In recent years we have driven improvements in the auditors reporting on client assets, as well as introducing the Client Money and Assets Return (CMAR) that firms submit monthly to us. These reports, as well as other key data sources, are used in the Unit's risk-based supervisory approach to prioritise our efforts. We have also introduced the new controlled function of client assets oversight function (CF10a) to enhance governance and oversight in firms. These and other measures we have introduced in the past few years have led to improvements in firms, some of which are publicised in the public enforcement actions. Nevertheless, compliance with the client assets regime remains a regulatory priority, with the Unit continuing to lead our efforts.

**1.11** Recent insolvencies and the supervisory work undertaken by the Unit have identified the weaknesses in some firms' client assets safeguards and the need to enhance this regulatory regime. The conclusion of the Lehman Brothers International (Europe) Supreme Court client

2 The custody assets held by CASS Large and Medium firms as at April 2013

3 The client money held by CASS Large and Medium firms as at April 2013

money case in 2012[4] (the LBIE case), has finally allowed us to undertake a fundamental review of the client assets regime (the Review). The Review draws on the lessons learnt from these recent insolvencies and the observations identified by the Unit, as well as drawing on the feedback from firms, their associations and their auditors.

**1.12** The Review is focused on improving the regime to lead to better results, supporting the FCA objectives relating to consumer protection and market integrity, by aiming to:

- improve the speed of return of client assets following the insolvency of an investment firm;
- achieve a greater return of client assets to clients following the insolvency of an investment firm; and
- reduce the market impact of an insolvency of an investment firm that holds client assets.

**1.13** In September 2012, we published a Discussion Paper (Part III of CP12/22) on this Review setting out our objectives and the ideas we are considering.[5] This Consultation Paper incorporates the feedback we received as part of the proposals we presented.

**1.14** In the lead up to this we also held a number of advisory group meetings, bringing together a cross section of industry participants and their associations to discuss some of the specific issues and initial concepts behind some of the proposals.

## Summary of our proposals

### Client money distribution regime

**1.15** In Chapter 2 we ask whether we should make a change to the client money distribution regime that will enable the insolvency practitioner (IP) of a firm that has begun insolvency proceedings to distribute client money based on the firm's records (rather than agreed claims of clients). This will allow the distribution of client money to be undertaken within weeks of insolvency rather than the years and months it currently takes.

**1.16** If this change is implemented it could increase the speed of recovery and affect the amount returned to clients in most cases. Some clients will enjoy increased recoveries, but there may be less or no recovery for others. At the heart of the proposals is the balance between what constitutes an 'accurate' recovery for clients and the speed at which a distribution should be made following a firm's insolvency.

**1.17** We are conscious that other national regimes may be able to achieve a speedy distribution of client assets without the negative consequences to some clients identified in our proposals. However, our proposals recognise the limits of what the FCA can do within its powers.

**1.18** If the government introduces changes that could speed up the distribution of client money following the review of the Special Administration Regime (see below), then some of the proposals that concern the speed of distribution of client money in Chapter 2 may not be necessary while others would be enhanced. However, if no changes are made in the legislation, then the proposals in Chapter 2 reflect what we consider the limit of what we can achieve in our rules to speed up the distribution of client money.

4 Lehman Brothers International (Europe) (In Administration), [2012] UKSC 6

5 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

**1.19** In addition to the above proposal, we are also proposing changes to the rules in relation to matters raised in recent insolvencies, including the valuation of positions open at the time of insolvencies, treatment of multiple currencies and payment of interest.

### Multiple pools

**1.20** In Part II of CP12/22 we proposed to introduce multiple client money pools. In Chapter 3 we respond to the feedback we received and consult on a limited introduction of client money multiple pools for clearing member firms.

### Client money rules, custody rules, mandate rules and new disclosure requirements

**1.21** In Chapters 4 and 5 we consult on proposals to changes to the client money rules and custody rules. The changes relate to a wide variety of aspects, including reconciliations, delivery versus payment exclusions, buffers, unclaimed client money and assets and acknowledgment letters.

**1.22** In addition to these specific proposals we are taking the opportunity to clarify other client money and custody rules, adding guidance where appropriate and restructuring sections to make the sourcebook easier to understand and navigate.

**1.23** In Chapter 6 of this CP, we propose introducing new disclosure requirements that would see firms report to their clients at least annually on the client assets protections they provide them.

**1.24** We are also proposing to increase the scope of the mandate rules by requiring firms to establish and maintain adequate records and internal controls for all mandates, including those not obtained in written form (see Chapter 7).

### European Market Infrastructure Regulation (EMIR)

**1.25** We are proposing changes to client money rules and client money distribution rules to comply with the EMIR Regulatory Technical Standards (RTS) regarding indirect client clearing.

## The SAR review

**1.26** The client assets regime is built on a framework of insolvency and company legislation. Of key relevance to the insolvencies of investment firms that hold client assets is the Special Administration Regime (SAR). The SAR was introduced in February 2011 following the experience gained from the LBIE case. It was first used in the failure of MF Global Ltd and subsequently in a number of other failings, including Pritchard Stockbrokers Ltd (Pritchards) and Worldspreads Ltd (WSL).

**1.27** Earlier this year, a government-commissioned independent review[6] of the SAR reported on how well it is meeting its objectives and whether more could or should be done to speed up the return of client assets if an investment firm failed.

**1.28** The report concluded that the SAR should be retained and made some initial recommendations on how it could be improved, as well as making some good practice recommendations. These recommendations included introducing mechanisms to facilitate the rapid transfer of customer relationships and positions, the extension of the bar date mechanism to client money, and the extension of some of the information sharing and cooperation provisions.

6 P. Bloxham, Review of the Special Administration Regime for Investment Banks (23 April 2013), available at: https://www.gov.uk/government/news/review-of-the-special-administration-regime-for-investment-banks-published

**1.29** The report also set out areas that warrant further consideration, including client preference, administrator immunities and the role of the courts in SAR cases. A second phase review is currently ongoing and is likely to report later this year.

**1.30** We await the conclusion of this work to understand the changes the government are likely to introduce following its recommendations. We recognise that our proposals, in particular those in relation to the client money distribution regime, may need amending if the government introduces material changes to legislation.

**1.31** We will review the proposals in this CP in light of any changes the government intends to make and we will aim to implement (subject to consultation feedback) all the proposals unaffected by changes the government introduces to legislation. We will only re-consult if necessary, for example on those matters affected if the government introduces changes.

## Compensation regimes

**1.32** As discussed in CP12/22, the Financial Services Compensation Scheme (FSCS) is the UK's compensation scheme of last resort when a UK-authorised financial services firm is unable, or unlikely to be unable, to pay claims against it.

**1.33** The compensation regime has played an important role in protecting consumers (those that are eligible) in recent insolvencies that have involved client assets. The SAR report published earlier this year has made recommendations in relation to the FSCS, which included a proposed amendment to the FSCS product perimeter. We will carefully consider these recommendations and any further recommendations made by the second phase of the SAR review.

## The draft Handbook text

**1.34** In the appendix we include the draft handbook text showing our proposed changes to the provisions. We encourage you to consider the text of the draft rules alongside the summary of the key enhancements on which we are consulting as set out in the chapters of this CP.

**1.35** We would welcome your comments on these draft rules and on how they can be improved to better reflect the policy intention.

## Equality and diversity considerations

**1.36** We have assessed the likely equality and diversity impacts of the proposals and do not think they give rise to any concerns, but we would welcome your comments.

## Next steps

**1.37** We want to know what you think of our proposals. Please send us your comments by the following dates:

- **12 August 2013 – in relation to EMIR RTS proposals** (Chapter 8)
- **11 October 2013 – in relation to all other proposals** (Chapters 2 to 7, inclusive and 9)

**1.38** Please use the online response form on our website or write to us at the address on page 2.

**1.39** We will consider your feedback and aim to publish our final rules in September 2013 in relation to EMIR RTS proposals and in the first half of 2014 for all other proposals.

# 2. Client money distribution rules: prioritising speed (CASS 7A)

**2.1** This chapter focuses on some of the issues with the current client money distribution rules (CASS 7A) and sets out our proposals to address these issues. The proposals include:

- increasing the speed of distribution of client money on firm failure;
- applying 'hindsight' to value certain margined transactions carried out for clients ; and
- amending the secondary pooling event rules to capture the possibility of the failure of central counterparties.

**2.2** If implemented, we propose that the majority of these proposals come into effect at the same time the changes to the client money and custody proposals come into effect (six months after the publication of the policy statement in the first half of 2014). However, subject to consultation responses, to the extent the final client money distribution rules are not dependent on the changes to the client money and custody rules we will consider having the rules come into effect immediately following publication of the policy statement.

## Distribution of client money following an investment firm's insolvency (primary pooling event)

**2.3** Part IV of CP12/22 discussed some of the measures being considered as part of the Review to achieve better results for the consumers (both retail and wholesale) and enhancing confidence in financial markets. At the heart of this discussion is a debate about the accuracy of distribution of client money versus the speed of any distributions made to clients. Under the current regime, accuracy is effectively prioritised leading to a regime that takes months, and in some cases years, to return client money to clients following an insolvency of an investment firm.

**2.4** In this section we consult on whether we should make 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. Given the limits of the FCA powers, this proposal, if implemented, could increase the speed of recovery and affect the amount returned to clients in most cases. Some clients will enjoy increased recoveries, but there may be less or no recovery for others.

**2.5** A faster return of client money following an insolvency is important to maintain confidence in financial markets and reduce the effect on other participants. Plus the longer client money is trapped in the client money pool (CMP) of a failed firm, the more likely that it will have a negative effect on clients. These clients could be other firms who have their own clients; and these firms could then also suffer significant loss of business and become insolvent.

**2.6** This proposal is different from the current client money distribution rules and we want your views on whether we should implement this or maintain the existing regime (subject to some changes and clarifications explained in this chapter).

### The current regime

**2.7** Under the current CASS 7A rules, when an investment firm fails – a type of primary pooling event (PPE) – broadly speaking, all client money held by the firm in client money bank accounts and client transaction accounts is notionally pooled, forming the CMP. The CMP is then distributed to the clients of the firm on a pro-rata basis in accordance with their entitlements to the CMP.

**2.8** The client assets rules are part of a framework of European law and English primary and secondary legislation that governs the protection of client money and assets. This framework includes MiFID, FSMA, the Insolvency Act 1986 and the SAR.

**2.9** The insolvency of Lehman Brothers International (Europe) (LBIE) in September 2008 saw the application of the CASS 7A rules in the context of a large firm failure. The LBIE case confirmed (among other points) that, under the current CASS 7A rules: (i) the CMP is made up of all client money in client bank accounts and client transaction accounts and any identifiable client money in house accounts; and (ii) any client who can establish a claim to the CMP because they should have been protected should be entitled to participate in the CMP (the so called 'claims basis' of distribution).

**2.10** Since the LBIE collapse, we have seen the CASS 7A rules applied in the failures of a number of firms, including MFG, Pritchards and WSL. When a firm fails it can be months or years under the current regime before an interim distribution from the CMP is made and such distributions are often limited percentages of the recovered client money.

**2.11** There are a number of factors that contribute to delays in the return of client money when a firm fails. The firm holds the client money for all clients and the CMP must be distributed pro rata to clients in accordance with their entitlements. This necessarily involves an often lengthy process of the insolvency practitioner (IP) quantifying clients' entitlements.

**2.12** Verifying claims made under the basis of distribution confirmed by the LBIE case causes further delays, as clients must have an opportunity to assert claims to the CMP. These delays are compounded by the IP's personal liability to clients, which further compels them to verify the accuracy of client entitlements as far as possible and seek court approval for their actions. In addition, there are often disputes regarding the amount claimed resulting in significant delays. For example, in both the LBIE and MFG failures there have been court actions by clients who have claimed that they should be entitled to share in the CMP even though the firm did not treat them as CASS clients.

**2.13** Most of the matters we refer to above are beyond our remit; however, in our speed proposal we discuss what we can achieve given the above matters and the limits of our powers.

### The speed proposal

**2.14** To minimise these delays as far as possible within the FCA's powers and increase the speed of return of client money on firm failure, we propose introducing a client money distribution regime that permits an initial distribution of client money on the basis of a firm's records.

**2.15** We propose to introduce a two-stage client money distribution process: (1) the formation and distribution of an 'initial' client money pool (CMP1); and (2) the formation and distribution of a 'residual' client money pool (CMP2). We also propose to introduce a process for transferring

the whole client money pool, which may operate in parallel with the preparation stages of the distribution process (see paragraphs 2.39 and 2.40).

**2.16** **Stage 1:** The failure of an investment firm would trigger a primary pooling event. On the occurrence of a PPE (subject to certain carve outs as a result of EMIR) the firm (or its IP) will be required to notionally pool all the money held in client bank accounts or client transaction accounts of the failed firm forming the initial client money pool (CMP1). The firm (or its IP) would be required to repeat the firm's reconciliation calculation – in accordance with the firm's existing methodology (whether or not it is fully compliant with the CASS rules) – as at PPE to effectively update the firm's records to the point of the firm's failure.

**2.17** The firm would then use those updated records to determine each client's entitlement to CMP1. The new rules would then require (making it a term of the statutory trust) the firm to distribute on the basis of these recorded entitlements. Clients not appearing in the firm's updated records as having an entitlement would not be eligible for a distribution from CMP1 (even though they would have been under the current regime). Under this proposal, we would expect that within a couple of weeks of a PPE there will be a prompt interim distribution of client money entitlements from CMP1.

**2.18** **Stage 2:** A second, residual client money pool (CMP2) constituting any client money not in client bank accounts or client transaction accounts (for example, 'identifiable' client money in house accounts) and any surplus client money from CMP1 would also be formed. The firm would be required to establish a claims process to allow clients who believe they should have had a claim on the client money held by the firm to establish an entitlement to CMP2. The firm must then distribute CMP2 rateably on the basis of the agreed client entitlements. There could be situations where CMP2 may not arise – namely where all client entitlements have been met by CMP1 or where there is no identifiable client money in house accounts of surplus from CMP1.

**2.19** **The alternative (combined CMP):** In certain circumstances a firm may not be able to follow the distribution process set out in stages 1 and 2 above. If the firm cannot repeat the firm's reconciliation calculation due to systems failure, or there is a difference of more than 10% between the amount the firm should have been holding according to its last reconciliation and the amount it had actually segregated in client bank accounts immediately prior to the occurrence of the PPE, or the firm cannot reasonably determine the eligible clients' entitlements to CMP1 as described in stage 1, the IP will required to form a single, notional combined CMP made up of all the client money from CMP1 and CMP2. The firm would then be required to perform a client money reconciliation. In this context, the reconciliation would not be a repeat of any calculation previously carried out by the firm, but a new calculation on the basis that the IP thinks is correct. The reconciliation would then be used to determine the clients' client money entitlements to the CMP. To validate the clients' client money entitlements and to provide an opportunity for clients to assert claims on the CMP, the firm would also be required to establish a claims process. The firm must then distribute the CMP rateably on the basis of the clients' client money entitlements. The combined CMP most closely resembles the current distribution regime (see paragraphs 2.30-2.31).

**2.20** Under these proposals, the statutory trust over client money will continue to arise on the receipt by the firm of the client money (we are not proposing to change this in this CP).

**2.21** Table 1 summarises the constitution of each type of CMP and the clients who may receive a distribution from each.

***Table 1: The constitution of the CMPs and the clients who may receive a distribution from each***

| | CMP1 – Records based distribution | CMP 2 – Claims based distribution | Combined CMP |
|---|---|---|---|
| When is the CMP formed? | CMP1 is formed at PPE. | CMP2 is formed at PPE where there is surplus from CMP1 and any other identifiable client money. | Combined CMP is formed at PPE, where certain conditions are met. |
| What constitutes the CMP? | All money in client bank accounts and (subject to the application of 'hindsight') client transaction accounts of the firm at the time of the PPE.<br>All client money deriving from the liquidation of clients' approved collateral and units in qualifying money market funds. | Any client money in other accounts of the firm (e.g. identifiable client money in a firm's house account) and any surplus client money from CMP1. | All client money that would have made up CMP1 and CMP2. |
| Who can claim on the CMP? | Clients with an entitlement according to the firm's reconciliation records. | Clients who did not receive 100% of their entitlement to CMP1 may wish to assert claims on CMP2 and other clients who successfully assert a claim against CMP2 through the claims process. | Clients with an entitlement according to the firm's new reconciliation calculation and/or clients who successfully assert a claim against the firm through the claims process. |

### Emphasis on firm records in CMP1

**2.22** Under the current regime, which also involves the IP/firm determining clients' entitlements to the CMP, there is an element of reliance on firm records. Stage 1 of the speed proposal would shift the reliance of the IP and clients, squarely onto the firm's records by requiring the IP to distribute the client money on the basis of the firm's records (where those records reasonably determine the eligible clients' entitlements).

**2.23** Where a firm's records are accurate, a records based distribution of CMP1 is likely to be quick and meet clients' expectations. However, where a firm's records are inaccurate and do not reflect all client claims, clients whose claims are not recorded will not receive a distribution from CMP1. There will be a greater responsibility on firms to ensure that their records are accurate and on clients to check up as far as possible on their firms. Similarly, there will be greater pressure on the FCA to supervise firms' compliance with our requirements in this area.

**2.24** We believe that the risks presented by a firm having materially poor records are mitigated to a degree by the fact that at the beginning of stage 1 of the speed proposal, when the IP repeats the firm's reconciliation, an assessment of whether the clients' client money entitlements can reasonably be determined from the reconciliation, and whether certain other circumstances have arisen, may be carried out. In the event that the IP determines, for example, that it cannot reasonably determine the entitlements from the reconciliation, a distribution based on firm records does not take place. The combined pool is formed and the IP carries out a 'correct' reconciliation and a lengthy claims process.

### More limited entitlement to a distribution from CMP1

**2.25** Distribution of CMP1 solely on the basis of a firm's records is likely to mean that some client claims that would have been entitled to a distribution under the current regime will not be entitled to a distribution from CMP1. Examples include client claims in relation to a particular type of business that a firm failed to include in its client money reconciliation or the claims of an affiliate who the firm failed to treat as a client with client money protection.

**2.26** While it may be argued that this outcome is unfair on the clients excluded from CMP1, on the other hand the overall outcome for the clients included in the firm's records is likely to be better.

**2.27** By way of illustration, when LBIE failed, the amount of client money it had actually segregated for clients was approximately US$2 billion. However, LBIE had failed to treat some clients, mostly notably its affiliates, as clients. In part due to legal cases (which ultimately lead to the Supreme Court) in a need to reach accuracy, it has taken over four years for LBIE to distribute any client money to clients.[7] However, under the speed proposal, the IP would have been able to distribute the segregated client money promptly thereby reducing the impact of LBIE's insolvency on other market participants. However, the consequence of the speed proposal is that for LBIE's clients who the firm failed to reflect in its client money records, they would not have been entitled to participate in CMP1.

**2.28** Under the speed proposal, those clients who are ineligible to claim from CMP1 may not lose out entirely as they may be able to establish an entitlement to any CMP2. The outcome for these clients will depend on: (i) the amount of client money in CMP2; and (ii) the number of successful claimants to CMP2.

**2.29** Depending on the circumstances in any particular firm failure, the effect of the proposed policy is likely to lead to different outcomes for certain categories of clients when compared with the existing rules. Our ability to make changes to the rules may be constrained in various ways, including the limits of our statutory powers and by EU legislation, but also by domestic legal precedent. The current rules have been the subject of judicial scrutiny at the highest level, and we have carefully considered the implications of making changes which do not merely 'codify' in the rules the impact of the Supreme Court's rulings. We will continue to consider these issues and they will inform our thinking in shaping any regime that we put in place. We would welcome comments on these issues as part of this consultation, including in light of the potential impact of the proposed policy in different circumstances.

### The alternative to speed: codifying the existing regime

**2.30** Without changes to the legislation framework, we believe that the only other viable option to the speed proposal would be to retain the existing distribution regime and codify some of the lessons learnt from firm insolvencies. The rules for this would resemble the rules for the combined CMP in the speed proposal.

**2.31** If we were to implement this proposal, we would make it clear in the rules:

- what money constitutes the CMP;
- a 'corrected' reconciliation is to be carried out at PPE; and
- the process to be followed to determine clients' entitlements to the CMP.

7 For more information, see Lehman Brothers International (Europe) – In Administration: Joint Administrators' ninth progress report for the period from 15 September 2013 to 14 March 2013, available at: http://www.pwc.co.uk/business-recovery/administrations/lehman/lehmans-joint-administrators-progress-report-140409.jhtml

**Q1: Do you think we should implement the speed proposal or codify the existing regime? Please explain the reasons for your response.**

### Our powers and comparisons with other national regimes

**2.32** We are conscious that other national regimes may be able to achieve a speedy distribution of client assets without the negative consequences to some clients identified in the speed proposal. However, the above proposals recognise the limits of what the FCA can do within its powers.

**2.33** For example, the potential for a shortfall in the CMP is built into the current regime. This shortfall arises because, while the CMP effectively crystallises into a finite pool at PPE (subject to an exercise of tracing identifiable client money into house accounts), any client who can establish that it should have been given client money protection, may be able to bring a successful claim on the CMP. The greater the number of successful claimants, the greater the shortfall for each client.

**2.34** While operating as a going concern and complying with the client money rules, if firms determine that there is a shortfall in the amount of client money that they segregate, they are required to immediately 'top up' the amount of client money that they segregate from the firm's own money. However, if the firm fails, UK insolvency law may prevent such a top up from taking place, as this would prefer the clients over the general creditors of the firm.[8]

**2.35** Another cause of the delay to the return of client money in the current regime may partially stem from the fact that IPs are open to personal liability in certain circumstances. This means that before making a client money distribution, an IP may feel compelled to go through a more thorough claims process than perhaps otherwise necessary to validate clients' claims (e.g. beyond any doubt) and/or seek court direction before taking action.

**2.36** The speed proposal amends the terms of the statutory trust to require the IP to distribute on the basis of the firms records, narrowing the bases on which a client may be able to bring a claim against an IP to speed up the distribution of client money for the benefit of clients and the reduce the impact on the market. Other national regimes, may have managed to address this issue in different guises – for example, in both the United States and Canada, we understand that an IP's personal liability is limited to gross negligence and wilful misconduct.[9] In Hong Kong, we understand that an IP might be excused from personal liability where they can demonstrate that they acted fairly and honestly.[10] These limitations on liability may allow an IP in these jurisdictions to make faster decisions and secure a quicker distribution of client assets.

**2.37** A further factor which may contribute to a delay, or at least a reduction, in the return of client money may result from the costs and expenses associated with the distribution of client money being allocated to the CMP as opposed to the general estate. An IP will typically apportion the costs associated with distributing client assets between the general estate and client assets in accordance with equitable principles. By comparison, we understand that other national insolvency regimes, such as in the United States, allow for most costs and expenses an IP incurs in distributing client assets to be borne by the general estate.[11] This may not only protect the

8 MF Global client money shortfall application witness evidence can be found here www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Pages/mfglobaluk-shortfalls-application.aspx

9 See IOSCO Recommendations Regarding the Protection of Client Assets, Consultation Report, Appendix B, Collated Responses to the Client Asset Protection Survey (February 2013). Available at: www.iosco.org/library/pubdocs/pdf/IOSCOPD401.pdf.

10 *Ibid.*

11 *Ibid.*

[size] of the pool of client assets available but reduce the number of decisions an IP needs to take before distributing client assets.

## Other proposals relating to the distribution of client money

**2.38** Here we consult on further changes to the rules around the distribution of client money. These proposals, except where stated, will apply irrespective of whether we implement the Speed Proposal or codify the existing regime discussed above.

### Transfer of the client money pool

**2.39** In the lead up to a firm failure or immediately after a firm fails, the opportunity may arise to transfer the firm's business to a purchaser. In many cases, this is a better result for clients, as it means that some value of their business is preserved, they continue to receive services uninterrupted and they are not immediately forced to find another service provider. The client money distribution rules currently prevent the CMP from being transferred to a purchaser (even where the firm's business is transferred), as the rules require the CMP to be distributed directly to the clients.

**2.40** We propose to amend the client money distribution rules so that, where certain conditions are met, and where a decision to transfer the CMP is made within 14 business days of a PPE taking place, the firm may transfer the CMP to a purchaser. The conditions include: all the client money held by the firm must be transferred (that is, the CMP cannot be transferred in part); the purchaser must make a number of notifications to the clients and the clients must be entitled to the return of their client money from the purchaser. Where the conditions are met, the client money transferred ceases to be client money of the firm. The value of each client's entitlement to the transferred pool of client money is determined in the same way as an entitlement to a 'combined pool' would have been determined had a combined pool been formed (see paragraph 2.19 ) for distribution to clients. In the event that a transfer of the CMP takes place, distributions directly to clients as outlined in paragraphs 2.16-2.19 will not take place.

**Q2: Do you agree that, where used, this transfer proposal will be beneficial to clients? If not, please provide reasons**

### Deletion of certain events as primary pooling events

**2.41** We are proposing to amend the client money distribution rules so that neither (i) the coming into force of a requirement for all client money held by a firm (currently CASS 7A.2.2R(3)), nor (ii) a notification by a firm that it is unable to comply with its record keeping requirements following a secondary pooling event (currently CASS 7A.2.2R(4)), constitutes a PPE.

**2.42** In the case of (i), this is because, in most cases, the imposition of the requirement on all the firm's client money will be sufficient to protect the client money in the short term. In our view a PPE and subsequent distribution should not be triggered automatically as it may be preferable for the firm, in communication with the FCA, to work towards rectifying the issues that lead to the imposition of the requirement in the first place.

**2.43** Similarly, in the case of (ii), in our view, a PPE should not be automatically triggered as it may be preferable for the firm to rectify its record keeping breaches, rather than cause a distribution of client money which may lead the firm into greater difficulties.

### Application of 'hindsight' to the valuation of clients' open positions

**2.44** The current regime requires that, to determine clients' money entitlements to the CMP, their open positions at the point of a PPE should be valued using notional closing or settlement prices. The liquidation value that was applied to close out a position, possibly days or weeks after PPE, is not the one used to value a client's entitlement to the CMP.

**2.45** Under the current client money rules, where a firm carries out margined transactions for its clients that are: (i) cleared through a central counterparty (CCP); and/or (ii) placed with a third party intermediary, the firm is required to place clients' money in a client transaction account at the CCP or the third party intermediary. When such margined transactions are closed out, the liquidation value attributed to the transactions by the CCP or the third party intermediary, as the case may be, is credited to the relevant client transaction account. Where close out of such margined transactions is taking place in the context of a firm failure, the liquidation values credited to the client transaction accounts are the amounts that should form part of the CMP.

**2.46** If a firm fails, where there is a delay between the PPE and the close out of a client's open margined transactions, there may be a mismatch between the value attributed to that open margined transaction for the purposes of determining a client's client money entitlement to the CMP at the point of PPE and the actual liquidation value of the margined transaction credited to the relevant client transaction account (i.e. the value of client money in the notional pool). Such delays are likely to be out of the control of the firm carrying out the transactions on behalf of clients.

**2.47** In addition, where such a mismatch creates a shortfall in the CMP (i.e. where the value of the open position falls between PPE and close out of the position, meaning there is less money than the value of the client's entitlement), this shortfall is suffered by all clients in the CMP, even those who had not been conducting margined business through the firm.

**2.48** We propose amending the client money distribution rules so that clients' margined transactions that are open at PPE and: (i) are cleared through a CCP; or (ii) are placed with a third party intermediary, are valued at the amount at which they are liquidated to determine client money entitlements to the CMP. That is, hindsight should be applied.

**2.49** We propose that the hindsight valuation would not be applied to clients' margined transactions that are not cleared. This is because the firm does not place client money in client transaction accounts for such transactions, so there can be no change in balance of client money held by the firm for such transactions post-PPE.

**Q3: Do you agree that 'hindsight' should be applied to the valuation of clients' cleared open margined positions to determine their entitlements to the relevant CMP? If not, please provide reasons.**

### Allocated unclaimed client money entitlements

**2.50** Under the client money rules, in the normal course of business, a firm may cease to treat as client money any balances allocated to an individual client when those balances remain unclaimed, if the firm can demonstrate that it has taken 'reasonable steps' to trace the client concerned and return the balance.

**2.51** We are aware that the issue arises of what the firm/IP should do with balances of allocated but unclaimed client money that remain in the CMP following a distribution. The IP cannot hold onto the unclaimed client money indefinitely, but equally, a client must be given sufficient opportunity to claim its money.

**2.52** We propose introducing rules to allow an IP to use any unclaimed client money entitlements to make good any shortfalls in the client money pool if the firm takes certain reasonable steps to trace the clients concerned and distribute the client money entitlements. The steps include:

- locating current contacts details of the clients;
- writing to the client to let them know that the firm no longer intends to treat the entitlement as its client money and that it has 28 days to contact the firm; and
- and attempting to communicate with the client at least three times by other means (phone, advertisement) where the firm cannot get in touch by post or email.

**Q4: Do you agree that where a firm takes these reasonable steps, it should be able to use unclaimed client money entitlements to make good any CMP shortfalls? If not, please provide reasons.**

**2.53** We also propose that, where a client's client money entitlement is less than £10, a firm/IP will be required to take fewer steps before it can use unclaimed client money entitlements to make good any CMP shortfalls. For example, the IP will be required to make only one attempt to contact the client.

**Q5: Do you agree that these less onerous 'reasonable steps' should apply where a client's entitlement is less than £10? If not, please provide reasons.**

### Payment of interest and currencies

**2.54** We propose to include a rule to make it clear that any interest earned on pooled client money after a PPE should be used to reduce any shortfall in that client money pool.

**2.55** We propose to include a rule to require pooled client money to be converted to the most prevalent currency in the pool promptly following the recovery of the client money by the IP. Client entitlements will also be valued in this currency as at the date of the PPE.

**Q6: Do you agree with the proposals regarding treatment of interest and currency conversion? If not, please provide reasons.**

### Treatment of client money received after a PPE

**2.56** We propose to make some clarifications to the drafting of the existing rule that deals with post-PPE receipts of client money.

**2.57** We propose to amend the rule to make it clear that post-PPE receipts of client money can be placed in: (i) client bank accounts that are opened following PPE; or (ii) client bank accounts of the firm that existed at the time of the primary pooling event, if the money constituting the CMP has been transferred out of those client bank accounts.

**2.58** We propose to insert a rule allowing the firm to retain costs properly attributable to the distribution of the client money received by the firm after the primary pooling event.

**2.59** We propose to insert a rule to make it clear that where the application of hindsight to the valuation of open cleared margined transactions results in the client owing money to the firm in relation to those transactions and the firm obtains a post-PPE receipt of client money for

that client, the firm may retain that client money to the value of the amount due to it from that client for those transactions.

**Q7: Do you agree with the proposals regarding the treatment of client money received after a PPE? If not, please provide reasons.**

## Redistribution of client money following a secondary pooling event

**2.60** Broadly speaking, if a bank or a third party holding client money on behalf of a firm fails and the firm does not top up any shortfall in the client money that arises as a result of the failure, this constitutes a secondary pooling event for the firm. The secondary pooling event rules (CASS 7A.3) require a firm to do the following:

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

**2.61** We are proposing to make the following changes to secondary pooling event rules.

### Extension to exchanges and clearing houses

**2.62** Currently, the secondary pooling event rules only apply in the event of the failure of certain types of third parties: a bank, an intermediate broker, a settlement agent or OTC counterparty. We propose to extend the rules to also apply if an exchange or central counterparty fails. Although the failure of a central counterparty in particular may not be considered likely, possibility and this proposal means that the CASS rules contemplate this eventuality.

### Carving out certain client transaction accounts

**2.63** We have proposed that the client money in certain transaction accounts should not be pooled with other client money of the firm for a secondary pooling event.

**2.64** We propose that if a CCP fails, any firms (usually clearing member firms) for which this constitutes a secondary pooling event will not be required to nationally pool money from individual client accounts (or omnibus client accounts that relate to a sub-pool that that firm operates) with other client money the firm holds. If the firm were to pool monies in such accounts, all clients of the firm would share in any potential shortfalls that may result. Given that in other circumstances, such as the failure of the firm itself, all other clients of the firm do not share in any benefits of these types of accounts (such as porting or the direct return of client money to the client), in our view, only the clients these accounts relate to should share in these shortfalls.

**2.65** We have included similar carve outs for certain client transaction accounts in the event that a firm has created a client money sub-pool (see paragraph 3.34).

### Notification requirements

**2.66** The rules currently require that a firm notifies the FCA as soon as it becomes aware of the failure of a bank or other third party with which it has placed client money and whether it intends to make good any resulting shortfall and the amounts involved.

**2.67** We propose that these notification requirements be deleted. We consider that the existing requirement to notify the FCA if a firm is unable to correctly identify and allocate in its records all valid claims arising as a result of a secondary pooling event is sufficient.

**Q8: Do you agree with the proposals regarding a secondary pooling event? If not, please provide reasons.**

# 3.
# Multiple client money pools

## Background

**3.1** As discussed in Chapter 2, under the current client money distribution rules, in the event of a firm failure, broadly speaking, all the client money held by the firm is notionally pooled for *pro rata* distribution to the firm's clients. In Part II of CP12/22 we consulted on permitting firms to establish and operate discrete 'pools' of client money such that in the event of a firm's failure, 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.

**3.2** Having received feedback to the multiple pools proposal in Part II of CP12/22 and having undertaken further discussions with the industry, in this chapter we set out an amended multiple pools proposal.

**3.3** Subject to the feedback received in response to this amended proposal, we currently anticipate publishing final rules in this area at the same time as the final rules resulting from the consultation set out in the other chapters to this CP.

**3.4** We propose that the rules, if made, come into effect in the first half of 2014.

## The proposal in Part II of CP12/22

**3.5** The multiple pools proposal in Part II of CP12/22 would have allowed firms to create 'sub-pools' of client money that belong to a defined subset of client beneficiaries. This would have allowed, for example, firms to operate a discrete pool:

**i.** in relation to client positions cleared through net omnibus client accounts at EMIR authorised or recognised CCP.

**ii.** a particular client or a particular business line.

**3.6** In the context of client positions cleared through net omnibus client accounts, the intention was to facilitate as far as possible the porting of net omnibus client accounts pursuant to EMIR. The intention behind allowing firms to establish client money pools in other contexts was to allow firms (and their clients) to ring-fence risks, for example, ring-fence the risks of loss of client money to a particular business line or client.

## Consultation feedback and amended proposal

**3.7** In summary, the feedback from CP12/22 was that the industry is generally supportive of solutions to facilitate the porting of net omnibus client accounts and that the formation of a separate client money pool has the potential to increase the likelihood of porting. The industry was also generally supportive of the proposal that firms be able to offer pools in other contexts at their discretion. However, a significant proportion of respondents were consistently concerned that the operation of multiple pools would be operationally complex for some firms and that this complexity has the potential to undermine the benefits of operating multiple pools.

**3.8** Examples given of operational complexities included: increased frequency and complexity in handling mixed remittances; greater chance of error in crediting or debiting a client bank account belonging to the wrong pool; being required to carry out multiple client money reconciliations; and having to comply with the diversification requirements in relation to each pool. Though the operation of sub-pools would have been optional, respondents expressed that some firms may operate them when they do not have the necessary systems and controls, or it is unsuitable for their business models.

**3.9** Taking into account this feedback we have developed a more limited version of the multiple pools proposal, which is aimed at achieving the core objective of supporting the porting of net omnibus accounts, but reducing the overall operational complexity of the original proposal as set out in Part II of CP12/22.

**3.10** We are now proposing to permit only those firms that are also clearing member firms that offer net omnibus client transaction accounts at EMIR authorised or recognised CCPs to operate multiple client money pools and only in relation to these net omnibus client transaction accounts. Client money in such pools can be used to facilitate the porting of client positions in the event of firm failure. In limiting the number and scope of multiple client money pools that firms are permitted to operate, the proposal limits the operational complexity to clearing firms, and to the number of net omnibus accounts maintained by a given clearing firm. For example, under the amended proposal, the number of pools a firm could operate would be limited to the number of net omnibus client transaction accounts it has at relevant CCPs and consequently the number of reconciliations it is required to carry out would be limited.

**3.11** In the context of client positions cleared through net omnibus client accounts at EMIR authorised or recognised CCPs, a proportion of client money margin will be held by a clearing member firm and a proportion will be posted to the omnibus client account at the CCP.

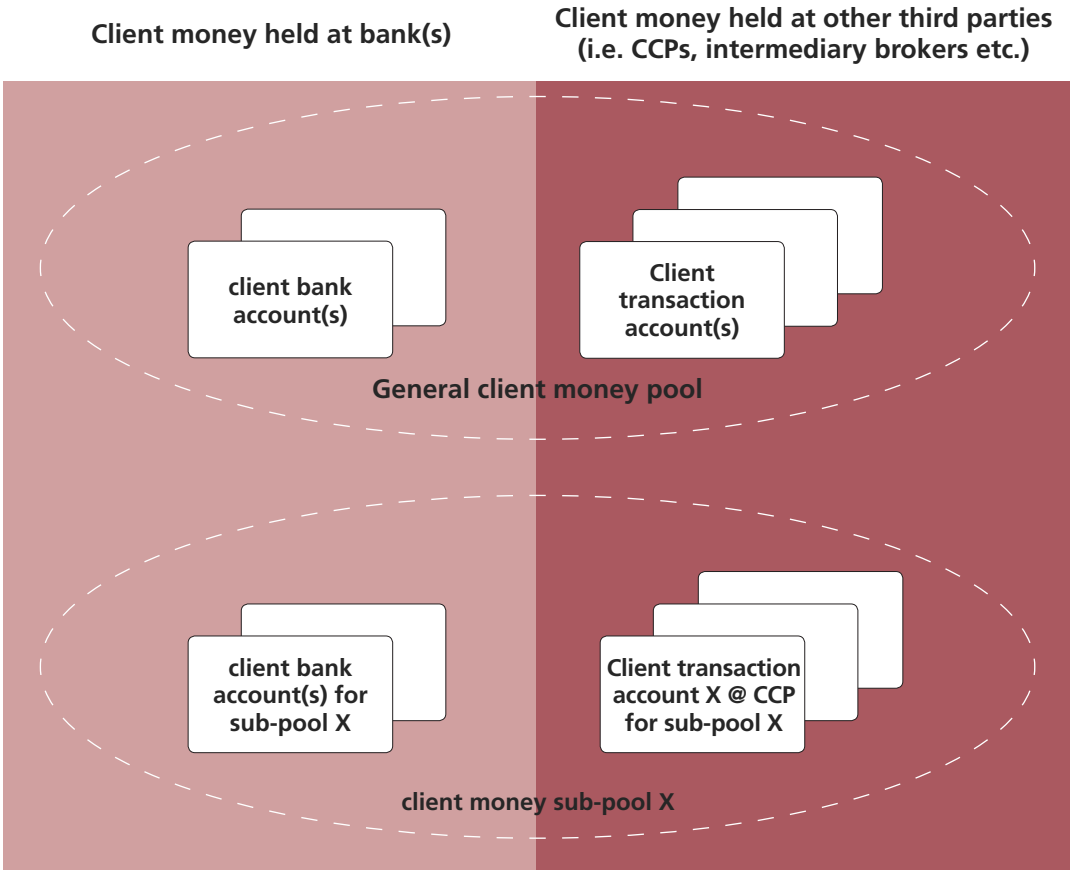
**3.12** Following EMIR, when a firm fails, a CCP will attempt to port the client positions and margin that it holds in an omnibus client account to a back-up clearing member. However, in relation to a net omnibus client account, porting is likely to be possible only where the back-up clearing member is satisfied that it has sufficient margin to cover its exposure to each of the clients, not just the net exposure for all client positions. To port a net omnibus client account in these circumstances, the clients would have to provide further margin to the back-up clearing member ('double margin') and would have to do so before receiving a distribution from the failed firm.

**3.13** This multiple client money pools proposal would permit firms that are also clearing members of EMIR authorised or recognised CCPs to establish and operate separate client money pools in relation to net omnibus client accounts at CCPs. If a firm operates a separate pool in this way, it would be required to segregate the proportion of client money margin that it holds in relation to the omnibus client account from any other client money that it holds (in relation to any other client business) as well as its own money. The firm would also be required to carry out separate reconciliations and keep separate records in relation to this money.

**3.14** In the event of the firm's failure, the firm/IP would make the client money in that pool available to facilitate the porting of the omnibus client account, for example, by providing the money to the back-up clearing member so that the relevant clients are not required to double margin. If the omnibus client account failed to port, or the client money in the pool held at firm level was not used to facilitate porting, the client money in the pool would remain separate from any other client money held by the firm and would be distributed to the relevant clients rateably in accordance with their entitlements to that pool.

**3.15** The operation of such pools would be optional. We therefore envisage that clearing members would only use such pools where there is a good likelihood that porting would be achievable.

***Figure 1 – clearing member firm operating a general client money pool and a client money sub-pool relating to omnibus client account x at a CCP***




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

## Segregation, record keeping and reconciliations

**3.16** As in CP12/22, the proposed rules will require a firm to apply the provisions of segregation (CASS 7.4 ) and records, accounts and reconciliations (CASS 7.6) separately to the general pool and to each sub-pool it creates. These requirements will only apply if the firm chooses to utilise sub-pools. This is to ensure that each sub-pool is effectively segregated from the general pool and any other sub-pools, that a firm's accounts and records accurately reflect this segregation and that the balance on each sub-pool is calculated and reconciled frequently. In the event of an insolvency, these requirements will ensure that it is clear to an IP which money belongs to which pool and the latest balance on each.

**3.17** Each client money sub-pool would be required to have its own client money bank accounts and client money belonging to one pool cannot be placed in client money bank accounts belonging to another client money pool. However, in the event that a firm receives client money to be credited in part to one pool and in part to another, the firm may pay the money into a client bank account relating to one pool and promptly pay out any of the client money that belongs to another pool into a client bank account relating to that pool. The names of the bank accounts maintained for each sub-pool must contain a unique reference that enables the account to be identified as relating to that sub-pool.

**3.18** Firms will be required to perform separate internal and external reconciliations on each sub-pool.

## Sub-pool disclosure document

**3.19** In CP12/22 we proposed that firms would be required to create both sub-pool terms as well as a disclosure document in relation to each sub- pool. The purpose of the sub-pool terms was to identify the beneficiaries of the sub-pool, identify where the client money in the sub-pool is held and where relevant, to make it clear that the money could be used for porting. The purpose of the disclosure document was to ensure that clients were made aware of the risks of putting their money in a particular sub-pool, as a result of the purpose of the sub-pool and the other clients sharing in that sub-pool.

**3.20** In response to feedback received and as a result of restricting the use of client money sub- pools to net omnibus client accounts we have amended the proposal so that firms will be required to:

**i.** comply with certain record keeping requirements, and

**ii.** produce and maintain a sub-pool disclosure document.

**3.21** The firm will be required to maintain records in relation to a sub-pool that identify at all times all and only the beneficiaries of that pool and be sufficient to determine at any time the balance held for each client in that sub-pool. On the failure of the firm, these firm records will be definitive for the purposes of distributing the pool. The firm would also be required to keep a record of the client bank accounts and client transaction accounts that it uses for that pool. We propose that these records should also form part of the firm's CASS Resolution Pack.

**3.22** We propose that the sub-pool disclosure document in relation to each sub-pool must:

**i.** identity of the omnibus client account and the CCP to which the document relates;

**ii.** state that the beneficiaries of the sub-pool are at any time, only those clients identified as

such in the firm's record;

**iii.** include a statement that in the event of the firm's failure the beneficiaries direct the firm to use the sub-pool to facilitate porting;

**iv.** describe how the firm expects the sub-pool to be distributed in the event that porting of the omnibus client account fails and/or the client money held in sub-pool client bank accounts is not used to facilitate porting; and

**v.** a statement that highlights that in the event of the firm's failure, the beneficiaries' entitlements to the sub-pool will be as set out in the firm's records relating to the sub-pool and (subject to the client being able to establish a claim on a residual pool in accordance with the amended client money distribution rules) that a client who is a beneficiary of one pool shall have no claim to or interest in the client money held in any other pool unless that client is also a beneficiary of that other pool.

**3.23** The purpose of the sub-disclosure document is to ensure that clients fully understand how their money would be treated in the event of the firm's failure and that they would only be entitled to a share of that sub-pool in their capacity as beneficiary of that sub-pool.

**3.24** This document must be provided to a client before the firm receives or holds that client's money for a specific sub-pool. The client must provide written acknowledgement that it has received the sub-pool disclosure document and the firm must obtain the client's written consent to the firm holding its money in the sub-pool. In addition, the firm must provide a copy of the sub-pool disclosure document at any time on a clients' request.

**3.25** If the firm wishes to make a material amendment to the sub-pool disclosure document or wishes to dissolve the sub-pool by merging it into the general client money pool, the firm will be required to give the affected clients two months written notice. The notice must explain the proposal fully, state that the client has the right to terminate the relevant business with the firm immediately without charge before the implementation date and state that if the client does not notify the firm of its intention to terminate, it will be deemed to have accepted the proposal.

**3.26** We believe that giving clients two months' notice will allow clients to consider whether they are comfortable with the proposed changes or make other arrangements for their client money.

**3.27** In response to the feedback received, we propose that firms will be required to use the template document set out in an annex to the proposed rules.

## Notification requirements

**3.28** We propose that a firm will be required to notify the FCA of its intention to establish a client money sub-pool not less than two months before the date on which it establishes the sub-pool. This is because the FCA would like to be aware of which firms are operating multiple client money sub- pools and two months will provide the FCA with an opportunity to ask any questions it may have on the systems and controls that the firm has put in place in order to support the operation of such a pool.

### Impact of the speed proposal on the distribution of multiple pools of client money

**3.29** Chapter 2 sets out the proposed amendments to the client money distribution rules. The distribution rules would apply separately to each client money sub-pool.

**3.30** In the event of a firm failure, an initial client money pool would be formed in relation to each client money sub-pool. The reconciliation that the firm had carried out before failure in relation to that sub-pool would be repeated at PPE and the sub-pool would be distributed on the basis of the clients' entitlements to the initial pool as set out in those records.

**3.31** In the event that the firm did not consider that it could reasonably determine the clients' entitlements to the sub-pool, the combined CMP rules (see paragraph 2.19) would be followed.

**3.32** A separate residual client money pool would not be formed in relation to a sub-pool. Any excess from the initial client money pool relating to a sub-pool together with any 'identifiable' client money (belonging to a sub-pool or otherwise) in house accounts will be pooled forming a single residual pool. Clients who did not receive an entitlement to the initial pool formed in relation to a relevant sub-pool, may be able to establish a claim to the residual pool.

### Proposal to carve out certain client transaction accounts from the secondary pooling rules in the context of sub-pools

**3.33** We propose that the client money in certain transaction accounts should not be pooled with other client money of the firm in the context of a secondary pooling event.

**3.34** We propose that if a clearing member firm fails, any firms for which this constitutes a secondary pooling event (e.g. for a client firm of such a clearing member firm) will not have to pool money from a client transaction account (at the failed clearing member firm) that forms part of a client money sub-pool (relating to an omnibus client account) operated by that clearing member firm. The same reasoning as set out in paragraph 2.64 applies here. If the failed clearing member firm has been operating a sub-pool in which only some of the clients of the firm participate (i.e. the indirect clients of the failed firm), any shortfall to that sub-pool that results from the clearing firm failure, should be ring-fenced in the sub-pool.

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

# 4.
# Client money rules (CASS 7)

**4.1** In this chapter we discuss changes to the client money rules, which will affect all firms who hold client money. These changes are designed to clarify and enhance the regime to ensure the best protection of client money held in relation to investment business.

**4.2** In addition to the changes set out below, we are also updating other references within the client money rules to ensure that they remain relevant and to ensure that cross-references and consequential updates are addressed.

**4.3** We propose that the changes discussed in this chapter, if made, come into effect six months after the publication of the policy statement (in the first half of 2014).

## Application of the client money rules

### Background

**4.4** Subject to general application provisions in CASS 1, the provisions of CASS 7.1.1R set out how the client money rules relate to a firm's business. These currently provide 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 or its designated investment business … in respect of any investment agreement entered into, or to be entered into, with or for a client…'.

### Issues and risks

**4.5** We have seen some situations where firms do not treat money as client money when they should do. This creates a risk that client money is not protected by firms when the firm is trustee of the money in accordance with the statutory trust and should comply with the client money rules.

### Current policy and proposed changes

**4.6** We propose to clarify the existing rules by adding guidance to the application provisions to remind firms that when their activities are caught by the client money rules they should ensure that the money is held in accordance with the client money rules. If money relating to investment business is not held by the firm (as client money) the firm must assess whether it is providing appropriate protection for clients' money, for example by complying with the mandate rules. Firms should at all times be aware of any client money obligations they owe to their clients. We are also proposing to remove the reference to 'investment agreement' in CASS 7.1.1(4) so that these rules apply to MiFID business and all designated investment business that is not MiFID business.

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

## Banking exemption

### Background

**4.7** The banking exemption is set out in the client money rules (CASS 7) and applies to BCD credit institutions and approved banks. This exemption allows firms with permission to accept deposits (banks) to hold money which would otherwise be client money as a deposit. There are various requirements for disclosure to clients, with which firms should comply when using the banking exemption.

### Issues and risks

**4.8** Recent supervisory activity suggests that a number of firms do not comply with the requirements when using this exemption. For example, we found in some instances that firms do not disclose to clients that their money will be held as banker, not as client money.

**4.9** We also found that firms are uncertain as to how they should be holding money under the banking exemption and in what circumstances the money would cease to be held under the banking exemption. In line with financial reporting requirements, when holding money as a deposit we would generally expect the firm to recognise a liability to the client on its balance sheet. We found some instances of firms arranging deposits in the name of clients at a third party banks, so that sometimes the client was unaware that they had a direct relationship with the third party bank. In addition, we found firms were depositing this money in the firm's own name with third party banks. By doing this the firm is not holding the money as a deposit itself and the money is client money and the firm must comply with the client money rules.

### Current policy and proposed changes

**4.10** Currently, banks that hold money for clients in relation to investment business hold client money unless they apply the banking exemption. The firm then chooses whether to apply the banking exemption and if it does, notifies the client accordingly. We are now proposing that for firms who are able to use the banking exemption, that the default is that money relating to investment business is held by that firm under the banking exemption. The firm then must comply with the relevant notification requirements. The notification requirements will include an explanation 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.

**4.11** In all situations, the firm must also ensure that it complies with the requirements in COBS 6.1.16R in relation to making available to the client details of the relevant compensation regime (and for any firms to whom these rules do not apply, a similar requirement to identify the compensation regime relevant to those clients whose money may be held under the banking exemption) and those requirements in relation to the proposed Client Assets Disclosure Document (please refer to Chapter 6).

**4.12** Should the firm chose not to apply the banking exemption and to hold the money as client money then the client should be notified of this and the firm must then comply with the client money rules in respect of that money. There will also be situations where the firm may cease to hold the money as a deposit, such as if the money is transferred to a third party in the course of a transaction, and should then be treated as client money. We are proposing that firms analyse the situations in which the money will be held as client money and clearly agree with the clients accordingly that this money will be treated as client money, for example by including the situations in the terms of business.

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

## Trustee firms

### Background

**4.13** A firm that is acting as a trustee firm when it conducts designated investment business, which is not MiFID business is required to apply only some of the client money rules[12][13].

### Issues and risks

**4.14** Through supervisory work, there have been various issues highlighted to us with the application of the client money rules to trustee firms. These issues include confusion as to whether the client money distribution rules apply to client money held by a trustee firm. Another issue which has been highlighted is that the client money rules apply to all client money held by a firm, whereas the trustee may think it prudent to hold all money relating to a specific trust separately from all other trust or firm money. The client money rules currently do not facilitate this.

### Current policy and proposed changes

**4.15** We are proposing to amend our rules to make it clear that the client money distribution rules do not apply to client money held by a trustee firm. We consider in these circumstances it is more appropriate that on a failure of the trustee firm the money is dealt with in accordance with the terms of the trust deed under which it is held or in accordance with general trust law. This leaves the approach as to how client money should be dealt with in the hands of the IP appointed over the failed trustee firm to facilitate the purpose of the trust.

**4.16** We are proposing to set out in the client money rules the option for trustee firms to comply with the requirements set out in Segregation of client money (CASS 7.4), Records, accounts and reconciliations (CASS 7.6) and Notification and acknowledgement of trust (CASS 7.8) in their entirety rather than the current limited application of these chapters. Should firms wish to do this they would be required to document their decision accordingly.

**4.17** We are also proposing that trustee firms should be permitted to apply the relevant CASS provisions separately to each trust of which they are trustee. This would enable firms to effectively segregate client money held for different trusts operated by the firm. Firms would need to conduct a separate reconciliation exercise and rectify any shortfall in each trust separately. If firms chose to do this they will need to document their decision accordingly.

**4.18** We are aware that in certain circumstances issues may arise where, for example, clients may instruct a trustee firm to hold all the client money in specific institutions rather than diversified in accordance with the requirements in the client money rules. In these situations firms may benefit from applying to us for a waiver of the relevant rules.

**4.19** We are proposing these changes for all trustee firms who hold client money in relation to its designated investment business that is not MiFID business. The changes will not affect how trustee firms hold client money that they are not holding as a trustee firm (i.e. not holding solely as trustee of the statutory trust). The changes will affect all firms who fall within the definition of 'trustee firm' which includes both firms acting as trustee (other than in accordance with CASS 7.7, the statutory trust) and personal representatives.

**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.**

12 These rules are set out in a table in CASS 7.1.15F.

13 The client money rules (CASS 7) do not apply to a trustee acting as a depositary.

## Restrictions on switching out of TTCA

### Background

**4.20** Following the implementation of MiFID we introduced the concept of title transfer collateral arrangements (TTCA) into the client money regime. These arrangements allow for a firm to stop treating money as client money if the money was transferred to the firm to secure or otherwise cover present or future, actual or contingent or prospective obligations. When money is subject to TTCA it ceases to be client money and becomes the firm's own money. We restricted the use of TTCA for retail clients of Contract For Difference (CFD) and spread betting products following supervisory work which showed that for certain businesses the use of TTCA was not appropriate for retail clients and was not generally in the clients' best interests.

**4.21** MiFID revisions (which are yet to be finalised) are likely to prohibit the use of TTCA in relation to all retail clients. The European Commission also published a MiFID consultation where they identified the potential need to strengthen the existing TTCA provisions to address inappropriate use of TTCA with non-retail clients.[14]

### Issues and risks

**4.22** We have observed that when a firm is approaching insolvency there has been a demand from clients to move money from being held by the firm subject to TTCA to client money protection. This provides the potential for disputes as to the status of money when firms enter into insolvency proceedings for example in circumstances where client agreements were not updated adequately, where clients instructions where not followed (and their money not segregated), or where the firm did not make the necessary changes in its records.

### Proposed changes

**4.23** We are therefore proposing to introduce rules requiring firms to document their TTCA agreements. In addition, we are proposing a mechanism, which must be followed should the client request client money protection as to how money previously subject to TTCA may be protected. On agreeing to a request for protection the firm must notify the client of its agreement including notification of when the protection would come into effect. If the notification did not include this then the money should be protected as client money on the business day following the agreement by the firm that the money would cease to be subject to TTCA (i.e. following the completion of the next internal client money reconciliation).

**4.24** As stated above, TTCA is, however, being considered at a European level. We will keep these rules under review and effect changes in accordance with European requirements.

**Q13: Do you agree with the proposals relating to the TTCA provisions? If not, please provide reasons.**

14 http://ec.europa.eu/internal_market/consultations/2010/mifid_en.htm

## Delivery versus payment exclusion – transactions through a commercial settlement system

### Background

**4.25** Both the custody rules (CASS 6) and client money rules (CASS 7) currently allow firms to disapply the rules during the course of a "delivery versus payment" transaction through a commercial settlement system if certain conditions are met. Broadly speaking, these conditions are that it is intended that the transaction settles within one business day of the fulfilment of a payment obligation or a delivery obligation, but that in any event, the transaction settles by the close of business on the third business day following the date of payment or delivery of the asset by the client. This exclusion is commonly referred to as the 'DvP window'.

### Issues and risks

**4.26** During the course of the delivery versus payment transactions, if the DvP window is used, the money or assets are not protected as client money or custody assets. In the event that the firm fails during this time, clients could be unsecured creditors of the firm for any loss.

**4.27** We have also observed some stretching of the use of the DvP window, including that firms hold money or assets under the DvP window for a significant length of time (in extreme cases months) rather than the limited period permitted in the rules. There have also been many interpretations of what a 'commercial settlement system' actually encompasses.

### Proposed changes

**4.28** Due to the potential risks of the use of the DvP window to take money out of the client money protections, we are proposing to amend the rules to clarify the meaning of 'commercial settlement system' and to set out exactly when the DvP window begins and ends to ensure that firms are aware that they must be able to comply with the CASS 6 and 7 rules should a transaction fail to settle within the DvP window. We will be keeping the use of the DvP window under review and will take action to 'close the window' should firms not use it correctly.

**4.29** We propose to define 'commercial settlement system' as a system that is commercially available to firms that are qualified to act as participants, the purpose of which is to facilitate the settlement of transactions using money or assets held on a settlement account. An example of a commercial settlement system is CREST.

**4.30** We are also proposing that clients should agree that their client money or custody assets may cease to be protected through the firm's use of the DvP window in this way. This may be, for example, included in the terms of business between the firm and the client.

**Q14: Do you agree with the proposal of clarifying the requirements around the DvP window? If not, please provide reasons.**

## Delivery versus payment exclusion – regulated collective investment schemes

### Background

**4.31** There is also a DvP window, which operates in a similar manner to that set out above, but relates to delivery versus payment transactions for the purpose of settling a transaction in relation to units in a regulated collective investment scheme. The window allows an authorised fund manager to not treat money as client money if it receives the money from a client in relation to the authorised fund manager's obligation to issue units in an AUT or to arrange for

the issue of units in an ICVC subject to certain conditions. The DvP window is also available for redemption proceeds, again, subject to certain conditions.

### Issues and risks

**4.32** If the DvP window is used and such transactions are settled, the money is not protected as client money. If a firm fails during this time, clients could be unsecured creditors of the firm for the money and may suffer a loss.

**4.33** We have also seen certain differing interpretations of the DvP window including the length of time redemption proceeds are subject to the window. This exposes the client to the risk of being an unsecured creditor of the firm for some significant time.

**4.34** In addition, the rules currently exclude any cheques issued to clients for redemption proceeds from the normal requirement on firms to continue to protect the money represented by the cheque as client money until the cheque has cleared.

### Proposed changes

**4.35** Given the importance of protecting client money and the feedback we received to our pre-consultation survey, we are consulting on removing the DvP window so that authorised fund managers should treat money from clients in relation to transactions in units in regulated collective investment schemes as client money and all redemption proceeds in the same way. This should ensure that clients remain protected when their money is held by authorised fund managers.

**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.**

## Interest

### Background

**4.36** A firm holding client money is currently required to pay a retail client interest unless the firm has notified the retail client that it will not be paying any interest. There are no requirements to pay interest to clients other than retail client as this is a matter for agreement between the client and the firm.

### Issues and risks

**4.37** Supervisory visits have identified that there is some confusion about when interest should be segregated by firms for client money. This leads to a risk that retail clients do not receive interest they are entitled to.

### Proposed changes

**4.38** We propose to clarify the application of this rule and further enhance it through additional guidance setting out the segregation and allocation requirements when the firm receives interest or contractually agrees to pay interest to clients.

**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.**

## Money ceasing to be client money

### Background

**4.39** The client money rules (specifically CASS 7.2.15R) sets out some circumstances under which money ceases to be client money. This list includes paying client money to a client or authorised representative of a client or into a bank account in the name of the client, to a third party on the instruction of a client where money is not transferred in the course of effecting a transaction, and to the firm when it is due.

### Issues and risks

**4.40** There are various issues which have been highlighted as to how these rules operate, including how money can cease to be client money on the transfer of business to another firm and circumstances when the firm may be under a legal obligation to transfer money to a third party but does not have the required client instruction or consent. Issues have also arisen when a firm transfers client money to a bank account in the name of the client, which may occur without client knowledge or consent.

### Proposed changes

**4.41** We are proposing various changes to CASS 7.2.15R to address the issues highlighted above, these include among other changes:

**i.** money ceasing to be client money when the firm transfers money to a third party when it is legally obligated to do so (e.g. to HMRC);

**ii.** allowing a firm to transfer client money when the client has provided consent to a transfer in advance (e.g. through an assignment clause in terms of business); and

**iii.** requiring clients to instruct or consent to any payment of client money into a bank account in the name of the client.

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

## Transfer of business

### Background

**4.42** Currently when a firm transfers client money to a third party in the course of a transfer of business the client must obtain consent to the transfer from each client for whom client money is held.

**4.43** Although firms may obtain this consent through an assignment clause in their client terms of business, there are no rules or guidance around this and such clauses are not frequently used in practice.

### Issues and risks

**4.44** There is often a timing issue with obtaining consent to the transfer of client money and the process rarely results in all clients responding to a request for consent. This leaves an issue for the transferring firm often resulting in a waiver application to the FCA.

### Proposed changes

**4.45** We are proposing to put rules around the contents of an assignment clause, pending client consent to the transfer of client money, so that if firms wish to transfer client money along with the transfer of business, they have obtained consent in advance. This may remove a significant hurdle for the transfer of business, while retaining protection for clients. Firms will however still need to ensure that the client money will be protected on receipt by the transferee firm and comply with the requirements set out in the assignment clause.

**4.46** We are proposing that the assignment clause must provide that:

**i.** the client consents to the transfer of client money relating to the business or part of the business to be sold

**ii.** the client money transferred will be held in accordance with the client money rules (which include money being held in accordance with the banking exemption by the transferee where relevant should the transferee have relevant permissions as a deposit taker)

**iii.** where the transferee firm is not subject to the client money rules, the transferor firm must use best endeavours to ensure the transferee firm will provide adequate measures to protect the money

**iv.** the client will be notified within seven days after the transfer as to how the money will be held by the transferee firm

**v.** the client will be notified of the relevant compensation scheme limits (in the UK the FSCS would treat such claims as investment business), and

**vi.** the client will be given the option of having its client money returned by the transferee firm as soon as is practicable.

**4.47** We further propose to allow firms to transfer amounts of client money of less than £10 per client without having to obtain consent from the client as part of a 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.**

## Allocated but unclaimed client money

### Background

**4.48** CASS 7.2.19 R allows a firm in the normal course of its business, to cease to treat as client money any balances allocated to an individual client when those balances are unclaimed and the firm is not able to return the money to the client. The firm may do this if it can demonstrate that it has taken reasonable steps to trace the client concerned and to return the relevant balance.

### Issues and risks

**4.49** The aim of this rule is to allow firms to deal with amounts of client money when there have been no movements on the account for a period of six years or more. However the current rule does not expressly state what should happen to the money once it ceases to be client money. This has resulted in some firms writing such amounts back to their balance sheet. This is in conflict with general principles of trust law, which state that a trustee should not benefit financially from his position as trustee.

### Current policy and proposed changes

**4.50** This rule sets out the reasonable steps a firm should undertake before ceasing to treat money as client money. These steps include: entering into an agreement with the client to release client money balances in relevant circumstances; writing to the client at the last known address of the client to inform the client of the release; determining that there has been no movement on the balance for at least six years; retention of records and requiring the firm to make an undertaking to make good any valid claims against any released balances.

**4.51** We propose to clarify the reasonable steps we expect a firm to take before paying money away and to restrict payment of these unclaimed balances to registered charities. The reasonable steps include obtaining current contact details for the client and providing details about the method, medium, frequency and intervals of communication a firm is expected to complete.

**4.52** Other proposals include requiring the firm's governing body to review and approve the payment of unclaimed client money to charity and to make an undertaking to make good any valid claim to the money should the client come forward. Where a firm is unable for any reason to make such an undertaking, it must ensure that a suitable legally enforceable undertaking is made by a group company covering this liability. The arrangements must be effective so that clients can identify the company making the undertaking in the future. If a firm choses to insure the liability covered by the undertaking it may purchase insurance from its own funds.

**4.53** Also proposed is the expansion of the record keeping requirement to include details of the relevant client to whom the money was allocated, as well as details of the original firm with whom the client initially contracted and if relevant, details of subsequent firms to which client money has been transferred. We also propose that where a group company makes an undertaking to make good valid claim where the concerned firm is unable to do so, that group company should have unrestricted access to the relevant records of the firm.

**4.54** We propose to allow firms to pay unclaimed balances less than or equal to £10 for any one client to charity after having made at least one attempt to contact the client and return the money. If firms chose to use this mechanism, that money will no longer be client money and firms are not required to make an undertaking in respect of future claims.

**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.**

## Segregation of client money

**4.55** Segregation of client money is one of the key safeguards for the protection of client money on the failure of a firm. We are proposing various enhancements to the requirements for segregation, which are set out in full in the draft instrument in Appendix 1. We encourage you to consider the text of the draft rules alongside the summary of the key enhancements on which we are consulting set out below.

## Client bank accounts (general)

### Background

**4.56** Client bank accounts are used by the firm to deposit client money. Subject to limited exceptions in the rules, such as around mixed remittances, only client money should be held in a client bank account.

**4.57** When setting up a client bank account the firm must take into account various factors which include diversification and due diligence to ensure that client money is held accounts at appropriate institutions.

### Issues and risks

**4.58** Many of the requirements around how and where to open client bank accounts are currently contained in guidance within the segregation of client money rules (CASS 7.4). This does not highlight the importance of the requirements or ensure that all firms hold client money in an appropriate manner with suitable institutions.

### Proposed changes

**4.59** We propose to put various clarifications of the current policy in the segregation of client money rules, whilst making some changes as set out below.

**4.60** In relation to diversification, we propose rules requiring firms to consider to a greater extent appropriate diversification of their client money held in client bank accounts to mitigate the loss of client money on the failure of an institution holding the client money. This means that a firm should, in effect, assess the amount of client money it holds and consider whether it would be inappropriate to hold all their client money in one institution. If a firm holds only a small amount of client money, it may be appropriate to hold that client money in one institution; however, if a firm holds a significant sum the firm should consider diversifying across a number of institutions. Firms should also consider whether it would provide better protection for client money, and reduce the risk of loss of client money, if client money is not held exclusively by one group of institutions, even if the money is diversified across a number of members of that group.

**4.61** We propose that firms should conduct enhanced due diligence over the banks with which they deposit client money. Factors that must be considered include those set out in CASS 7.4.9 but also, for example, the financial soundness of the bank, the percentage of the firm's overall client money held by that institution and the protection provided by the relevant deposit protection scheme (this would be the FSCS for deposit takers authorised by the UK regulators).

**4.62** We are also taking this opportunity to reiterate that the counterparty to the bank must be the firm in relation to client bank accounts. Any bank account in which a firm deposits client money must be in the name of the firm.

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

## Unbreakable client money term deposits

### Background

**4.63** All investment firms must hold client money in either client transaction accounts or client bank accounts. For the latter, they can use term deposit accounts such as money market deposits. The following proposals relate to amendments to restrict the use of term deposits.

### Issues and risks

**4.64** We have discovered that a number of investment firms have been placing client money in certain types of deposits that do not allow the investment firm any contractual ability to request the return of the monies before the end of the agreed term (an 'unbreakable term deposit'). This introduces two potential risks to clients. Firstly, it prevents investment firms from reacting to market developments if a deposit taker or credit institution where such a term deposit has been placed encounters financial difficulties and ultimately becomes insolvent. Secondly, on the failure of the investment firm placing the deposits (a primary pooling event as defined by CASS 7A.2) the duration of any unbreakable term deposits may create a delay in the process of the distributing client money to clients through the administration of the firm. Similar concerns arise where firms place their client money in 'notice accounts', that is, accounts where you need to give a period of notice before withdrawing funds.

### Current policy and proposed changes

**4.65** Client money rules (CASS 7) currently require a firm that receives client money to promptly place that client money in a bank account at a bank. CASS 7 further requires a firm to 'exercise due skill care and diligence in the selection, appointment and periodic review' of the banks with which they place client money. If a firm sees that the bank it has opened client bank accounts with has become too risky, it may wish to withdraw that client money and place it elsewhere.

**4.66** We are proposing to amend our rules to make it clear that firms are prohibited from placing client money in unbreakable term deposits or notice accounts by requiring the ability to make withdrawals of client money promptly, and in any event within one business day of a request for withdrawal. However, this will not stop firms from placing client money in money market deposits overnight or longer term deposits or notice accounts that provide for return of client money upon request (albeit at potential financial penalty, for example, loss of interest income) just as long as the principal client money can be withdrawn promptly, and in any event within one business day of a request for withdrawal.

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

## Immediate segregation

### Background

**4.67** In accordance with MiFID and general trust law requirements, investment firms must segregate client money promptly into client bank accounts. Currently the client money rules provide that firms who do not use the alternative approach must promptly segregate client money into client bank accounts and that these firms should be receiving client money into its client bank accounts.

### Issues and risks

**4.68** The main risk of a firm not segregating client money promptly into client bank accounts and holding the client money in a firm account is the risk that on the firm's failure the client money is not segregated or identified as client money. This could result in the money being treated by the relevant IP as the firm's own money and result in a shortfall in the client money which can be distributed.

**4.69** There is also the risk that the firm does not identify the relevant remittance as client money and so does not segregate the money for some time.

### Current policy and proposed changes

**4.70** The current policy is to require firms who do not use the alternative approach to segregate money promptly. To mitigate the risks highlighted if firms do not segregate client money promptly, we are proposing to codify this into the client money rules by clarifying the current rules so that all client money must be received directly into a client bank account. This would mean that no client money should be received into the firm's own accounts. This would not stop firms from 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.

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

## Qualifying Money Market Funds

### Background

**4.71** MiFID specifically allows for segregation of client money into units in Qualifying Money Market Funds (QMMFs). When a firm segregates client money in this way it must then hold the units as safe custody assets either for the benefit of those clients entitled to client money protection, or for the benefit of a specific client if the client money was segregated in this way from a designated client bank account.

### Issues and risks

**4.72** There have been various inconsistencies highlighted as to how client money might be segregated into QMMFs and which regulations apply.

### Proposed changes

**4.73** We are intending to clarify how units in QMMFs should be held and recorded by the firm, including the requirement that they be liquidated on the failure of the firm and the money added to the client money pool. When client money is segregated into units of a QMMF the units should be treated as safe custody assets and held in accordance with the custody rules (with the firm's records showing that the units in the QMMF are held for the benefit of the

client money clients). Furthermore, the value of the units must be taken into account when conducting the firm's internal client money reconciliation.

**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.**

## Physical receipts and allocation of client money

### Background

**4.74** Cash, cheques and payment orders can be received by a firm and may represent client money. There is some confusion and differing practices in the industry about how these payments are treated and recorded by the firm, the timing around this and when the firm may trade for a client using that money.

**4.75** Firms also receive client money which they know is client money but are unable to identify the client for whom they hold the money. This could be, for example, a refund from HMRC covering a large number of clients who have invested in the relevant products.

### Issues and risks

**4.76** Without clarification, there are differing practices within the industry. This leads to the risk of clients receiving different levels protections over their money when received by firms, for example, cheques (which are themselves client money), may be held insecurely by a firm for a day before being banked.

**4.77** There is also an issue as to when firms may utilise client money represented for example by a cheque. We have seen some firms beginning to trade for a client immediately on receipt of a cheque even though the cheque has not cleared. This generally results in another client's money being used to fund the client whose cheque has not cleared and may result in loss of client money should the cheque bounce.

**4.78** There are various risks around client money not being allocated to clients in a timely manner and the firm's records would not show the relevant clients true entitlement.

### Proposed changes

**4.79** We propose that firms who receive physical payments of client money such as cash, cheques and payment orders must record their receipt immediately and deposit the client money in a client bank account promptly but no later than one business day following receipt. This should ensure that all client money received by a firm is protected, however it is received.

**4.80** We propose that it is explicitly set out in the rules that firms may only use a client's client money when that money has cleared into a client bank account. That would affect payments, for example, made by cheque, which may take a number of days to clear into the client bank account, and credit cards, which again can take some days to clear into the client bank account. The firm may use its own money to fund a client's transaction, it just may not use other clients' money to do this.

**4.81** We propose to set out in the rules that firms must allocate receipts of client money to the relevant clients within five business days. We also propose rules around 'unidentified' receipts, which the firm believes may include a payment of client money but the firm has not been able to identify to what the payment relates. If the firm reasonably believes that the payment

represents client money (wherever received) the firm should segregate the amount that it reasonably believes to represent client money as client money while working to allocate the payment. If the payment proves not to be client money the firm should remove the payment from the client bank account at the next available opportunity.

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

## Prudent over-segregation of client money

### Background

**4.82** Investment firms that hold client money are currently permitted to 'over-segregate' an amount of firm money in the client money bank account where they consider it prudent to do so. That money will then become client money and form part of the client money pool in the event of the firm's insolvency. The use of prudent over-segregation might occur on either an 'ad-hoc' basis (for example, to protect against one-off occurrences, such as system failure) or on an 'ongoing' basis (for example, a particular sum of money maintained in a client bank account to address certain risks).

### Issues and risks

**4.83** There is currently some uncertainty among firms over when it is appropriate for them to segregate additional money as a prudent over-segregation, which has led to differing practices through-out the industry.

**4.84** There is a risk that firms who prudently over-segregate do so to protect clients without complying with the detailed rules around segregation and record-keeping set out in the client money rules (i.e. they consider there to be enough money without calculating the actual required amount). This is inappropriate and prudent over-segregations of client money should not be used in this way.

### Proposed changes

**4.85** We propose to clarify the existing requirements, the process firms should follow when they assess it would be appropriate to hold a prudent over-segregation (for example, the risk of systems failure, or business conducted on a day on which a top-up of client money could not be performed such as a UK weekend or bank holiday). Firms would also be required to keep appropriate records including oversight and calculation policies to ensure that it is clear that the firm intends this money to become client money. As part of this proposal we also wish to clarify that a firm may also choose to maintain a prudent over segregation of client money in its client bank accounts for costs that may be borne by the client money pool following the firm's failure. If a firm chooses to maintain such a prudent segregation, this should be properly recorded within its records and the amount maintained as a prudent segregation calculated in accordance with its internal policies.

**4.86** We are also proposing a mechanism for money being held as a prudent over-segregation to be removed from the client bank account when a firm has assessed that that amount is no longer required to be held as client money (for example the firm may re-evaluate the relevant risks or liabilities and determine that a sum is no longer required to address the anticipated liability or risk).

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

## Alternative approach

### Background

**4.87** Under the alternative approach to client money segregation, client money may be received into and paid out of a firm's own bank accounts rather than client bank accounts. The alternative approach was designed to cater for the evolution of the UK financial industry's operations and settlements and not prohibit firms from operating in a global environment.

**4.88** The alternative approach is relevant for a firm that operates in a multi-product and multi-currency environment for whom adopting the normal approach (i.e. receiving client money into and paying client money out of a client bank account) leads to greater risks to client money than the alternative approach. In these circumstances, we believe that the use of the alternative approach is suitable.

### Issues and risks

**4.89** By receiving client money into the firm's own accounts there is a risk that receipts into that account that represent client money are not identified promptly as such and are therefore held in the firm's account for a long period (measured in days, sometimes weeks). There is also an intra-day risk under which if a firm were to fail during the day then there may be client money which has been received into the firm's own accounts and not segregated as client money. This intra-day or timing risk was demonstrated by the failure of LBIE, which when it failed on a Monday morning had last segregated client money on the previous Friday using the figures from close of business on Thursday.

**4.90** We undertook research in 2012 and discovered that a number of firms were using the alternative approach in situations where we believe were inappropriate, such as those operating only in the UK and firms trading in derivatives (both of these situations do not give rise to complexities which would necessitate the use of the alternative approach). This exposes the clients to the risks associated with the alternative approach inappropriately.

**4.91** We also found a number of firms not taking adequate steps to mitigate the risks to unidentified credits in house accounts and intra-day risk.

### Proposed changes

**4.92** Given the results of our research and the risks identified, we are intending to clarify our rules in this area to restrict the use of the alternative approach to only those firms where its use would be appropriate. We intend to require firms wishing to use the alternative approach to:

**i.** Establish why the alternative approach would be appropriate for the relevant business line and document this in writing;

**ii.** notify the FCA of their intention to use the alternative approach no less than three months before adopting it;

**iii.** demonstrate for each business line why adopting the normal approach would subject client money to greater operational risk and how the use of the alternative approach would result in less risk to client money;

**iv.** demonstrate adequate systems and controls to operate the alternative approach;

**v.** calculate and hold a buffer of client money to cover the risk that there would not be enough client money segregated at any particular time (relating to unidentified credits and intraday risk), reviewed regularly and calculated using averages from the previous three months business, and

**vi.** provide an auditor report to the FCA covering the adequacy of the firm's systems and controls to effectively operate the alternative approach and the appropriateness of the firm's calculation of its buffer before commencing use of the alternative approach.

**4.93** We are also proposing to set out at a high level how the alternative approach would operate, for example, that client money should be received into and paid out from the firm's house account, the details of how client money reconciliations should be performed and the ability of firms to adjust their client money holdings between calculations.

**4.94** Given the changing nature of business, we are proposing that firms should review whether the alternative approach remains appropriate and they meet the criteria set out in the client money rules on at least an annual basis or when such a review is otherwise required.

**4.95** Given the limited number of situations we see where the alternative approach exposes clients to less risk than otherwise, we expect that it should only be used by the largest investment banks and we would not expect to see it used in any other types of firm. Firms that do not access markets in multiple jurisdictions for their clients should not be using the alternative approach but should be receiving and paying money out directly from client bank accounts.

**4.96** If these changes are implemented, we propose to provide firms six months to assess whether the alternative approach remains appropriate for them given the clarifications set out above and to implement systems changes if appropriate to change from using the alternative approach to the normal 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.**

## Client money held by third parties

### Background

**4.97** The very nature of investment business results in the possibility that a firm may have to transfer client money to a third party in the course of a transaction for a client. Firms can do this under the existing provisions[15], which provide that a firm may transfer money to a third party while retaining a fiduciary responsibility over the money, or alternatively, by transferring client money to a third party who also has a direct contractual relationship with the client. In the latter case the money is no longer client money as far as the firm is concerned, and third party holds that money directly for the client in accordance with the third party's relationship with the client.

### Issues and risks

**4.98** There have been situations highlighted to us that provide for a third party to hold client money for a firm's client where the firm has not first received the money from the client. However,

15 See CASS 7.5.2.

the existing requirements (CASS 7.5.2) only provides for a firm to 'transfer' client money to the third party. This has meant in the situation where because the money was placed with the third party directly there has been confusion as to the client money responsibilities that the firm has to the client and the third party to the client.

### Current policy and proposed changes

**4.99** We propose to clarify our rules to ensure that if a third party ends up holding money for a client which is a client of the firm (rather than a client of the third party), the money remains client money of the firm and that the firm should include these amounts in its internal client money reconciliations.

**4.100** We also propose to re-emphasise guidance in CASS 7.5 to the effect 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. The firm should therefore not hold excess amounts of client money in a client transaction account, but should recover the money from the third party and hold it in a client bank account.

**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.**

## Client money relating to custody assets held at custodians or sub-custodians

### Background

**4.101** Investment firms who hold safe custody assets may deposit these assets with third parties such as custodians or sub-custodians in accordance with CASS 6.3. When there is activity around those assets, be that a payment of a dividend or a sale or stock lending activity, client money may arise. This client money should be held by the firm.

### Issues and risks

**4.102** There are a variety of models used by firms to deal with this money. These range from the firm holding a client bank account at the custodian (if it has a deposit taking permission) to the custodian holding the money as its own client money (which is correct, however it is also client money of the firm). This leads to the risk of confusion and delay on the failure of a firm if the IP needs to identify and recover client money held by different custodians, which may not form part of the firm's internal client money reconciliations.

### Current policy and proposed changes

**4.103** We are proposing that firms who hold safe custody assets, which deposit these assets 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. Alternatively, 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 the custodian is holding the monies on behalf of the firm's clients. Firms which do this should take note of the guidance that excess client money should be held in a client bank account rather than a client transaction account and arrange for the money to be transferred back to the firm when appropriate.

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

## Client money reconciliations and recordkeeping

### Background

**4.104** Article 16(1)(a) MiFID Implementing Directive, as set out in the client money rules at CASS 7.6.1, requires that 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.' The internal and external client money reconciliation requirements and guidance set out in CASS 7.6 and CASS 7 Annex 1 are an essential part of firms being able to meet this MiFID requirement. The internal client money reconciliation is also the means by which we expect firms to ensure they are correctly segregating an appropriate amount of client money under our rules.

**4.105** For its internal client money reconciliations (i.e. a reconciliation between internal records and accounts of the amount of client money held for each client with internal records and accounts of the client money that should be held in client bank accounts or placed in client transaction accounts), a firm may choose to follow either one of the two standard methods of internal client money reconciliations set out in CASS 7 Annex 1 G (the standard methods) or to carry out a non-standard method of internal client money reconciliation (non-standard method).

**4.106** If following one of the standard methods, a firm must carry out an internal client money reconciliation each business day. If following a non-standard method, a firm must be able to demonstrate that its proposed non-standard method provides an equivalent degree of protection to clients as the standard methods and must provide a written confirmation to the FCA from the firm's auditor that it has systems and controls adequate to enable it to use the non-standard method effectively.

**4.107** We also require firms to carry out external client money reconciliations (i.e. a reconciliation between internal accounts and records and those of third parties where client money is held) 'as regularly as is necessary'.

### Issues and risks

**4.108** We have observed firms failing to appreciate the importance of carrying out appropriate and robust client money reconciliations (including both internal and external) and to understand our requirements in this area. For example, we have identified a wide divergence in views among firms as to what constitutes good practice for reconciliations, including at what frequency and the methods of reconciliation appropriate for their business.

**4.109** We view our requirements around recordkeeping and reconciliations to be an important part of the controls a firm should have in place to ensure both the accuracy of its records and the protection of client money. We note further that robust requirements and controls around client money reconciliations and recordkeeping will be increasingly important given the above proposals around distribution of client money based on speed.[16]

### Proposed changes

**4.110** We propose to make clear in our rules that firms will be required to perform an internal client money reconciliation on a daily basis (regardless of what method used) and an external client money reconciliation as regularly as necessary but no less often than once a month (prior to the implementation of MiFID our rules required a frequency of no less often than every 25 business days). However, since we consider the external reconciliation to be an important control to prevent misappropriation and fraud, we propose that firms be required to consider the frequency, number and value of transactions which they undertake for clients and the risks

16 See the speed proposal discussed in Chapter 2.

to which their client money is exposed when determining the appropriate frequency at which an external reconciliation should be undertaken and that firms be required to periodically review this decision. We propose to set out in guidance that a firm which often undertake transactions on a daily basis should conduct an external reconciliation on a daily basis.

**4.111** We also propose to insert guidance in our rules on the purposes of internal and external client money reconciliations and details around how both the internal and external reconciliations should be conducted and what should be included. Both the internal and external client money reconciliations are intended to be one of the means by which a firm ensures the accuracy of its records. However, the internal client money reconciliation is also intended to be the means by which a firm calculates the amount of client money it is required to have segregated in client bank accounts under our rules. For a firm operating the alternative approach to client money segregation, the calculation is used by the firm to determine how much client money it needs to have segregated in client bank accounts by the close of business that day. For any other firm, the calculation is used to check that the firm had segregated on the previous business day the correct amount of client money in its client bank accounts.

**4.112** We similarly propose to make some further technical amendments to the existing guidance around the standard methods for the internal client money reconciliation. Our proposed revisions are intended to improve its clarity and address inconsistencies. This includes converting many of the provisions set out currently in CASS 7 Annex 1 into requirements and inserting additional guidance on the steps a firm should be taking to comply with these requirements.

**4.113** We propose further to continue to allow firms to make use of a Non-standard Method, clarifying that a non-standard method is one which does not meet the requirements set out for the standard methods. However, we note that under these proposals firms will not be allowed to deviate from our requirements on frequency, regardless of the method of internal client money reconciliation they undertake (if firms wish to do this they would have to apply for a waiver).

**4.114** We propose also to require firms intending to use a non-standard method to first notify and provide to the FCA a report from their auditor confirming that the proposed method affords an equivalent degree of protection to the standard methods (retaining the current requirements for the firm to establish and document in writing its reasons for concluding that the proposed method affords an equivalent degree of protection and the auditor to confirm that the firm has systems which will allow the firm to perform the proposed non-standard method effectively).

**4.115** We propose to further clarify that any change in a firm's non-standard method will require the firm to update its records to ensure it retains records documenting how the revised method affords an equivalent degree of protection to its client and to obtain and provide to the FCA a new written report from the firm's auditor confirming this. We intend also to state in guidance that a non-standard method will afford a firm's clients an equivalent degree of protection as the standard methods if it achieves the purposes of an internal client money reconciliation.

**4.116** We intend also to introduce more detailed recordkeeping requirements. This includes proposed requirements for firms to retain copies of reconciliations conducted and each review the firm undertakes of its arrangements for recordkeeping and reconciliations (including decisions on frequency of external client money reconciliations). In addition to this we are introducing record keeping requirements around how receipts of client money and payments out of client money should be recorded, together with an overarching requirement that the firm must maintain records so that at any time and without delay the firm can determine the total amount of client money it should be holding for each client.

**4.117** We also note that our proposed notification requirements, although more prescriptive, retain a materiality threshold at which a firm's failure to comply with a requirement becomes notifiable to the FCA. We are providing no additional guidance on when a firm's failure to comply with a specific requirement is material as materiality needs to reviewed on a case-by-case basis and depends on many varying factors including the firms business model. If necessary, firms with specific concerns should approach us on an individual basis for guidance.

**4.118** And finally, we propose restricting the use of one of the two standard methods to certain firms with specific controls and systems in place. One of the existing standard methods, often referred to as either the 'bank balance method' or 'negative add-back method' (currently CASS 7 Annex 1 G, para. 6(2)), was introduced in the FSA Handbook in 2002 to accommodate firms whose 'internal ledger systems and business practices were designed on a bank account by bank account, not client by client, basis'[17].

**4.119** This method differs from the other standard method, often referred to as the 'individual client balance method' (currently CASS 7 Annex 1 G, para. 6(1)), because it does not necessitate a firm, in calculating its client money requirement, considering how much it should be holding in total (i.e. across all accounts and businesses) for each of its individual clients. The 'negative add-back method' instead allows a firm to calculate how much client money it should have segregated in a client bank account based on whether any of its individual client's balances in a particular account have run negative.

**4.120** A firm using the 'negative add-back method' without any additional controls runs the risk that it may not have records sufficient to demonstrate how much money it is required to be holding for an individual client at any given moment. As a result, we propose clarifying that all firms, including those making use of the 'negative add-back method' as a standard method, be required to maintain their records so that at any time and without delay the firm is able to determine the amount of client money it should be holding for each client.

**4.121** We propose to also limit the availability of the 'negative add-back method' as a standard method to asset managers (i.e. firms which would previously have been regulated by IMRO) and to restrict firms which undertake margined transaction business from making use of the method. We believe that the 'negative add-back method' is not suited for other types of firms and business. We understand that these proposals should limit the use of the 'negative add-back method' to only those types of firms which currently make use of the method.

**4.122** Should these proposals be implemented following consultation, we propose six months before they come into force. During this period firms who are currently operating a non-standard method of client money reconciliation should ensure that their method meets the new requirements, or to amend their method accordingly.

**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.**

17 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.

## Acknowledgement letters

### Background

**4.123** CASS 7.8 requires a firm, when arranging to place client money with a bank or other third party (e.g. in a client bank account or a client transaction account), to engage in an exchange of letters providing and confirming notice to the third party of specific matters. The purpose of these rules is to ensure that the segregation of client money placed with third parties is appropriately secure. This includes ensuring that the relevant monies are protected from third party claims and separately identifiable as from money belonging to the firm.

**4.124** The requirements differ slightly depending on the type of account the firm is opening, but broadly speaking the firm must notify the third party that the money to be placed in the relevant account is client money held on trust by the firm. The firm must also request that the third party acknowledges the account has been opened in accordance with the instructions of the firm and that the third party is not entitled to combine the account with any other account nor is any right of set-off or counterclaim to be exercised by the third party against sums standing to the credit of that account in respect of sums owing on any other account at that third party.

**4.125** The process places two obligations on a firm: (1) to provide specific notifications to banks and other third parties when it is opening an account with that third party for the placement of client money; and (2) to withdraw client money placed with the third party (unless the relevant account is a client bank account and located outside the UK), if that third party does not provide the required acknowledgements within 20 business days following dispatch of the notification to the third party (the 'grace period').

### Issues and risks

**4.126** The Unit has consistently observed firms making a number of different mistakes and poor practices when sending and obtaining these notification and acknowledgement letters.[18] These include:

- inaccurate or incomplete drafting of the required notifications and acknowledgments (including letters, which contain caveats altering the intended meaning or effect of the letter)
- inadequate identification of the relevant accounts (misquoting or failing to include account names and numbers), and
- the failure to follow basic execution formalities (such as clearly and accurately identifying the parties, obtaining signatures, including information identifying signatories and dating the letters).

**4.127** Deficient notification and acknowledgement letters create uncertainty around whether client money is being adequately protected while a firm is operating as a going concern and, in our experience, is likely to lead to disputes between an IP and the third party where the account is held in the event of a firm's insolvency. These disputes will either delay or prevent the release of client money following the failure of a firm.

**4.128** Our experience with firms shows that some firms experience difficulties when negotiating the drafting of an acknowledgment letter with the bank or third party with whom they are placing client money. Some banks and third parties misunderstand the requirements we place on firms

18 The FSA first discussed these concerns in a Dear Compliance Office letter dated March 2009 (available at: www.fsa.gov.uk/pubs/other/letter_client_assets.pdf) and its Client Money & Asset report dated January 2010 (available at: www.fsa.gov.uk/pubs/other/cass_risk.pdf).

when they are holding client money and, in certain cases, this can lead to multiple reiterations of the same draft letter, often involving significant staff time and resources.

### Proposed changes

**4.129** To reduce the likelihood of firms making errors with these letters and minimise the risks that flawed letters create, we propose that firms be required to use standard template acknowledgment letters. We believe also that mandating the use of the acknowledgement letters will simplify the process for firms and increase the likelihood that firms will be able to promptly obtain these letters when opening new accounts.

**4.130** The acknowledgment letters will be prepared by the firm on their own letterhead and signed and then sent to the relevant third party for their review and countersignature. The acknowledgment letters have also been drafted to: (a) ensure consistency in use, where appropriate, between the types of account opened (including introducing a notification in respect of client transaction accounts that the firm holds client money on trust); (b) clarify which provisions constitute an acknowledgment of notice and which require agreement between the parties; (c) ensure client money is protected from third party claims which may delay or prevent the release of client money following the failure of a firm (clarifying the circumstances in which the relevant third party will have no recourse or right to money deposited or placed in the relevant account); (d) introduce provisions to strengthen the terms of the letter, including governing law, forum, variation and merger/integration clauses; and (e) in respect of client bank accounts, introduce a clause requiring the bank to agree that it will 'release on demand all money standing to the credit of the account upon proper notice and instruction…'.[19] In drafting the acknowledgment letters we have engaged with the industry, including a selection of banks (both UK and foreign), clearing houses and intermediate brokers with whom we understand a significant proportion of client money is placed.

**4.131** We propose further introducing guidance notes on how firms should make use of the acknowledgment letters. This includes guidance on how to complete the acknowledgment letters, their use with different types of accounts (including money market deposits), the involvement of third-party administrators in this process and the steps a firm might take to ensure that an individual that has countersigned an acknowledgment letter was authorised to do so.

**4.132** We propose to require firms to obtain an acknowledgement letter for all client bank accounts (not just those located in the UK) and to remove the 20 business days grace period for firms to obtain a duly countersigned acknowledgment letter (in effect prohibiting the placement of client money into an account until the relevant acknowledgement letter has been signed and returned to the firm). We see no reason for client money to be provided a different degree of protection because the account in which it is placed is either new or held with a bank outside of the UK.

**4.133** We propose that firms be required to: (a) use reasonable endeavours to ensure that any individual that has countersigned an acknowledgment letter was authorised to do so on behalf of the third party; (b) periodically (at least annually and whenever it becomes aware that something referred to in an acknowledgement letter has changed) review and promptly update their acknowledgment letters to ensure they remain accurate; (c) to promptly draw up a new acknowledgment letter whenever its client bank account or client transaction account is transferred to a new entity (for example, as part of a merger or sale of business) and to ensure the new counterparty countersigns the letter within 20 business days; and (d) keep a copy of each signed acknowledgment letter for five years following the closure of the account/s to which

19 See proposals on unbreakable term deposits, discussed above at paragraphs 4.65 to 4.68.

it relates. We believe it is important that firms maintain current and accurate acknowledgment letters to ensure a clear legal status over the accounts in which they have placed client money.

**4.134** Finally, given the importance of these letters in providing certainty around the protections afforded client money, we propose that all firms be required to repaper their existing notification and acknowledgment letters with the proposed acknowledgment letters. However given the time and costs which could be involved in this type of exercise, we propose a six month transitional period to allow firms sufficient time to reissue and obtain updated acknowledgment letters for their existing accounts. However, we propose firms be given the choice to comply with either the current rules or the proposed rules in respect of this proposal during the six month transitional period.

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

## Commodity futures trading commission part 30 exemption order

**4.135** We understand that the US legislation restricts the ability of non-US firms to trade on behalf of US customers on non-US futures and options exchanges. However, we also understand that the relevant US regulator (the Commodity Futures Trading Commission (CFTC)) operates an exemption system granting relief to firms from Part 30 of the General Regulations under the US Commodity Exchange Act. The terms of this relief are set out in a Part 30 exemption order the CFTC issued on 15 May 1989, as consolidated and updated by a subsequent order issued on 10 October 2003 (Part 30 Exemption Order).

**4.136** We understand further that the CFTC has issued certain no-action letters in relation to alternative arrangements a firm may have in place for complying with specific conditions of the Part 30 Exemption Order when holding money on behalf of US customers for transactions undertaken on the London Metal Exchange (LME Bond Arrangements). These arrangements include obtaining a binding letter of credit in a pre-specified format to be issued which covers the 'secured amount' (as defined under section 30.7 of the General Regulations under the US Commodity Exchange Act).

**4.137** CASS 7.4 and CASS 7 Annex 1 both contain guidance reminding firms of how the Part 30 Exemption Order and LME Bond Arrangements are relevant to the holding of money belonging to US clients and how these arrangements should likely interact with the requirements elsewhere in our client money rules. We propose to revise this guidance in accordance with our current understanding of the terms of the Part 30 Exemption Order and operation of LME Bond Arrangements. If relevant to your firm, we encourage you to consider the text of this draft guidance.

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

# 5.
# Custody rules (CASS 6)

**5.1** In this chapter we discuss proposed changes to the custody rules, which will affect all firms that hold custody assets. These changes are designed to clarify and enhance the regime to ensure the best protection of custody assets held in relation to investment business.

**5.2** We propose that the changes, if made, come into effect six months after the publication of the Policy Statement.

## Applying the custody rules: physical share certificates

**5.3** We have received a number of queries on whether a firm that holds a client's physical share certificate, registered in that client's name, is captured within the activity of safeguarding and administering investments and is therefore subject to the custody rules (CASS 6) in relation to those assets. This is because some firms have questioned whether these paper certificates, as legal title is recorded on the company registrar or in CREST, are within the definition of designated investments or MiFID financial instruments.

**5.4** As the loss or destruction of share certificates could harm the client in certain circumstances, even though it might not automatically create a loss of title to shares, we reiterate that we believe that firms who are safekeeping physical share certificates do fall within the scope of the 'safeguarding' part of the activity of safeguarding and administering investments under Article 40 of the RAO[20]. Should they also be administering the assets they would be conducting the regulated activity and require appropriate permissions and comply with the custody rules as appropriate.

## Delivery versus payment exclusion – transactions through a commercial settlement system

### Background

**5.5** Both the custody rules (CASS 6) and client money rules (CASS 7) currently allow firms to disapply the rules during the course of a "delivery versus payment" transaction through a commercial settlement system if certain conditions are met. Broadly speaking, these conditions are that it is intended that the transaction settles within one business day of the fulfilment of a payment obligation or a delivery obligation, but that in any event, the transaction settles by the close of business on the third business day following the date of payment or delivery of the asset by the client. This exclusion is commonly referred to as the 'DvP window'.

20 See also PERG 2.7.9G(1).

### Issues and risks

**5.6** During the course of the delivery versus payment transactions, if the DvP window is used, the money or assets are not protected as client money or custody assets. In the event that the firm fails during this time, clients could be unsecured creditors of the firm for any loss.

**5.7** We have also observed some stretching of the use of the DvP window, including that firms use hold money or assets under the DvP window for a significant length of time (in extreme cases months) rather than the limited period permitted in the rules. There have also been many interpretations of what a 'commercial settlement system' actually encompasses.

### Current policy and proposed changes

**5.8** Due to the potential risks of the use of the DvP window to take assets out of the scope of the custody rules, we are proposing to amend the rules to clarify the meaning of 'commercial settlement system' and setting out exactly when the DvP Window begins and ends to ensure that firms are aware that they must be able to comply with the CASS 6 and 7 rules should a transaction fail to settle within the DvP Window. We will be keeping the use of the DvP window under review and will take action to 'close the window' should firms not use it correctly.

**5.9** We propose to define 'commercial settlement system' as 'a system that is commercially available to *firms* that are qualified to act as participants, the purpose of which is to facilitate the settlement of transactions using *money* or assets held on a *settlement account*.' An example of a commercial settlement system is CREST.

**5.10** We are also proposing that clients should agree that their client money or custody assets may cease to be protected in this way. This may be, for example, included in the terms of business between the firm and the client.

**Q33: Do you agree with the proposal of clarifying the requirements around the DvP window? If not, please provide reasons.**

## Unclaimed custody assets

### Background

**5.11** Currently there are provisions in the client money rules for firms to deal with unclaimed client money, but there are no similar provisions in the custody rules (CASS 6) to deal with unclaimed custody assets.

### Issues

**5.12** Without a mechanism in the rules to allow firms to deal with unclaimed custody assets, firms have limited choice in resolving the holdings of unclaimed custody assets. For some firms, continuing safeguarding and administering custody assets, where the clients are no longer traceable, can be costly and burdensome, particularly where the firms wish to cancel their permissions in relation to that activity.

### Proposed changes

**5.13** We propose to set out the reasonable steps a firm should undertake when liquidating safe custody assets should they wish to do so in circumstances when they are unable to return the assets to the relevant client. These steps include entering into an arrangements with the client to liquidate the safe custody assets in relevant circumstances, writing to the client at the last known address of the client to inform the client of the proposed disposal of the safe custody

assets as well as determining that there has been no movement on the account for at least twelve years, retention of record and requiring the firm to make an undertaking to make good any valid claims against any released balances.

**5.14** We propose to clarify the reasonable steps we expect a firm to take before liquidating the assets and paying the resultant money away and to restrict payment of these monies to registered charities. The reasonable steps include obtaining current contact details for the client and providing details about the method, medium, frequency and intervals of communication a firm is expected to complete.

**5.15** Other proposals include requiring the firm's governing bodies to review and approve the payment of money resulting from the liquidation of safe custody assets to charity and make an undertaking to make good any valid claim to the assets should the client come forward. Where a firm is unable for any reason to make such undertaking, it must ensure that a suitable legally enforceable undertaking is made by a group company covering this liability. The arrangements must be effective so that clients can identify the company making the undertaking in the future. If a firm choses to insure the liability covered by the undertaking it may purchase insurance from its own funds.

**5.16** Also proposed is the expansion of the record keeping requirement to include details of the relevant client to whom the safe custody assets were allocated, as well as details of the original firm with which the client initially contracted and if relevant, details of subsequent firms to which the safe custody had been transferred. We also propose that where a group company makes an undertaking to make good a valid claim where the concerned firm is unable to do so, that group company should have unrestricted access to the relevant records of the firm.

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

## Registration of custody assets

### Background

**5.17** A firm may currently register or record legal title to its own applicable assets in the same name as that in which legal title to a client's safe custody asset is registered or recorded[21], under a number of specific conditions.

### Issues

**5.18** Allowing a firm to register or record legal title to the firm's own applicable assets and client's safe custody assets under the same nominee's name poses the risk that when a firm fails, the client's safe custody assets may not be easily identifiable as separate from a firm's assets, thereby delaying the return of custody assets and reducing client protection.

### Current policy and proposed changes

**5.19** To address these risks, enhance client protection and promote the speedier return of custody assets should a firm fail, we propose to remove the ability of firms to register their own assets in the same name as safe custody assets they hold, save where the safe custody assets are registered in the name of the firm itself. Registering safe custody assets in the name of the firm will continue to be permitted only in specified circumstances[22], namely where the asset

21 See existing CASS 6.2.5R and CASS 6.2.3R(4).

22 See existing CASS 6.2.3R(4).

is subject to local law or market practise outside the UK and with the client's agreement, will remain.

**5.20** We anticipate that few firms should have to change the arrangements of how they register custody assets; however, some firms may need to put in place new arrangements.

**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.**

## Written custody agreements

### Background

**5.21** Investment firms often place their clients' safe 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. These firms will usually have written agreements in place with these third parties that set out the terms of the arrangements.

### Issues and risks

**5.22** When depositing safe custody assets with third parties, firms are required to ensure that there adequate arrangements for the holding and safekeeping of the assets. There is currently no explicit requirement in the custody rules requiring firms to have in place a written agreement to document the terms on which they place client assets with a third party, but the FCA expects that the vast majority of circumstances will necessitate written agreements.

**5.23** We have observed firms placing client assets with another group entity and not documenting these arrangements in writing. The failure to adequately document the terms upon which assets are held creates uncertainty as to how assets should be treated in the event of a firm's failure and may lead to disputes over the responsibilities and obligations of the different parties involved in the chain of custody over custody assets. Where there is a written agreement we have observed that some of these agreements do not adequately address important issues such as the responsibilities of each party.

### Proposed changes

**5.24** We propose to introduce an explicit requirement for firms to have in place a written agreement whenever they place custody assets with a third party. We also intend to provide further clarification on the terms and details that a firm might include in such an agreement.

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

## Custody assets reconciliations

### Background

**5.25** All investment firms that hold safe custody assets are required by the custody rules (CASS 6) to maintain their records in a way that ensures their accuracy and, in particular, correspondence to the safe custody assets held for clients. In discharging their obligations under this requirement, firms are expected to perform internal and external reconciliations as often as necessary and promptly correct any discrepancies they identify in their records when performing these reconciliations.

**5.26** The purpose of an internal custody reconciliation is to allow a firm to validate the accuracy of its internal records. The purpose of an external reconciliation is to require a firm to compare its records against the records of third parties with whom they have deposited or registered (including sub-custodians, Central Securities Depositaries (CSDs) or registrars). The external reconciliation requirements require the firm to make good any discrepancies between the records.

**5.27** Historically, we have identified instances of poor reconciliation practices and inadequate internal and external reconciliation frequencies being set by firms. We have also found that many firms do not fully understand the 'internal reconciliation' requirement and in some cases do not even perform this reconciliation.

**5.28** We are therefore proposing to amend and clarify the existing custody reconciliation requirements, setting out that firms should undertake the following types of reconciliations:

- reconciliation of internal records ('internal custody reconciliation')
- reconciliation of any physical custody assets that are held ('physical custody reconciliation'), and
- reconciliation of firms records against third party records where custody assets are held ('external custody reconciliation').

**5.29** We are proposing further changes in respect of reconciliation frequencies, handling discrepancies and the policies and procedures that need to be in place for custody reconciliations.

### Internal custody reconciliation

**5.30** We are aware that many firms use integrated systems to maintain their client custody records and are not able to perform an internal custody reconciliation in the manner currently envisaged in the rules. This is because an internal custody reconciliation requires a firm to compare two records to identify, investigate and correct any discrepancies identified. In some instances we do not consider that a firm will be able to meet this requirement if it uses an integrated custody records system, as it is not possible to extract two independent records from such a system to perform a reconciliation.

**5.31** We are proposing to require all firms to carry out internal custody reconciliations in the form of 'internal custody records checks'. An internal custody record check is a check as to whether the firm's internal records and accounts of the safe custody assets held by the firm correspond with the firm's obligations to its clients to hold those safe custody assets, which is performed using one of the following two methods:

**5.32** The internal reconciliation method, whereby the firm will be required to:

- identify the safe custody assets held for each individual client to calculate a 'total assets held for clients' figure;

- separately identify (i.e. using a separate record) the aggregate total of safe custody assets that the firm holds on its premises and/or deposits with third parties to calculate a 'total assets held for clients' figure; and

- compare the two figures to identify any discrepancies and investigate and correct any them.

or

- The internal evaluation method, whereby the firm will be required to evaluate the completeness and accuracy of its internal records systems in order to assess whether it records the safe custody assets belonging to each client and the total of safe custody assets held by the firm and to investigate and resolve any discrepancies identified.

**5.33** We propose that before making use of the internal evaluation of custody records system method, a firm should document the system design to show and explain the evaluation it will make of its internal records systems.

**5.34** We propose to require a firm, before using the internal evaluation of custody records system method, to first send to the FCA a written report from an auditor. This report should be prepared on the basis of a reasonable assurance engagement and provide an opinion of the adequacy of the design of the proposed method.

**Q37: Do you agree with our proposals to provide the two different methods for the internal custody assets reconciliation? 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.**

### Physical custody reconciliations

**5.35** We propose to require firms to conduct a separate reconciliation specifically for safe custody assets a firm holds in its physical custodyin addition to carrying out an internal custody reconciliation. This will require firms to count the safe custody assets using one of two methods already prescribed in the rules ('the total count' method or 'the rolling stock' method) and reconcile the total number of safe custody assets held with a firm's internal records of the physical stock it holds.

**5.36** In addition, we are proposing requiring a firm, before using the 'rolling stock method', to first send to us a written report from an auditor. This report should be prepared on the basis of a reasonable assurance engagement and provide an opinion of the adequacy of the design of the proposed method.

**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.**

### External custody reconciliations

**5.37** We are clarifying the current requirement as to how external custody reconciliations should be carried out. The purpose of the external custody reconciliation is to check the firms internal records against those of third parties. If safe custody assets are deposited with third parties this reconciliation would consist of checking the firms internal records against information provided by the third party. If the firm does not deposit assets with third parties this may consist of checking with the records of the third parties responsible for the registration of legal title to safe custody assets (for example, and as appropriate: central securities depositaries, operators of collective investment schemes, and administrators of offshore funds).

### Frequencies of custody reconciliations

**5.38** Firms must ensure their records are correct to appropriately safeguard their clients' assets. Firms have better understanding of the complexity of their business and the risks posed to the custody assets they hold and so are best placed to determine the frequency with which they should conduct reconciliations. We therefore propose to require firms to set the frequencies of their reconciliations, subject to minimum requirements and to clarify that a firm should, when setting the frequencies of their reconciliations, consider the risks to which the safe custody assets are exposed, such as the nature, volume and complexity of their business.

**5.39** As stated above, we also propose to set minimum frequencies for the different types of custody reconciliations. For the internal custody reconciliations this will be as often as necessary but no less than every 25 business days. For the external custody reconciliation this will also be as often as necessary but no less than every 25 business days. In relation to assets held in CREST, we believe that firms should conduct external custody reconciliations daily, reflecting current good practice.

**5.40** The proposed prescribed frequency for physical custody reconciliation would be as often as necessary but at least every six months.

**5.41** Firms will have an obligation to review the frequency of their custody reconciliations at least annually and keep appropriate records of these reviews, the decisions made and the reasons for the decisions.

### Discrepancies

**5.42** Where a reconciliation has highlighted a shortfall in the safe custody assets held by the firm, the firm must resolve the shortfall. If it is unable to do so immediately it must ensure client protection by segregating an equivalent amount of the firm's own assets or by segregating client money to the value of and in respect of the shortfall.

**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.**

### Policies and procedures for custody reconciliations

**5.43** Existing systems and controls requirements require firms to document their policies and procedures for their custody reconciliations.

**5.44** We expect that these documents should set out the frequencies the firm will follow for its custody reconciliations and the rationale for these frequencies, the procedures for the resolution of reconciliation discrepancies and the firm's procedures for escalating breaches and records related issues to the firm's board and to the FCA where appropriate (this would include any materiality policies a firm adopts).

**5.45** Along with the relevant procedures, firms will also be required to maintain records of each reconciliation conducted. The proposed changes to internal and physical custody reconciliations rules, frequencies and the requirement for written policies and procedures for some firms may require significant internal review, preparation and engagement with auditors where necessary. It is therefore proposed that if these rules are implemented after consultation, they come into effect six months from the date they are made.

**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.**

## Restrictions on switching out of TTCA

### Background

**5.46** Following the implementation of MiFID we introduced the concept of title transfer collateral arrangements (TTCA) into the custody regime. These arrangements provided allow for a firm to cease treating assets as safe custody assets if the assets were transferred to the firm for the purpose of securing or otherwise covering present or future, actual or contingent or prospective obligations. When assets are subject to TTCA they cease to be safe custody assets becoming the firm's own assets. We restricted the use of TTCA in respect of retail clients of CFD and spread betting products following supervisory work which showed that for certain businesses the use of TTCA was not appropriate for retail clients and was not generally in the clients' best interests.

**5.47** MiFID revisions (which are yet to be finalised) are likely to prohibit the use of TTCA in relation to all retail clients. Furthermore, the European Commission published a MiFID consultation where they identified the potential need to strengthen the existing TTCA provisions to address inappropriate use of TTCA with non-retail clients.[23]

### Issues and risks

**5.48** We have observed that when a firm is approaching insolvency there has been a demand from clients to move assets from being held by the firm subject to TTCA to protection under the FCA's custody rules. This provides the potential for disputes as to the status of the assets when firms enter into insolvency proceedings, for example in circumstances where client agreements were not updated adequately, where clients instructions where not followed (and their custody assets not segregated), or where the firm did not make the necessary changes in its records.

### Current policy and proposed changes

**5.49** We are therefore proposing to introduce requirements as to how a firm documents TTCA requirements, requiring TTCA to be contained in a written agreement. In addition, we are proposing a mechanism that must be followed if the client requests that their assets be subject to the custody rules for assets subject to TTCA. These proposals include the firm setting out in the contract the arrangements should the firm agree to a request for protection. On agreeing to a request for protection the firm must notify the client of its agreement including notification of when the protection would come into effect taking into account the time required to segregate the safe custody assets or amend registration details if relevant.

23 Public Consultation – Review of the Markets in Financial Instruments Directive (MiFID), European Commission (8 Dec 2010) available at: http://ec.europa.eu/internal_market/consultations/docs/2010/mifid/consultation_paper_en.pdf

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

### Right to use arrangements

**5.50** We believe that the blanket inclusion of the 'right to use arrangements' in agreements with clients is inappropriate. Retail clients in particular may be unaware of the increased risks to their assets from these arrangements. We are therefore proposing new guidance in our rules to require firms consider their client's best interests when agreeing right to use arrangements with clients. We will keep firms' use of 'right to use arrangements' under review and will take further action if necessary.

### Notification requirements

**5.51** We have clarified the notification requirements to ensure that the FCA is aware of instances where firms are not conducting reconciliations and/or topping up shortfalls as required. However we note that our proposed notification requirements, although more prescriptive, retain a materiality threshold at which a firm's failure to comply with a requirement becomes notifiable to the FCA. We are providing no additional guidance on when a firm's failure to comply with a specific requirement is material as materiality needs to reviewed on a case-by-case basis and depends on many varying factors including the firm's business model. If necessary, firms with specific concerns should approach us on an individual basis for guidance.

# 6.
# Client reporting and information (CASS 9)

## Overview

**6.1** Our current client information and reporting requirements in relation to client assets held by investment firms largely derive from MiFID and are found in the conduct of business rules (COBS 6.1.7R and COBS 16.4). We also have disclosure and reporting requirements specific to prime brokerage firms in client assets rules (CASS 9).

**6.2** We have reviewed these requirements and considered proposals aimed at increasing market transparency and improving market awareness about the operation of our regime for the protection of client assets in the UK. We have also considered the extent to which these proposals should improve the outcome for clients following a firm failure.

**6.3** In our experience of recent firm failures, we have observed among clients misconceptions around the protections afforded to client assets. Clients of all types have failed to understand the protections available to client assets under the client assets rules and the impact contractual terms may have on these protections.

**6.4** The proposals set out below are intended to reduce the likelihood of discrepancies between a firm's records and clients' expectations and to likewise reduce the number of disputes and queries following the failure of a firm. Other possible benefits of enhanced client reporting and information requirements for firms holding client assets should include ensuring clients do not unwittingly give away protections otherwise available under the custody rules (CASS 6) or client money rules (CASS 7); and an improvement in firm recordkeeping.

## Regular reporting to clients

**6.5** The conduct of business rules (COBS) require a firm that holds client designated investments or client money to send that client at least once a year a statement of all the designated investments or client money held by the firm at the end of the period covered by the statement and details regarding any investment or money which have been subject to a securities financing arrangement (COBS 16.4). Furthermore, these rules impose additional requirements on firms that manage investments to periodically report to their clients between once a month to once every six months depending on specific circumstances (COBS 16.3).

**6.6** In the client assets sourcebook (CASS 9.2), prime brokerage firms must also report to their clients on a daily basis on the total value of safe custody assets and total amount of client money, along with the cash value of other specific items, and any other information the firm considers necessary to ensure that a client has up-to-date and accurate information about the amount of client money and value of custody assets held by the firm.

**6.7** In any of these circumstances, the report to the client may be provided in any durable medium, which would include any form of electronic message which can be stored, such as by email or messaging through an online portal.

### Proposed changes

**6.8** We propose introducing guidance in the client assets rules (e.g. in CASS 9) reminding investment firms of their client reporting obligations in relation to client assets. We intend also to clarify that, consistent with firms' existing obligations to be fair, clear and not misleading in their communications with clients (COBS 4.2), firms should ensure that in any report provided to clients on client assets, it is clear from the report when assets or monies the firm reports as holding for the client are, or are not, protected under either or both the custody rules (CASS 6) and the client money rules (CASS 7). Inaccurate or misleading information provided to clients can lead to confusion following the failure of a firm and a delay in the distribution of client assets.

**6.9** We plan to also require firms to report to their clients on their holdings of client assets more frequently if a client so requests. In these circumstances, we intend to clarify that any charges associated with these requests must reasonably correspond to the firm's actual costs for providing the relevant report. These proposals are aimed at ensuring that clients are provided sufficient and timely information about their holdings of client assets so that clients can adequately manage their own arrangements.

**6.10** We will keep the topic of reporting to clients on firms' holding of client assets under review (including the minimum frequency at which firms should be reporting to their clients). Furthermore, this is a topic that featured in a consultation on client assets recommendations published recently by IOSCO[24].

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

## Information to clients on client assets protection arrangements

### Background

**6.11** The conduct of business rules (COBS 6.1.7R) require a firm that holds client designated investments or client money to provide its clients with specific information about how the firm holds those designated investments and monies and how certain arrangements might give rise to specific risks for those client designated investments and/or client money. These requirements do not cover all the circumstances in which a client might contractually modify its rights or protections under the client assets rules and the majority of these requirements only apply (although not entirely) in respect of retail clients.

**6.12** In the client assets sourcebook (CASS 9.3), a prime brokerage firm must additionally ensure that every prime brokerage agreement that provides the firm a right to use safe custody assets for its own account includes a disclosure annex. The disclosure annex must set out, among other things, a summary of the key provisions within the prime brokerage agreement permitting the use of safe custody assets and a statement of the key risks to those assets if they are used by the firm, including but not limited to the risks to safe custody assets on the failure of the firm.

24 IOSCO Recommendations Regarding the Protection of Client Assets – Consultation Report (February 2013), available at: www.iosco.org/library/pubdocs/pdf/IOSCOPD401.pdf

### Proposed changes

**6.13** Regarding the information a firm is required to provide clients about their holdings of client assets, we propose to introduce guidance reminding investment firms of the information they are required to give clients about their holdings of client assets before they provide an investment service.

**6.14** We intend also to ensure that our existing information requirements in the conduct of business rules (COBS 6.1.7R) cover all the types of assets that an investment firm may hold under the custody rules. Our current requirements only give rise to an obligation to provide clients with information when a firm is holding 'designated investments' or 'client money'. However, the custody rules (CASS 6) also create obligations about custody assets that are not 'designated investments'. This includes any assets that a firm holds or may hold in the same portfolio as a 'designated investment' held for or on behalf of a client (for example, artwork, crates of wine, etc.). We see no reason for our requirements for information concerning client assets to differ in scope from our custody rules for client assets. As a result, we propose to widen the scope of assets, which could give rise to an obligation to give clients information (under COBS 6.1.7R) to match the scope of assets that a firm might hold under the custody rules (CASS 6).

**6.15** We propose to also remove the distinction made between types of clients in COBS 6.1.7R, with the effect that the same information on client assets would be required to be provided to every client of the firm. We see no logical reason for varying the information provided to clients based on the classification of a client. We have observed clients of all types failing to understand the arrangements their firm has in place for the holding of client assets and the effect those arrangements may have on the protections available to those assets and monies. We note also that the EU Commission is considering introducing similar requirements in the recast of MiFID.[25]

**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.**

### Client Assets Disclosure Document

**6.16** We propose to introduce a requirement for all firms subject to either the custody rules (CASS 6) or client money rules (CASS 7) to highlight to their clients in the form of a stand-alone disclosure document a summary of the key provisions within their client agreements which modify rights or protections, which would otherwise be available to the client under the custody rules or client money rules ('Client Assets Disclosure Document').

**6.17** We envision that where a firm obtains a lien or right of set-off over client assets, has a right to use client assets, has in place a title transfer collateral arrangement or makes use of a client money opt-out and/or the banking exemption (all examples of arrangements which require client consent and affect a client's rights and/or protections under the client assets rules), this Client Assets Disclosure Document would be used to highlight where those arrangements are explained within the firm's client agreements. We further propose to require the Client Assets Disclosure Document to include a statement of the likely consequences of these arrangements for the treatment of a client's custody assets and client money. This would include how client assets may be treated on the failure of the investment firm.

25 Public Consultation – Review of the Markets in Financial Instruments Directive (MiFID), European Commission (8 Dec 2010) (pg. 71), available at: http://ec.europa.eu/internal_market/consultations/docs/2010/mifid/consultation_paper_en.pdf ("The Commission services considers that the described information [Article 32(7) of Directive 2006/73/EC] is a useful tool irrespective of the type of client and would be consequently extended to all categories of clients in order to increase awareness of the risk of such practices [use of financial instruments]").

**6.18** The Client Assets Disclosure Document is intended to be a tool by which clients are reminded of the arrangements in place for the protection of their client assets. It is also intended to be a single-source record of the contractual arrangements a firm may have in place which could impact a client's rights to or interests in client assets.

**6.19** Following recent firm failures, clients of all types have demonstrated a lack of awareness over the arrangements to which they have agreed for the holding of client assets and the impact those arrangements may have on the protections available for those client assets. The Client Assets Disclosure Document should serve to narrow this gap between client expectations and firm behaviour and ensure clients do not unwittingly give away protections otherwise available under the custody rules or the client money rules.

**6.20** We also plan to require firms to review their Client Assets Disclosure Document and provide a copy to their clients before the provision of services and on at least an annual basis thereafter, including whenever the terms of an underlying client agreement are amended such that the Client Assets Disclosure Document no longer accurately records all of the relevant provisions. We believe this document is only useful to clients to the extent it remains accurate, up-to-date and in periodic circulation.

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

# 7.
# Mandates (CASS 8)

## Non-written mandates

### Background

**7.1** The mandate rules (CASS 8) require firms carrying on investment business or insurance mediation business to establish and maintain certain internal controls when they have mandates. The sole purpose of the mandate rules is to reduce the risk of a firm misusing a mandate that could harm consumers. The following proposal relates to amendments to the definition of a mandate.

### Issues and risks

**7.2** In some cases a client may provide a firm with certain information via a non-written means that gives the firm the ability to control the client's assets or liabilities (for example if a client provides their credit card details to a firm over the telephone). If the firm retains this information, there is a greater risk that the information could be misused by the firm (for example fraudulently). The purpose of the mandate rules is to reduce the likelihood of a firm misusing the mandates. However for a mandate to be in scope of the rules currently it must firstly have been received in written form (for example in an application form).

**7.3** In January 2013 we implemented additional rules and guidance in the mandate rules (CASS 8) to address various industry misconceptions on the scope of this chapter. When consulting on these changes, we received responses to suggest that the scope the mandate rules (CASS 8)

should also cover mandates that are not received in written form. We did not implement this into the rules in January 2013 as we had only intended to clarify the scope in line with existing policy. Nevertheless, in response to this feedback we did express the intention in *PS12/20 client assets firm classification, oversight, reporting and the mandate rules* to consider widening the scope of the definition in the future.

### Current policy and proposed changes

**7.4** A mandate is defined as any means that give a firm the ability to control a client's assets or liabilities and that meets a certain criteria set out in CASS 8, one of which is that the mandate must be received in written form. A firm that has mandates must establish and maintain adequate records and internal controls in respect of its use of those mandates.

**7.5** We are proposing to extend the definition of a mandate to include all mandates that a firm receives that are not in written form when they are received regardless of the form that they are in when they are received.

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

# 8.
# Indirect client clearing (EMIR)

**8.1** Here we consult on minimal changes to the client money rules to comply with the requirements established by EMIR Regulatory Technical Standards (RTS). These requirements apply directly to clearing members and their clients who are acting on behalf of their clients.

**8.2** Please note that the consultation period for the proposals in this chapter is for a period of 1 month, ending on 11 August 2013. Subject to the feedback we receive, we will aim to publish our final rules (with immediate effect) in September 2013.[26]

## Background

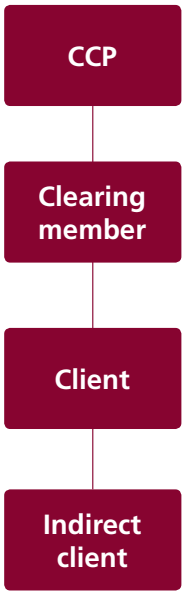
**8.3** An indirect clearing arrangement is where a clearing member is prepared to facilitate clearing the positions of its client's clients, that is to say, its indirect clients.

**8.4** Illustration of direct clearing arrangement in which each party acts as principal (Figure 1).

**8.5** Illustration of indirect clearing arrangement in which each party acts as principal (figure 2).

Figure 1


Figure 2




26 The timetable is driven by a combination of EMIR deadlines and the expected development of indirect client clearing arrangements by the industry.

**8.6** There are two requirements of the RTS that underlie the proposed changes to CASS 7 and CASS 7A:

- The RTS contemplate that indirect clients should be '…included in the transfer of client positions to an alternative clearing member under the portability requirements…'[27] To achieve this, the RTS require clearing members to have in place a 'credible mechanism for transferring the positions and assets to an alternative client or clearing member'[28] as part of the management of the default of the client. This can be seen as somewhat analogous to porting as conceived in the Level 1 Regulation.

- The RTS also provide that the clearing member 'shall … ensure that its procedures allow for the prompt liquidation of the assets and positions of indirect clients and the clearing member to pay all monies due to the indirect clients following the default of the client,'[29] – a requirement somewhat similar to default management requirements applicable to CCPs made in the Level 1 Regulation.

### Current policy and proposed changes

**8.7** We will be responding to the requirements in the RTS only in so far as they affect the client assets rules. The RTS discuss the requirements on CCPs, clearing members and clients in relation to clearing arrangements for indirect clients. The client assets rules do not speak to CCPs[30]; rather, they speak to clearing members and clients that are UK-authorised. The changes proposed will only affect such clearing arrangements to the extent that there is a client money relationship between two relevant parties.

**8.8** Our proposals intend to accommodate the two requirements. We therefore propose to provide in CASS that if a clearing member acting in accordance with the RTS makes payment to an indirect client, then the money paid in this way shall cease to be client money. We note that while in a principal to principal model, it seems that any payment would be more likely from clearing member to client, this is already provided for in CASS 7.2.15R(1).

**8.9** Without detailing how firms would meet the requirements in the RTS, we propose to make amendments so that CASS will provide that if a clearing member acting in accordance with the RTS makes payment to an indirect client, then the money so paid shall cease to be client money from the perspective of the client and, if applicable, the clearing member.

**8.10** We therefore propose to:

- modify our CASS 7 rules to allow for 'porting', i.e. for the clearing member to remit any client money relating to indirect clearing to an alternative client or clearing member (in accordance with the agreements in place) and to discharge its fiduciary duty by doing so, and

27 Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements, etc., Recital 6

28 Ibid., Chapter II Article 4(4)

29 Ibid., Chapter II Article 4(5)

30 However, it may be worth noting that regulation 16 of the *Financial Markets and Insolvency Regulations 1991* stipulates that a market contract effected as principal by a member of a recognised clearing house in relation to which money received by that member is clients' money for the purposes of the client money rules, shall be treated as having been entered into in a different capacity from other market contracts for the purposes of s. 187(1) of the *Companies Act 1989*.

- amend CASS 7A (client money distribution rules) so that (i) a clearing member, in accordance with the RTS, may remit any client money relating to indirect clearing directly to the relevant indirect clients in the event of the failure of the client, (ii) the money so remitted shall cease to be client money in the hands of the client, (and if applicable, the clearing member) and (iii) the clients' entitlement to the client money pool (of the failed client-firm) be reduced by any sum so remitted.

**8.11** In addition to these changes, we will add definitions to the Glossary, identifying the RTS and adding other useful or necessary terms.

**8.12** We plan to allow a short consultation period and to publish feedback with made rules at the first available opportunity following close of consultation.

**Q48: Do you agree that our proposed changes will ensure that CASS is compatible with the EMIR RTS? If not, please provide reasons.**

# 9.
# Structure of the draft rules

**9.1** In the final rules we intend to include additional consequential changes to other relevant parts of the FCA handbook as necessary. For example, the provisions in Chapter 10 of CASS regarding the CASS Resolution Pack and the CMAR in SUP 16 Annex 29 will be updated to reflect the relevant provisions which are the subject of this consultation.

**9.2** In the appendix we include the draft handbook text showing the proposed changes to the current client assets sourcebook provisions. We have done this so you can track through the proposed changes. This has meant the rule references are often elongated, however we will aim to arrange the final rules so they are simpler and easier to follow. We are also considering whether to replace the existing client assets sourcebook with a new sourcebook.

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

# Annex 1
# Cost benefit analysis

## Integrated analysis of the markets subject to the client assets regime

1. This section discusses the main market failures in the protection of client assets and the interaction of these failures with firm and consumer behaviour, competition and the regulatory system. In doing so it takes an integrated approach to the analysis of the problems in the market and provides the basis on which policy should be developed.

2. Throughout this Annex the term 'client assets' refers to both client money and custody assets.

### Customers placing client money and assets with investment firms cannot assess the associated risks (asymmetric information)

3. While it may be in clients' interests to monitor firms to ensure sufficient protection of client assets, monitoring costs may prevent them from doing so. Clients may not be fully aware of how their client assets placed with an investment firm are being used or whether their funds are being adequately segregated and accurately recorded. As such they cannot assess the risks they would be exposed to in the event of firm failure (for example significant delays in the return of client money/assets or shortfalls). This is particularly the case for retail customers who will have limited time, knowledge or bargaining power when placing client assets with firms.

4. Similar risks exist for wholesale customers. Although wholesale customers have more expertise, resources and bargaining power to ensure their funds are adequately protected, there is evidence that wholesale customers that allow re-hypothecation of assets (and therefore lower levels of client asset protection) receive higher levels of return when placing their money at a firm. Anecdotal evidence from several high-profile firm failures suggests that some wholesale customers were not aware they had agreed to reduced client assets protection. However, more recent evidence suggests that wholesale customers are currently paying significantly more attention to CASS protections, making more informed choices regarding their decision to waive these protections. This behaviour may not continue as the impact from recent firm failures fades.

5. **Interaction with firm behaviour in the lead-up to failure:** In the lead up to failure, firms may attempt to 'gamble for resurrection' – by taking larger risks in attempt to avoid default. For example, as firms holding client assets head towards insolvency, they may be tempted to take risks regarding their client assets holdings, either by cutting corners on adequate segregation, reconciliation and record keeping, or by outright misappropriation and fraud. In recent high profile failures, we are not aware of this happening and note that there may be some incentives for firms to maintain records and maximize client assets holdings.

6. In addition, during normal business conditions, some firms holding client assets may be overconfident and incorrectly believe that: (i) they are unlikely to fail; and (ii) they sufficiently comply with the rules. The latter is likely to be made worse where regulatory oversight is weaker and rules are less clear.

7. **Interaction with inattention of retail consumers**: Since the protection of client assets is not the primary purpose for which clients place assets with investment firms, they may not pay full attention to client asset protections, even if they have the time and resources to investigate them. As such, the level of protection does not inform their choice of provider and as a result investment firms do not have a strong incentive to improve their record keeping processes and client asset segregation. This reduces the quality of competition in the market.

8. **Interaction with myopia/overconfidence in wholesale customers**: It is possible that wholesale customers exhibit myopia with regards to how much they pay attention to client assets protections. In other words, they are overly influenced by recent experiences. Given the recent financial crisis, it is natural that customers are paying more attention to the possibility of firm failure and the protections that firms provide regarding client assets. However, over time and during periods of benign or positive market sentiment this attention may quickly fade, even for wholesale customers. Such 'disaster myopia' is well documented in the behaviours of wholesale financial firms.[31]

9. **Reputation and brand no longer a relevant factor for firms**: In most well-functioning markets, the reputation of particular firms and brands plays an important role in signaling quality and price information to consumers. This helps to discipline firms to provide good service and develop good value products. In the absence of regulation, and where we are considering the quality of client asset protections in the event of firm failure, the firm has no incentive to maintain a good reputation. Failure of the firm by its definition means that the firm will most likely exit the market and that the fact it has not kept adequate client asset records does not alter its future reputation or profitability. This creates a similar competitive dynamic as when consumers do not pay attention to CASS protections – that is firms do not compete on the basis of client asset protection and therefore have no incentive to improve or even maintain standards.

**Delays in the return of clients' asset or shortfalls in the asset returned can, if significant, cause market instability (negative externality of poor client money protections)**

10. Information and behavioural problems can lead to inadequate client assets protections, that in turn lead to delays and shortfalls in client assets returned to individual consumers. Inadequacies can lead to litigation by clients for their share of the client assets, leading to higher distribution costs and therefore higher shortfalls in returns to clients. At the macro level, delays and shortfalls for wholesale customers can have significant implications for market stability and the wider economy.

11. The delay and level of shortfall has knock on effects, as clients will need to close positions to meet their own obligations. Depending on the complexity of the failed firm and its centrality in the financial system, this can propagate wider market instability as trading strategies are disrupted, client requests cannot be carried out, and firms throughout the chain terminate their trades in an effort to shore up their own financial position, ultimately leading to a market wide decrease in liquidity.

31 See for example Hanson, S.G., Kashyap, A.K. and J. Stein (2011), 'A macro-prudential approach to financial regulation', Journal of Economic Perspectives, Vol.25, Winter 2011, pp.3-28 and L.Bebchuck and J.Fried (2003), 'Executive compensation as an agency problem', Journal of Economic Perspectives, 17(3), pp. 71-92.

**12.** The size of the market stability impact depends on the size, composition of the customer base (wholesale versus retail) and systemic importance of the failed institution. Having good record keeping can reduce the wider negative impact of firm failure. However, since investment firms do not bear the wider costs to the economy, they do not have an incentive to ensure their record keeping and segregation of client money is sufficient to maximise the speed and amount of client money returns in event of their failure.

**13.** In addition, since the total cost of market instability is not necessarily borne by the clients, clients do not value the full social benefit of client assets protections. Since they do not place sufficient value on the positive social market impacts that proper client assets protection provide, they do not demand the socially optimum level of client assets protections. This is exacerbated by the information and behavioural market failures above. As a result, in the absence of regulation, client asset protections will be under-provided compared with the socially optimum level.

### Market outcomes and competition

**14.** Without regulation, the market outcome is that firms do not adequately segregate, and/or keep accurate records, of client asset they hold. Since competition between these firms is often not on the basis of client assets protection provided, the market alone does not adequately deliver acceptable standards of client asset protection. Indeed in some circumstances (such as when dealing with poorly informed or inattentive retail clients, or myopic or overconfident wholesale clients), firms may have an incentive to reduce the quality of their client asset protections as they seek to compete on salient features such as price and cut costs on non-salient features such as protection of client assets.

**15.** Competition, in the absence of regulation, could result in a 'race-to-the-bottom' on client assets protection standards, which could, in the event of a firm failure lead to significant delays and shortfalls in the return of client assets (and potential knock-on impact on market stability). Such effects present a risk to our strategic objective to make markets function well for consumers. In particular, it would leave consumers open to unacceptable levels of harm, increase the risk of market instability and allow competition that is not in the interests of consumers.

**16.** The potential for these poor market outcomes to materialise provide a rationale for regulators to intervene to maintain minimum standards. Recent firm failures suggest that the current rules have not fully protected against the risks of these poor outcomes. This review seeks to improve on the current rules where possible, and take into account of market, behavioural and competition issues. However, we acknowledge that our rules are one part of a wider regulatory system that determines the return of client assets in the event of firm failure (as explained below).

### Interaction with the wider regulatory system

**17.** We noted in CP12/22 that 'without changes to the wider framework that supports the client assets regime to enable prompt decisions and actions to be taken, any changes we introduce may only marginally speed up the return of client assets.' We discussed in Chapter 2 the limitations of FCA rules to improve outcomes when much of the process is determined by the framework of primary and secondary legislation (including the relevant insolvency, company and trust law).

**18.** Some of the issues relating to the prompt return of client assets relate to the overall legislative insolvency framework. The government, in accordance with the Banking Act 2009, has started a review of the regime created by the Investment Bank Special Administration Regulations 2011 (SAR). The report made some initial recommendations, but set out further areas that are currently being reviewed in a second phase.[32]

**19.** **Interaction with supervision and enforcement effort:** The extent to which firms will comply with existing or new rules is in part determined by the level of supervisory and enforcement activity around the rules. After the collapse of Lehman Brothers, the FSA increased the level of supervisory activity regarding CASS and identified some significant cases of bad practice.[33] The FCA has significantly increase supervision and enforcement activity. The FCA will have to maintain this effort to ensure that compliance does not fall.

## Cost-benefit analysis

**20.** Sections 138I and 138J of the Financial Services and Markets Act (FSMA) require us to publish a cost benefit analysis (CBA) when proposing draft rules. In particular, we are required to publish an analysis of the costs and the benefits and an estimate of those costs and benefits.

**21.** This CBA is structured as follows:

- benefits of the proposed package;
- costs to firms;
- impact on competition; and
- costs to the FCA.

**22.** This CBA compares the overall position if the proposed regulatory changes are applied and the overall position if they are not (i.e. the baseline).

**23.** The FCA's client assets regime as a whole aims to address the market failures identified above. However, recent firm failures, evidence from our supervisory efforts and ongoing dialogue with the industry suggest that certain elements of the regime are still not clear or address the market failures sufficiently. In extreme cases, this could lead to poor market and consumer outcomes. Poor outcomes are driven by poor compliance as well as insufficient coverage of the existing rules.

**24.** Previous efforts have helped to raise the level of compliance in firms, for example, after the collapse of Lehman Brothers, the FSA increased the level of supervisory activity regarding CASS and identified some cases of bad practice.[34] This review goes further, addressing low compliance where it may be driven by confusion or uncertainty, as well as strengthening requirements in certain areas. The FCA will need to maintain sufficient supervision and enforcement activity to ensure compliance remains high.

**25.** Many of the proposed changes that go beyond clarifications relate to better and more

32 P. Bloxham, Review of the Special Administration Regime for Investment Banks (23 April 2013), available at: www.gov.uk/government/news/review-of-the-special-administration-regime-for-investment-banks-published

33 www.fsa.gov.uk/pubs/other/cass_risk.pdf

34 www.fsa.gov.uk/pubs/other/cass_risk.pdf

frequent record keeping, and removing options to undertake certain activities without proper understanding of the effects. These will help firms to understand what client assets they hold and will help with faster and more complete distribution in the event of failure. The biggest change in this CP is to make the speed of return of client money a priority for IPs.

**26.** It is worth noting that the benefits (quicker return of client money, more complete distribution of client money and great market stability in the event of firm failure) of the proposed changes (as with the whole regime) are only realised in the event of a firm failure, whereas many of the costs that are outlined below will be incurred on an ongoing basis. We believe these costs are proportionate to the risks posed by poor client asset protections in the event of firm failure.

### Scope of firms affected

**27.** The client assets regime applies to around 1,500 firms regulated by the FCA that are permitted to safeguard and administer assets and/or hold client money, collectively holding in excess of £10tn of custody assets[35] and in excess of £100bn of client money[36] in relation to investment business. Firms will be affected differently by the proposals, and many may already be compliant with the proposed rules.

### Benefits of the package of proposals

**28.** The proposed changes aim to improve outcomes in the event of the insolvency of an investment firm, by:

1. faster return of money and assets to clients (or faster porting of margin where porting is possible);

2. lower shortfalls in the overall amount of money and assets returned to clients; and

3. greater market stability in the event of the failure of a large, complex and systemically important firm.

**29.** To estimate benefits, we look at three case studies of past investment firm failures: LBIE, MFG and Pritchards. These failures represent investment firms with varying compositions of customers (LBIE's customer base was almost solely wholesale customers, whereas Pritchard's customers were almost all retail), varying sizes (LBIE had over $4bn in potential client money claims, whereas Pritchards had c.£26.5m), business models (investment banks, brokers) and levels of systemic importance (LBIE was systemically important, whereas Pritchards was not). They provide an indication of the likely benefits that the package of proposals would provide. In each case we compare the real life outcome with what might be possible under an improved regime. We acknowledge that in most instances, benefits occur only when firms fail. For this CBA, we estimate the likely benefits of faster return and lower shortfalls in client money. We provide a qualitative indication of the likely benefits in terms of market stability, since such effects are difficult to untangle and any monetary estimates we make would be based on spurious assumptions.

35 The custody assets held by CASS Large and Medium firms as at April 2013

36 The client money held by CASS Large and Medium firms as at April 2013

### Faster return of client money

**30.** The faster return of client money as a result of our proposals is an efficiency gain for clients from being able to use their money sooner. We estimate this in each of the firm failures, by estimating the reduction in opportunity cost from a faster return of client money. We differentiate between wholesale and retail clients since they are likely to put their money to different uses.

**31.** For wholesale clients, we use a typical/average yearly return on a client money account (1%) as a conservative estimate of the opportunity cost saving from an earlier return of client assets. For retail clients, we use the average/typical deposit savings rate (2%) as a conservative estimate of the opportunity cost. In both cases, it is possible to argue that clients could have a higher opportunity cost. For example, wholesale clients could place their money in other funds and receive a higher return, whilst for retail clients, the correct opportunity cost measure could be the cost of borrowing, since in the absence of money tied up in a failed firm, they may need to borrow money to fund non-discretionary purchases.

**32.** In addition to these opportunity costs, there may be other welfare impacts on consumers if they are unable to access funds required for a significant purchase (such as deposit for a house) or for non-discretionary spending (such as to fund retirement or mortgage payments).

**33.** The Speed Proposal proposes to require the distribution of the segregated client money solely on the basis of a firm's records, with those clients who are ineligible to claim for this distribution being able to establish an entitlement for any excess client money or shortfall claim to general estate. While it may be argued that this outcome is unfair on the clients excluded from initial distribution because they had not been appropriately included in the firm's records, on the other hand the overall outcome for the majority of clients is likely to be better (both in speed and amount returned) than otherwise would have been.

### Case studies of potential benefits from previous firm failures

**34.** LBIE entered administration on the 15 September 2008 with approximately $2.1bn of client money segregated for its clients in accordance with its records.[37] Of that money, the administrators where able to recover $1bn, with the remainder largely deposited with an affiliated entity that had also entered insolvency proceedings.[38] LBIE's first (and only to date) interim client money distribution took place in April 2013, almost four and half years after the firm entered administration.

**35.** MFG entered special administration on the 31 October 2011, with over $900m of client money segregated for clients in accordance with its records. An interim distribution, representing 26c in the dollar of an agreed client's claim was agreed in February 2012[39], with no further distributions agreed to date. As at 30 April 2013, c $220m of this agreed distribution had been paid out to clients.

**36.** Pritchards entered special administration on the 19 March 2012 with approximately £23.7m of client money segregated against £26.5m of estimated total client claims. An interim distribution of 50p in the pound of an agreed client's claim was agreed, and payout commenced, in July 2012.[40] As at 5 April 2013, c £11.1m of this agreed distribution had been paid out to clients.

37 Lehman Brothers International (Europe) (in administration) – *Market update on Client Money* – 18/12/08 (www.pwc.co.uk/business-recovery/administrations/lehman/lehman-market-update-client-money-181208.jhtml)

38 $1bn was deposited with Lehman Brothers Bankhaus AG, an affiliated entity who entered insolvency proceedings soon after LBIE. There have been protracted proceedings in relation to the recovery of the $1bn, and at the time of the publication of the CP the matter is still subject to court proceedings in Germany.

39 MF Global UK Limited (in Special Administration) press release: *First interim distribution payment* – 13/02/12 (www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/NewsReleases/Pages/mf-global-uk-first-interim-distribution-payment.aspx)

40 Pritchard Stockbrokers Ltd – Progress Report from 9 March 2012 to 8 Sept 2012 (www.mazars.co.uk/Home/News/Our-publications/Creditor-Reports/Progress-Report-from-9-March-2012-to-8-Sept-2012)

**37.** The administrators of these firms are undertaking a lengthy process to quantify and make certain clients' entitlements to the client money pool before making distributions. Furthermore the distributions were limited to percentages of the available client money due to provisioning in relation to disputed client claims that have taken significant time to resolve. For example, in both the LBIE and MFG administrations there have been legal actions by clients who have claimed that they should be entitled to share in the CMP even though the firm did not treat them as client money clients.

**38.** If the proposal to distribute client money based on the firm's records were in place at the time that these firms had entered insolvency, they could have required the administrators to promptly distribute the recovered client money pool to the clients in accordance with firm's records. Assuming perfect records and provisioning for administrators costs of 10% of the recovered client money, that would have meant that in a space of a few weeks LBIE would have distributed c.$900m, MFG c.$800m and Pritchards c.£21m of client money – significant multiples of the actual client money segregated to date (see table below).

| | Current Regime (reported events) | | Proposal including faster distribution | |
|---|---|---|---|---|
| **Firm** | **When interim distribution commenced following administration (actual month)** | **Total Client Money distributed (as at reporting date)** | **Proposed changes may have distributed (and months earlier)[41]:** | **Opportunity cost saving[42]** |
| **LBIE** | **55 months** (April 2013) | [Not reported] | **c.$900m** (55 months) | **£26.4m ($41m)** |
| **MFG** | **4 months** (February 2012) | **c.$220m** (30 April 2013)[43] | **c.$800m** total, of which at the following intervals: $40m (12 months) $180m (est. 18 months) $580m (est. 24 months) | **£9.6m ($15m)** |
| **Pritchards** | **4 months** (July 2012) | **c.£11.1m** (5 April 2013)[44] | **c.£21m** total, of which at the following intervals: £9.3m (4 months) £10m (est. 12 months) | **£0.29m** |

41 We understand that in reality, claims are received and paid out on an on-going basis throughout this period. This linear approach provides a simple approximation of the pattern of pay-outs.

42 Figures given in dollar and £ amounts, using a exchange rate of $1=£0.64, from 19 June, 2013.

43 www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Documents/PDF/Advisory/mfglobal-uk-six-month-report-%20to-30-april-2013.pdf.

44 www.mazars.co.uk/Home/News/Our-publications/Creditor-Reports/Pritchard-Stockbrokers-Limited.

### Lower shortfalls in client money returned

**39.** Lower shortfalls in the money returned to clients represent a monetary transfer, from the general estate of the failed firm to the clients of the firm. Although in a strict welfare sense this does not constitute a benefit, the FCA has the objective to ensure the market works well in the interests of consumers (both wholesale and retail) and to consider transfers between firms and clients.

**40.** For the three case studies of past firm failures, we can look at the estimated shortfall in the client money pool – that is money that has been identified as being held on behalf of the client, but did not form part of the client money pool for distribution. This is currently estimated at $1.8bn, $156m and £3m, for LBIE, MFG and Pritchards respectively.

**41.** Shortfalls in client money can occur as a result of:

- unresolved deficits due to errors or debts;
- uncertainty over records and the level of protections offered, leading to time, legal and time costs which are borne by the client money pool; and
- intra-day or transfer risk that occurs as firms transfer client money between accounts or through their own house accounts.

**42.** The following proposals are all intended to increase the validity of client money records, and therefore to reduce shortfalls in the client money pool:

- Speedier return of client money (can reduce shortfalls by reducing the IP, warehousing, legal costs).
- Treatment of allocated but unclaimed client money.
- Clarification of the use of TTCA (will reduce the legal and time costs of uncertainties).
- DvP exclusions (will reduce the potential shortfall as client money unsegregated under the DvP exclusion will be reduced ).
- Banning the use of unbreakable term deposits (will reduce delays and associated legal costs which are borne by the client money pool and could avoid losses caused by failure of banks where client money is placed (secondary pooling)).
- Immediate segregation of client money (reduces the intra-day risk of shortfalls in the CMP)
- Restricting use of the alternative approach and requiring a buffer for doing so (reduces intra-day risk of the alternative approach and increases the possibility that any potential shortfalls would be made good by the buffer).
- More frequent internal and external reconciliations (reduces the risk that some client money is not identified as being part of the client money pool).
- Template acknowledgement letters (reduces the risk of legal challenge over how accounts are held and therefore reduces the time and legal costs that are borne by the client money pool).

**43.** Although it is difficult to precisely estimate the amount by which our proposals will reduce shortfalls in client money we believe that there will be a material improvement through a combination of better records; faster distribution (which leads to lower time and legal costs); intra-day and transfer risks; and the ability to top up the client money pool from buffers or unclaimed money.

**44.** For certain proposals detailed below, we have historical information that allows us to estimate the money that would be at risk of becoming a shortfall in the client money pool, were the firm to fail. This provides some certainty of the benefits of our proposals.

**45.** **Trust acknowledgement letters:** We are proposing to introduce a template for the provision of notification and acknowledgment letters, to strengthen the protections of client money held with third parties. Since 2010, we have enforced on a number of firms in relation to non-compliance with the existing acknowledgment letters requirements, with an aggregated average value of client money at risk in these cases of approximately £1bn. The proposals, if applied appropriately should hopefully mean such failings will not occur in the future (unless as a result of willful noncompliance).

**46.** **DvP – Collective Investment Schemes:** The CP proposes to remove the existing DvP exemption for operators of collective investment schemes, thereby requiring these firms to protect monies they hold in relation to redemptions and purchases. We estimate that c.350 firms can use the existing exemption, of which approximately half[45] are likely to be using it. Survey respondents noted that if we were to change the rules, they will be required to segregate between £6m to £20m per firm. Across all firms, and assuming a conservative average of £10m per firm, our proposals if applied correctly would protect £1.75bn - money that is currently at risk if these firms were to enter insolvency proceedings.

### Greater market stability

**47.** The positive impact on market stability as a result of our proposals is hard to estimate. It is difficult to isolate the contribution of poor client asset protections, in the event of firm failure, to market instability and the extent this contribution will be reduced as a result of the proposals set out in this consultation. However, it is entirely plausible that poor CASS protections that lead to longer delays and higher shortfalls in the return of client money can contribute to higher levels of instability and wider market uncertainty. If wholesale clients are unable to access their funds, close their positions or are uncertain about the solvency of other firms, then they will have to close other positions in order to cover existing obligations. This effect can propagate throughout the system as firms retrench, reducing liquidity.[46]

**48.** Our proposals, which prioritise fast distribution of client assets and require firms have stronger reconciliation and record keeping, should increase the speed and reduce the shortfall in client money returns, enabling wholesale firms to use their money sooner and continue trading as normal. This can help reduce the knock-on effects for other firms in the event of large and complex firm failing, and therefore reduce the effect on the wider economy. Previous FSA research estimated the cost of a financial crisis as approximately 60% of GDP[47]. If our proposals reduce the impact or probability of a subsequent financial crisis by even a small amount, the benefit will be very large.

45 45% of survey respondents identified that they use the current exemption in relation to redemptions and/or purchases.

46 As noted in FSA CP 10/15, there are several descriptions of the market impacts of large firm failures. Brunnermeier (2009) provides and account of why liquidity in wholesale financial markets dried up during the financial crisis and specifically mentions the issues around the LBIE failure. See Markus K. Brunnermeier (2009). 'Deciphering the Liquidity and Credit Crunch, 2007-2008', Journal of Economic Perspectives, Volume 23, Number 1, Winter 2009, pp. 77-100

47 See for example, FSA OP 42 and FSA OP 38. www.fsa.gov.uk/static/pubs/occpapers/op42.pdf and www.fsa.gov.uk/static/pubs/occpapers/op38.pdf

## Costs to firms

**49.** The package of proposals outlined in this paper may impose costs on investment firms. Many of the changes simply clarify to industry our expectations, and we do not expect that firm behaviour will change significantly. Other proposals require specific actions from firms and we expect these to result in some costs for firms.

**50.** To help us understand better the costs of our proposals and to ensure they are proportionate to the benefits, we surveyed approximately 400 firms on the following proposals:

| Client Money Proposals: | Custody Proposals: | Other Proposals: |
|---|---|---|
| Banking Exemption | Registering of custody assets | Reporting and Disclosure to clients |
| Restrictions on switching out of TTCA | Written custody agreements | Mandates |
| DvP Exclusions - commercial settlement system | Custody Reconciliations (internal & external) | |
| DvP Exclusions - collective investment schemes | Restrictions on switching out of TTCA | |
| Due diligence and diversifying | DvP Exclusions - commercial settlement system | |
| Allocation of client money | | |
| Unbreakable client money term deposits | | |
| Immediate segregation | | |
| Alternative Approach | | |
| Client money reconciliations (internal & external) | | |
| Acknowledgment letters | | |

### Summary of costs faced by firms

**51.** The client assets rules apply to a wide variety of firms and the proposals contained in this consultation paper will impact firms in different ways. Based on the surveys, there are firms that will incur no additional compliance costs to their business if these rules are implemented, while others will incur costs associated with a particular part of their activity. Below we provide a summary of the costs associated with the proposals, the drivers for those costs and the firms that would likely be affected.

### Client money distribution rules

**52.** The key proposal in the client money distribution rules is to speed up the distribution of client money by requiring the insolvency practitioner to distribute based on the firms records, rather than codifying the existing regime that focuses on accuracy. The proposals should not increase the operational compliance costs of firms while they are a going concern, as proposed rules are only applicable upon the failure of the firm. Furthermore, if implemented these proposals aim to reduce the time and costs associated with distribution of client money.

### Multiple Pools

**53.** In CP12/22 *Client assets regime: EMIR multiple pools and the wider review* we set out a summary of the results of a survey of costs from the introduction of multiple pools. The bases for costs calculation in the responses differed greatly, but are generally associated with the record-keeping requirements and updating systems and controls. The proposal is optional and firms can exercise their discretion over the complexity and number of sub-pools they create. Firms are unlikely to incur any costs if they choose not to create multiple client money pools.

### Client Money Proposals

**54.** The **banking exemption** proposals could require some banks that carry on investment business to enhance the disclosure they provide to their clients about the use of the banking exemption as well as their internal books and records. The majority of survey respondents did not identify one-off or on-going costs associated with the proposals, only a few respondents did. One respondent mentioned that the one-off costs could be as high as £100,000, while another respondent estimated that one-off costs could be as high as £400,000. These costs are associated with the potential re-papering exercise to their clients to ensure they are providing an appropriate level of disclosure.

**55.** The proposals relating to use of the **DvP-commercial settlement system** provisions will clarify how this client money and custody exemption will apply to investment firms, mostly brokers. Of the survey respondents, only 15% identified that they use this existing exemption for purchases and/or sales. Most of these respondents did not identify costs associated with the proposals, while some estimated between £3,000 and £73,000 of one-off costs. These costs are likely to be associated with changes to systems and controls to comply with the proposals.

**56.** The proposals relating to the removal of the **DvP-collective investment schemes** exemption will require operators of regulated collective investment schemes to start to segregate client money upon receipt. Approximately 40% of survey respondents to which this exemption could apply, stated that they use this existing exemption for purchases and/or redemptions of units in collective investment schemes. These respondents estimated that between £6,000 and £20m of client money was subject to this exemption at any given day by a firm, money that would be subject to protection should this proposal be implemented. The estimated one-off costs associated with system changes of ceasing to use this exemption varied between £4,000 and £750,000 (median of £4,000), and on-going costs of up to £200,000 (median of £21,000) associated with having to segregate up to £20m in client bank accounts.

**57.** The **client money reconciliation** proposals seek to improve the accuracy of firm records. Nearly all respondents to the survey did not identify costs associated with the proposals to clarify the frequency of reconciliations, as they believed they are already meeting the clarifications proposed. The majority of respondents (approximately 90%) did not identify costs associated with the proposed changes to the use of the 'negative add-back method' for internal client money reconciliations. However, some respondents did identify one-off costs associated with system changes, namely one respondent estimated a cost of £1.2m should this method be only available to investment firms only. The reconciliation proposals include the possiblity of firms using a different method than set out in the rules – if that method affords the equivalent degree of protection to clients – allowing firms to retain their existing methodology and systems.

**58.** The **alternative approach** proposals seek to improve the protections of client money when, in accordance with the alternative approach, it is first received and held in non-segregated bank accounts. The proposals will require firms to provide for a mandatory buffer in the client bank accounts to protect against the money held in the non-segregated accounts, improve the firm's records and policies and increase the scope of auditors reporting. We estimate that approximately 15 investment banks will use the alternative approach to client money segregation. Of these firms, some already have a client money buffer in place that adheres to the proposals, while others will be required to either increase the buffer or introduce one. The survey respondents identified median one-off costs approximately £60,000 related to records and auditor sign-off, and on-going costs of up to £8.1m mostly to finance the client money buffer. This buffer is a percentage of the money at risk, so is proportionately applied according to the size of the firm and the value of client assets.

**59.** The **acknowledgment letters** proposals will impact all firms that hold client money (approximately 750 firms). The proposals will require the use of template letters to be sent to banks and other third parties with whom the firm places client money. Approximately 50% of the survey respondents reported that the use of the template letter would save staff time and resource (i.e. compliance and legal costs to draft bespoke letters), while the rest did not identify any additional costs. However, the proposal will require the re-papering of letters for existing banks. We estimate that the costs associated with re-papering to be up to £200,000 for larger firms with significant numbers of third party relationships; however the median compliance cost for firms will be approximately £2,500.

**60.** The vast majority of survey respondents did not identify one-off or on-going costs associated with the other proposals surveyed (median costs of nil).[48] This is because these proposals improve and clarify existing requirements, to which the respondents have stated they already adhere.

**61.** Furthermore, there are a number of proposals in relation to client money where we estimate there are no material one-off or on-going compliance costs associated with them, namely:

- Application of the client money rules
- Trustee firms
- Interest
- Money ceasing to be client money
- Transfer of business
- Qualifying Money Market Funds
- Physical receipts of client money
- Prudent over-segregation of client money
- Client money held by third parties
- Client money relating to custody assets held at custodians or sub-custodians
- Commodity futures trading commission part 30 exemption order

48 Proposals surveyed that showed no material costs are: restrictions on switching out of TTCA; due diligence and diversifying; allocation of client money; unbreakable client money term deposits; and immediate segregation

**62.** These proposals either clarify existing requirements by removing ambiguity in the existing rules or are permissive (e.g. a firm can choose to use a qualifying money market fund) or could potentially reduce the costs to firms (e.g. for example, to allow firms to cease treating as client money unclaimed money below a certain de-minimis). We therefore do not believe there are material costs arising from these proposals.

### Custody Proposals

**63.** The proposals relating to **registering of custody assets** will apply to all firms that hold assets (approximately 650 firms). These proposals will restrict the ability of a firm to register its proprietary assets in the same name as assets held for its clients. This proposal aims to increase the safeguards to client's ownership rights and reduce the risk of misuse of custody assets. Approximately 90% of respondents reported no costs associated with this proposal, while others reported some costs and one firm reporting costs of up to £1.4m for necessary system changes and re-registration of custody assets.

**64.** The proposal for **written custody agreements** codifies an existing expectation that firms should have in place adequate records in relation to their arrangements with sub-custodians. The vast majority of survey respondents (95%) identified no additional costs to this proposal.

**65.** The proposals associated with the **custody reconciliations (internal & external)** add greater detail on what is expected from firms in relation to these reconciliations, as well as introducing the option for firms to use a different method of internal client money reconciliation prescribed in the rules where they use an integrated custody system. The vast majority of survey respondents identified no costs associated with these proposals. However, one respondent identified costs of up to £200,000 to use a different method of internal client money reconciliation in the rules. The proposals requiring firms to have written custody reconciliation policies and procedures have led some respondents to identify potential costs, with CASS Large firms stating one-off costs could be up to £100,000 and CASS Medium and Small firms identifying one-off costs of up to £500.

**66.** As discussed above, the proposals relating to use of the **DvP-commercial settlement system** provisions will clarify how this client money and custody exemption will apply to investment firms, mostly brokers. Of the survey respondents, only 15% identified that they use this existing exemption for purchases and/or sales. Most of these respondents did not identify costs associated with the proposals, however other firms estimated between £3,000 and £73,000 of one-off costs. These costs are likely to be associated with changes to systems and controls to adhere with the proposals.

**67.** The proposals relating to **restrictions on switching out of TTCA** aim to provide certainty about whether the client has client money and/or custody assets protection. This will reduce uncertainty and potential legal costs of disputes in the event the firm becomes insolvent. The vast majority of survey respondents did not identify one-off or on-going costs associated with this proposal.

**68.** The proposal relating to **unclaimed custody assets** provides a method to cease to treat unclaimed assets as a custody asset. This option will allow firms to potentially reduce the on-going burden they have of needing to comply with the custody rules in relation to assets they have held for a long period that have remained unclaimed. We therefore do not believe there are material costs associated with this proposal.

**69.** The proposals relating to **notification requirements** and **right to use** clarify the existing requirements by providing further guidance. We estimate there are no material one-off or on-going compliance costs associated with these proposals.

### Client reporting and information Proposals

**70.** The **client reporting and information proposals** aim to enhance the information provided to clients so they are better informed about the protections they are receiving from firms.

**71.** The requirements to provide a **disclosure document** will apply to all firms that hold client money and/or custody assets (approximately 840 firms). Firms will be required to provide this disclosure document annually, and there will likely be costs from having to create the document and then provide it on a regular basis. The majority of CASS Large firms reported one-off costs (highest £1.4m and median of £6,000). Approximately 60% of CASS Medium firms reported one-off costs with these proposals (highest £200,000 and median of less than £1,000). Likewise, approximately 60% of small firms estimate costs arising from these proposals (highest £60,000 and median of less than £1,000). The on-going costs vary significantly, but median for all categories of CASS firms is estimated to be less than £1,000.

**72.** The proposal to **remove the client distinction** for existing information requirements would require firms to provide the same information to all types of clients (in addition to retail clients as currently required). Half of CASS Large firms reported one-off costs (highest £1.3m and median of £2,000). Approximately 30% of CASS Medium firms reported one-off costs with these proposals (highest £30,000 and a median of less than £1,000). Approximately 70% of small firms estimate costs arising from these proposals (highest £20,000 and median of less than £4,000). The on-going costs vary significantly, but the median for all categories of CASS firms is estimated to be less than £6,000.

### Mandates Proposals

**73.** There are likely to be minimal costs imposed on firms as a result of the CASS 8 changes; many of the changes are just clarifications. The main changes that might impose costs include changing the mandates definition to include verbal mandates (firms need further internal controls and records to meet this wider definition). However, nearly all survey respondents reported no costs from the proposals.

### Indirect client clearing (EMIR RTS)

**74.** The proposed changes to client money rules due to EMIR will impact firms on distribution of client money in the event of the firm's failure. We therefore do not foresee any compliance costs to firms with the proposals. There could be changes in firms attributed to EMIR, however costs associated with these changes are not part of these proposals.

**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.**

## Competition impacts

### Nature of competition

**75.** Firms that are subject to the CASS regime operate in a range of different markets. Protection of client money and assets is an ancillary service provided alongside investment services by investment banks, trading firms, custodians, stock-brokers, asset managers and many other firms (of various sizes and operating diverse business models). The regime applies to 29 CASS Large firms, 610 CASS Medium firms and 1,475 other firms (the latter includes CASS Small firms and all firms authorized to hold client money but may not be using their permissions).

**76.** The proposed changes affect firms operating in a range of markets, see Table 1. However, there are some common characteristics across these markets:

**1.** Clients do not pay much attention to the level and adequacy of client money protections for a number of reasons:

- They underestimate the probability of firm insolvency.
- They focus on the main product (i.e. investment service) and not on the ancillary service.
- Competition focuses on the price and quality of the investment services.

**2.** Firms holding client money have an incentive to improve the quality and price of the investment service, at the expense of adequate client money protections.

**3.** Disclosures about the quality of protection are unlikely to improve competition on this ancillary service and therefore may not be enough to drive up the standard of client money protections.

**77.** Table 1 provides an overview of the types of firms that are subject to the CASS regime and identifies the main high level markets they operate in. Each of the markets outlined in the table will be made up of multiple economic markets. It is expected, however, that they are sufficient to understand the nature of competition in markets where investment firms operate and whether our proposals are likely to impact on the number of firms operating in these markets and/or their incentives to compete.

*Table 1: Summary of high-level markets*

| Market (1) | Market description (2) | Type of firms, subject to CASS regime, that are in the market (3) | Nature of competition (brief overview, e.g. what do they compete on for custom?) (4) | Rules changes relevant for those firms subject to CASS in the market (5) | Number of firms subject to CASS regime (6) ('L' = CASS Large, 'M' = Medium, and 'S' = Small) |
|---|---|---|---|---|---|
| Brokerage and other market intermediary firms | Broker or mediate the purchase and sales of investments for retail and wholesale clients. Includes provision of platform services for clients to purchase, sell funds and stocks. It is expected that the majority of this category of firms hold client money and assets. However, there will be a proportion that will outsource custody (to a sub-custodian) but retain responsibility, and others where there is a tri-party relationship where the client appoints a custodian (i.e. 'Model B' arrangement) Client money is held in relation to the monies for investment purchases or sales, for dividend income earned, and tax rebates. | Stockbrokers (arranging only, or advising and arranging intermediaries); wholesale market broker; own account trader; market maker; clear/ settlement agent; advising only intermediary; MTF operator; Bank or building society; and wholesale bank. | Primary income is from commission charged to clients for service or per transaction. | Distribution Rules<br>Multiple pools (to the extent that they are clearing firms)<br>Client Money rules (except DvP CIS)<br>Custody rules<br>Statements & Disclosure<br>EMIR | 239 BANKS (L9;M188;S42)<br>74 W/S BANKS (L10;M60;S4)<br>8 (L1,M5,S2) |
| Asset managers and advisers | Firms that offer investment advice and the management of assets. Some of these firms may not hold client money or be subject to the client assets regime. As such, it is possible that firms subject to the regime compete directly with those that are not. | Venture capital firm; discretionary investment manager; non-discretionary investment manager; CIS administrator; Corporate finance firm; Financial adviser; Bank or building society; wholesale bank; Personal Pension operators | Charges for advice and asset management services. | Distribution Rules<br>Client Money rules<br>Custody rules<br>Statements & Disclosure | 426 BANKS (L6;M320;S100)<br>74 W/S BANKS (L10;M60;S4)<br>8 SIPPS (L1,M5,S2)<br>40 BS (L0;M22;S18) |
| Custody firms | Firms that provide custody services. | Custodial service providers; retail bank or building societies; wholesale banks. | Fees for safe keeping of assets | Distribution Rules<br>Client Money rules<br>Custody rules<br>Statements & Disclosure | 14 (L3;M9;S2) |
| Other | Other firms that, in the course of business, hold client money and assets which is subject the client assets regime. | CIS Trustees, Energy market participant, home finance broker, home finance provider, service company, authorised professional firms. | | Distribution Rules<br>Client Money rules<br>Custody rules<br>Statements & Disclosure | 36 (L0;M13;S23) |

### Effect of our proposals on competition

**78.** Our proposals have multiple impacts on the nature of competition in the markets in which these firms operate. In the absence of incentives to improve client money protections, our rules provide a minimum standard that firms must adopt, thus ensuring that whilst competition may not be sufficiently focused on client asset protection, clients can be confident that firms are not competing on price at the expense of good quality client asset protections. Our proposals may eliminate incentives to firms to reduce the quality of non-observable elements of their service to improve the quality and/ or price of observable elements of their service. In this sense, our proposals may improve the quality of competition.

**79.** Our rules also involve some costs to firms, as outlined in section 3. These costs could lead to an increase in market concentration if they significantly increase the minimum efficient scale required to run the primary service that the firms offer. The increase in market concentration can come about through existing firms exiting the market as they are no longer profitable, consolidation between firms as existing firms attempt to gain economics of scale and scope that can maintain profit margins; and, lower levels of firm entry due to the higher costs involved.

**80.** Our assessment, based on the responses from our survey and from the revenue of firms in particular markets is that the incremental cost of our package of proposals does not represent a significant increase in costs for firms (see table 2 below). We do not expect they would increase barriers to new entrants or alter firm concentration in the market. It is possible, that in some cases, incremental costs prompt firms to consider and implement alternate business models. Table 2 summarises the one-off and ongoing costs applicable to firms in each of the markets identified above.

***Table 2: Summary of costs across markets***

| | Average yearly revenues | | Average one-off costs (% of revenue) | | | Average ongoing costs (% of revenue) | | |
|---|---|---|---|---|---|---|---|---|
| **Market** | **L** | **M** | **L** | **M** | **S** | **L** | **M** | **S** |
| Brokerage and other market intermediary firms | £43bn | £4.8bn | £124,000 (<1%) | £87,000 (<1%) | £2,000 | £1m (<1%) | £69,000 (<1%) | £3,000 |
| Asset managers and advisors | £51bn | £6.4bn | £64,000 (<1%) | £102,000 (<1%) | £4,000 | £750,000 (<1%) | £14,000 (<1%) | £7,000 |
| Custody firms | £56bn | £10.8bn | £86,000 (<1%) | £88,000 (<1%) | £2,000 | £800,000 (<1%) | £7,000 (<1%) | < £1,000 |

**81.** The information is based on a limited sample of firms who responded and average costs from firms within each market. Some firms operate in more than one market, so these revenue and costs are not additive. It is also worth noting that the vast majority of costs for medium and large firms derive from the proposal that those firms operating the alternative approach hold the proposed buffer. This proposal affects a limited number of wholesale banks and market makers who have annual revenues in excess of £9bn. It is also worth noting that the buffer is a percentage of client money at risk and therefore is proportionate to firm size.

## Costs to the FCA

**82.** Supervision of compliance with client assets regime for firms that carry on investment business is led by the FCA's Client Assets Unit. Should the proposals in this consultation paper be implemented, the Unit will absorb assessment of compliance with the new rules within its normal supervisory workload. We therefore do not expect an increase in costs to the FCA associated with these proposals.

# Annex 2
# Compatibility statement

## Compatibility with the FCA's General Duties

**83.** This annex explains our reasons for concluding that our proposals in this consultation are compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA).

**84.** When consulting on new rules, the FCA is required by section 138I(2)(d) FSMA to include an explanation of why it believes making the proposed rules is compatible with its strategic objective, advances one or more of its operational objectives, and has regard to the regulatory principles in s.3B FSMA. We are also required by s. 138K(2) FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.

**85.** This annex also sets out our view of how the proposed rules are compatible with our duty to discharge our general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (s.1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.

**86.** This annex includes our assessment of the equality and diversity implications of these proposals.

### The FCA's objectives and regulatory principles

**87.** The proposals set out in this consultation are primarily intended to advance our operational objectives of:

- Delivering consumer protection – securing an appropriate degree of protection for consumers.
- Enhancing market integrity – protecting and enhancing the integrity of the UK financial system.
- Building competitive markets – promoting effective competition in the interests of consumers.

**88.** In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s. 3B FSMA.

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

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

### The principle that a burden or restriction should be proportionate to the benefits

**90.** We consider that the cost of these proposals is proportionate to the benefits, because as discussed in the cost benefit analysis (CBA) (Annex 1) they will:

- improve the speed of return of client assets following the insolvency of an investment firm;
- achieve a greater return of client assets to clients following the insolvency of an investment firm; and
- reduce the market impact of an insolvency of an investment firm that holds client assets.

### Expected effect on mutual societies

**91.** The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies than other firms as we are not aware of any mutual societies that hold client assets and would therefore be subject to these proposed rules.

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

**92.** In preparing the proposals as set out in this consultation, we have had regard to the FCA's duty to promote effective competition in the interests of consumers.

**93.** As we explain in the cost benefit analysis of these proposals in Annex 1, we do not expect these changes to have significant market impacts. In particular, in relation to competition, we do not expect that the proposed changes will materially affect the number of firms providing investment or custody services, or their incentives to compete with each other for customers.

### Equality and diversity

**94.** We are required under the Equality Act 2010 to 'have due regard' to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. As part of this, we conduct an equality impact assessment to ensure that the equality and diversity implications of any new policy proposals are considered.

**95.** Our findings indicate that these proposals have no anticipated positive or negative impacts on particular groups as a result of any protected characteristic.

# Annex 3
# List of questions

**Q1:** Do you think we should implement the speed proposal or codify the existing regime? Please explain the reasons for your response.

**Q2:** Do you agree that, where used, this transfer proposal will be beneficial to clients? If not, please provide reasons.

**Q3:** Do you agree that 'hindsight' should be applied to the valuation of clients' cleared open margined positions to determine their entitlements to the relevant CMP? If not, please provide reasons.

**Q4:** Do you agree that where a firm takes these reasonable steps, it should be able to use unclaimed client money entitlements to make good any CMP shortfalls? If not, please provide reasons.

**Q5:** Do you agree that these less onerous 'reasonable steps' should apply where a client's entitlement is less than £10? If not, please provide reasons.

**Q6:** Do you agree with the proposals regarding treatment of interest and currency conversion? If not, please provide reasons.

**Q7:** Do you agree with the proposals regarding the treatment of client money received after a PPE? If not, please provide reasons.

**Q8:** Do you agree with the proposals regarding a secondary pooling event? If not, please provide reasons.

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

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

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

**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.

**Q13:** Do you agree with the proposals relating to the TTCA provisions? If not, please provide reasons.

**Q14:** Do you agree with the proposal of clarifying the requirements around the DvP window? If not, please provide reasons.

**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.

**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.

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

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

**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.

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

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

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

**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.

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

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

**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.

**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.

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

**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.

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

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

**Q33:** Do you agree with the proposal of clarifying the requirements around the DvP window? If not, please provide reasons.

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

**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.

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

**Q37:** Do you agree with our proposals to provide the two different methods for the internal custody assets reconciliation? 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.

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

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

**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.

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

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

**Q48:** **Do you agree that our proposed changes will ensure that CASS is compatible with the EMIR RTS? If not, please provide reasons.**

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

**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.**

# Appendix 1
# Draft Handbook text

# CLIENT ASSETS SOURCEBOOK (AMENDMENT NO 4) INSTRUMENT 2013

## Powers exercised by the Financial Conduct Authority

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 on [*date*].

## Amendments to the Handbook

D. The Glossary of definitions is amended in accordance with Annex A to this instrument.

E. The Client Assets sourcebook (CASS) is amended in accordance with Annex B to this instrument.

## Citation

F. This instrument may be cited as the Client Assets Sourcebook (Amendment No 4) Instrument 2013.

By order of the Board of the Financial Conduct Authority
[*date*]

## Annex A

## Amendments to the Glossary of definitions

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

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

| | |
|---|---|
| *acknowledgement letter* | a *client bank account acknowledgement letter* (which is a letter in the form of the template in *CASS* 7 Annex 2R) or a *client transaction account acknowledgement letter* (which is a letter in the form of the template in *CASS* 7 Annex 3R). |
| *acknowledgement letter fixed text* | the text in the template *acknowledgement letters* in *CASS* 7 Annex 2R and *CASS* 7 Annex 3R that is not in square brackets. |
| *acknowledgement letter variable text* | the text in the template *acknowledgement letters* in *CASS* 7 Annex 2R and *CASS* 7 Annex 3R that is in square brackets. |
| *client assets disclosure document* | a document in a *durable medium* which a *firm* must provide to its *clients*:<br>(a) in the circumstances described in *CASS* 9.6.1R(1); and<br>(b) which includes the information in *CASS* 9.6.1R(2). |
| *client bank account acknowledgement letter* | a letter in the form of the template in *CASS* 7 Annex 2R. |
| *client equity balance* | the sum of *money* as described in *CASS* 7.6A.26R. |
| *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* calculated under *CASS* 7.6A.13R. |
| *client money resource* | the aggregate balance on the *firm's client bank accounts* (see *CASS* 7.6A.11R). |
| *client transaction account acknowledgement letter* | a letter in the form of the template in *CASS* 7 Annex 3R. |
| *combined pool* | the notional pool of *client money* established in the circumstances described in *CASS* 7A.2.4UR. |
| *combined pool entitlement* | the entitlement of a *client* to *client money* determined in line with *CASS* 7A.2.4ZAR. |

| | |
|---|---|
| *commercial settlement system* | a system commercially available to *firms* that are qualified to act as participants, the purpose of which is to facilitate the settlement of transactions using *money* or assets held on a *settlement account*. |
| *external client money reconciliation* | the *client money* reconciliation described in *CASS* 7.6.11AR. |
| *external custody reconciliation* | a reconciliation, in line with *CASS* 6.5.6R, between a *firm's* internal accounts and records of *safe custody assets*, and those of any third parties by whom those *safe custody assets* are held. |
| *firm's equity balance* | the sum of *money* described in *CASS* 7.6A.27R. |
| *individual client balance* | for each *client,* the balance of all *money* the *firm* holds, has received or is obligated to have received or be holding as *client money* for that *client* for *non-margined transactions*, calculated in line with *CASS* 7.6A.22R. |
| *individual client balance method* | (in *CASS* 7.6A) the method of calculating a *firm's client money requirement* described in *CASS* 7.6A.16R. |
| *initial pool* | the notional pool of *client money* established in the circumstances described in *CASS* 7A.2.4R(1). |
| *initial pool entitlement* | the entitlement of a *client* to *client money* determined in line with *CASS* 7A.2.4GR. |
| *internal client money reconciliation* | the *client money* reconciliation described in *CASS* 7.6.6AR. |
| *internal custody record check* | a check as to whether a *firm's* internal records and accounts of the *safe custody assets* held by the *firm* correspond with the *firm's* obligations to its *clients* to hold those *safe custody assets* – performed using the *internal custody reconciliation method* or the *internal system evaluation method*. |
| *internal custody reconciliation method* | a method for performing an *internal custody record check*, described in *CASS* 6.5.4ER. |
| *internal system evaluation method* | a method for performing an *internal custody record check*, described in *CASS* 6.5.4GR. |
| *LME* | the London Metal Exchange Limited. |
| *LME bond arrangement* | an arrangement for the segregation of *money* held by *firms* on behalf of US customers for transactions undertaken on the *LME*, which is an alternative to complying with condition 2(g) of the *Part 30 exemption order*, and which has been established in accordance with certain no-action letters issued by the Commodity Futures Trading Commission. |

| | |
|---|---|
| *margined transaction requirement* | the total amount of *client money* a *firm* is required to segregate in *client bank accounts* for *margined transactions* under the *client money rules*, in line with *CASS* 7.6A.30R. |
| *negative add-back method* | (in *CASS* 7.6A) the method of calculating a *firm's client money requirement* described in *CASS* 7.6A.17R. |
| *non-margined transaction* | (in *CASS* 7) a transaction *executed* by a *firm:*<br>(a) for, or on behalf of, a *client* in relation to *MiFID business* and/or *designated investment business*; and<br>(b) which is not a *margined transaction*. |
| *non-standard method of internal client money reconciliation* | the method of *internal client money reconciliation* referred to in *CASS* 7.6.6DR. |
| *physical asset reconciliation* | a reconciliation of a *firm's* internal records and the actual *physical safe custody assets* held by the *firm*, performed in line with *CASS* 6.5.4LR, using either the *total count methodology* or the *rolling stock methodology*. |
| *physical safe custody asset* | a *safe custody asset* (or tangible evidence of one) that is in a *firm's* physical custody and which may also be registered with the relevant issuer or agent of the issuer. |
| *pooling event* | (in *CASS* 7 and *CASS* 7A) a:<br>(a) *primary pooling event*; or<br>(b) *secondary pooling event*. |
| *residual pool* | the notional pool of *client money* established in the circumstances described in *CASS* 7A.2.4R(2A). |
| *residual pool entitlement* | the entitlement of a *client* to *client money* determined in line with the process in *CASS* 7A.2.4RR. |
| *revised non-standard method of internal client money reconciliation* | a *non-standard method of internal client money reconciliation* arising in the circumstances referred to *CASS* 7.6.6ER(3). |
| *rolling stock methodology* | a methodology for performing a *physical asset reconciliation*, as described in *CASS* 6.5.4PR. |
| *settlement account* | an account containing *money* and/or assets that is held with a central bank, central securities depository, central counterparty or any other institution acting as a settlement agent, which is used to |

| | |
|---|---|
| | settle transactions between participants in a settlement system. |
| *total count methodology* | a methodology for performing a *physical asset reconciliation*, as described in *CASS* 6.5.4OR. |
| *transfer entitlement* | the entitlement to *client money* determined in line with *CASS* 7A.2.4LR. |

Amend the following definitions as shown.

*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* 7.4.1R; 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

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

*client money* …

(2A) (in *CASS* 6, *CASS* 7, *CASS* 7A and *CASS* 10 and, in so far as it relates to matters covered by *CASS* 6, *CASS* 7, or *COBS*) 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*

…

| | |
|---|---|
| *client money segregation requirements* | ~~*CASS* 7.4.1R and *CASS* 7.4.11R.~~ [deleted] |
| *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* 7.5 (Client money held by a third party), which is in the *firm's* name and includes the word "client" in its title. |
| *designated client bank account* | a *client bank account* with the following characteristics:<br><br>…<br><br>(b) the account includes in its title the ~~word~~ words "designated client" (or, if that is not possible due to system constraints, an appropriate abbreviation of those words that conveys the same meaning); and<br><br>… |
| *designated client fund account* | a *client bank account* with the following characteristics:<br><br>…<br><br>(b) the account includes in its title the ~~word~~ words "designated fund client" (or, if that is not possible due to system constraints, an appropriate abbreviation of those words that conveys the same meaning); and<br><br>… |
| *general client bank account* | a *client bank account* that holds *client money* of one or more *clients*, which includes in its title the word "client", and which is not:<br><br>… |
| *Part 30 exemption order* | ~~an~~ the order under regulation 30.10 of the General Regulations under the US Commodity Exchange Act, issued by the Commodity Futures Trading Commission on 15 May 1989, as consolidated and updated by the subsequent order issued by the same body on 10 October 2003, granting a *person* exemption from the registration requirement contained in Part 30 of those General Regulations. |

| | |
|---|---|
| *segregated client* | ~~a *client* whose *money* must be segregated by the *firm* under *CASS* 4.3.3R (Segregation).~~ [deleted] |
| *shortfall* | … |
| | (3) (in relation to *safe custody assets*) the amount (in terms of monetary value) by which the *safe custody assets* held by a *firm* fall short of the *firm's* obligations to its *clients* to hold *safe custody assets*. |
| *standard methods of internal client money reconciliation* | ~~*CASS* 7 Annex 1G.~~ the methods of *internal client money reconciliation* set out in *CASS* 7.6A (The standard methods of internal client money reconciliation). |
| *trustee firm* | a *firm* which is not an *OPS firm* and which is acting as a: |
| | (a) trustee (other than for a trust of *client money* arising only under *CASS* 5.3.2R, *CASS* 5.4 (Non-statutory client money trust) or *CASS* 7.7.2R); or |
| | … |

## Annex B

## Amendments to the Client Assets sourcebook (CASS)

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

### 1 Application and general provisions

…

### 1.2 General application: who? what?

…

1.2.3A G The *FCA* would expect *incoming EEA firms* to which *CASS* does not apply to adhere to the applicable rules in their *Home State* for safeguarding clients' assets.

…

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*.~~

(5) 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).

…

## 1.3 General application: where?

…

1.3.5 G *CASS* does not apply to a *UK firm* in relation to its activities carried on from a branch that is not in an *EEA State*.

## 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*.

(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

…

6.1.6B R (1) A *firm* must ensure that any arrangement relating to the transfer of full ownership of a *safe custody asset* to a *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) The agreement in (1) must cover the *client's* agreement to the transfer of their full ownership of *safe custody assets* to the *firm*, as well as any terms under which ownership of *safe custody assets* is to transfer from the *firm* back to the *client* (eg, if the arrangement is not in effect from time to time or is terminated).

(3) A *firm* must record the written agreement in (1). The *firm* must keep the record from the date the agreement is entered into and for five years after the arrangement is terminated.

…

Termination of title transfer collateral arrangements

6.1.8A R (1) If a *client* asks a *firm* to terminate an arrangement relating to the transfer of full ownership of a *safe custody asset* to a *firm* for the purposes set out in *CASS* 6.1.6R(1) and *CASS* 6.1.6AR(1) and such request was not made to the *firm* in writing, the *firm* must make a written record of the *client's* request.

(2) A *firm* must keep a *client's* written request or a written record of the client's request in (1) for a period of five years, starting from the date the request was made.

(3) If a *firm* agrees to terminate an arrangement relating to the transfer of full ownership of a *safe custody asset* to a *firm*, the *firm* must notify the *client* in writing of its agreement, and the *firm's* notification must state when that termination is to take effect.

(4) A *firm* must keep a written record of any notification it makes to the *client* under (3) for a period of five years, starting from the date the notification was given.

6.1.8B G When a *firm* notifies a *client* under *CASS* 6.1.8AR(3) of when the termination of an arrangement relating to the transfer of full ownership of a *safe custody asset* to a *firm* is to take effect, it should take into account the period of time it reasonably requires to return the *safe custody assets* to the

client or to update the registration under *CASS* 6.2 (Holding of client assets) and update its records under *CASS* 6.5 (Records, accounts and reconciliations), as appropriate.

6.1.8C 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) does not have effect from time to time, or is terminated (in either case such that ownership of the *safe custody assets* transfers back from the *firm* to the *client*), and a *firm* does not immediately return the *safe custody assets* to the *client*, then the *custody rules* apply to those *safe custody assets* under *CASS* 6.1.1R from the time the arrangement stops having effect.

6.1.8D G If the *custody rules* apply to a *firm* for *safe custody assets* under *CASS* 6.1.8CR then the *firm* should, for example, update the registration under *CASS* 6.2 (Holding of client assets), update its records under CASS *6.5* (Records, accounts and reconciliations) and treat any unreconciled *shortfall* in line with *CASS* 6.5.10BR (in each case as appropriate) from the relevant time at which the *firm* is required to treat the *safe custody assets* in line with the *custody rules*.

…

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 business which is not *MiFID business*, the *custody rules* do not apply to a *firm* when it is carrying on the *regulated activity* of *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.

…

6.1.12 R (1) Subject to (3), where required by the very nature of the transaction and with the agreement of the relevant *client*, ~~A~~ 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:

…

(b) in respect of a *client's* sale, due to the firm within one *business day* following the fulfilment of a payment 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 *safe custody asset* by the *client*.~~

(2) Until such a delivery versus payment transaction through a ~~commercial settlement system~~ *commercial settlement system* settles, a *firm* may segregate *money* (in accordance with the *client money chapter*) instead of the *client's safe custody assets*.

(3) If the delivery or payment by the *firm* does not occur by the close of business on the third *business day* following the date a *firm* makes use of the exemption under (1), the *firm* must stop using that exemption for the *safe custody asset*.

6.1.12A G If a transaction for which a *firm* uses the exemption under *CASS* 6.1.12R(1) is settled before the end of the three *business day* period in that *rule*, the *client money rules* or the *custody rules* (as appropriate) will apply to any *money* or *asset* it receives upon settlement.

…

6.1.16F R …

| Reference | Rule |
|---|---|
| … | |
| *CASS* 6.2.3R and ~~*CASS* 6.2.6G~~ *CASS* 6.2.3BG | Registration and recording |
| *CASS* 6.2.7R | Holding |
| *CASS* 6.3.1R to *CASS* 6.3.4AR | Depositing safe custody assets with third parties |
| … | |

…

6.1.16H R ~~When a *trustee firm* or *depositary* within *CASS* 6.1.16FR arranges for, or delegates the provision of safe custody services by or to another *person*, the *trustee firm* or *depositary* 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]

Depositaries of AIFs

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 ~~and~~ to *CASS* 6.2.4R ~~to *CASS* 6.2.6G~~ | Registration and recording |
| *CASS* 6.2.7R | Holding |
| ~~*CASS* 6.3.1R(1A) and *CASS* 6.3.1R(4)~~ | ~~Arranging registration~~ |
| *CASS* 6.5.1R, *CASS* 6.5.1AG, *CASS* 6.5.2AR, *CASS* 6.5.3R, *CASS* 6.5.13R(1A) and *CASS* 6.5.14G | Records, accounts and reconciliations |

(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* 6.1.1BR | Application |
| *CASS* 6.5.2BR, ~~*CASS* 6.5.4G(1A)~~ *CASS* 6.5.4BR to ~~*CASS* 6.5.4G(4),~~ *CASS* 6.5.5R, *CASS* 6.5.7AG, ~~*CASS* 7.5.8AG,~~ *CASS* 6.5.8AG, *CASS* 6.5.9G, *CASS* 6.5.13R(3), *CASS* 6.5.13R(4), and *CASS* 6.5.15G | 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* 6.1.16JR | Arrangers |
| *CASS* 6.1.16KR | Records |
| … | |
| ~~*CASS* 6.3.1R(1A) and *CASS* 6.3.2G~~ | ~~Arranging for assets to be deposited~~ |

| | |
|---|---|
| | ~~with third parties~~ |
| ~~*CASS* 6.1.16KR~~ | ~~Records~~ |
| *CASS* 6.3.4BR and *CASS* 6.3.4CG | Arranging for assets to be deposited with third parties |

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.

…

## 6.2 Holding of client assets

…

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*;

…

(2A) the *trustee firm* if it is not possible for the *safe custody asset* to be held in line with (1) or (2);

…

(4) the *firm* if:

…

(b) the *firm* has notified the *client* if a *professional client*, or obtained prior written consent if a *retail client*;

provided that, if the *firm* registers or records legal title to its own *applicable assets* in the same name as that in which legal title to a *safe custody asset* is registered or recorded, the *firm* has to ensure that its applicable assets are separately identified in its records from those *safe custody assets*.

6.2.3B 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.

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 an *affiliated company* of the *firm*, with respect of any requirements of the *custody rules*.

6.2.5 R ~~A *firm* may register or record legal title to its own *applicable assets* in the same name as that in which legal title to a *safe custody asset* is registered or recorded, but only if:~~

~~(1) the *firm's applicable assets* are separately identified in the *firm's* records from the *safe custody assets*; or~~

~~(2) the *firm* registers or records a *safe custody asset* in accordance with *CASS* 6.2.3R(4).~~ [deleted]

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.~~ [deleted]

…

Allocated but unclaimed safe custody assets

6.2.8 G The purpose of *CASS* 6.2.9R is to set out the requirements on *firms* that wish to divest themselves of unclaimed *safe custody assets*.

6.2.9 R A *firm* may liquidate unclaimed *safe custody assets* it holds, at market value, and pay away the proceeds to a registered charity of its choice provided it:

(1) has held those *safe custody assets* for at least 12 years and, during this period, no instructions for that *safe custody asset* has been made by, for or on behalf of the *client*;

(2) is expressly permitted to do so under the arrangements under which the *safe custody assets* are held; and

(3) has taken reasonable steps to trace the *client* concerned and return the asset in question.

6.2.10 E (1) Reasonable steps for the purposes of *CASS* 6.2.9R(3) should include the following course of conduct:

(a) determining, as far as possible, current contact details for the relevant *client*;

(b) writing to the *client* at his last known address either by post or by electronic mail or using other means to inform him:

(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 liquidate the *safe custody asset* and pay the proceeds to charity; and

(iii) giving the *client* 28 *days* in which to make a claim.

(c) where the *client* has not responded after the 28 *days* referred to in (b) the *firm* should:

(i) place an advertisement in local media; and

(ii) attempt to communicate on at least three further occasions with the *client* by any other means including by post, electronic mail or telephone;

(d) after 28 *days* from the last communication under (c) the *firm* should write again to the *client* at his last known address to confirm that, as it did not receive a claim for the relevant *safe custody asset*, it will liquidate the asset and pay the proceeds to a registered charity of its choice.

(2) Compliance with (1) may be relied on as tending to establish compliance with *CASS* 6.2.9R(4).

(3) Contravention of (1) may be relied on as tending to establish contravention of *CASS* 6.2.9R(4).

6.2.11 R Where a *firm* liquidates *safe custody assets* and pays the proceeds to charity under *CASS* 6.2.9R, it must comply with either (1) or (2) and, in either case, (3):

(1) the *firm* must unconditionally undertake to make good any valid claim in respect of unclaimed *safe custody assets* that have been liquidated; or

(2) the *firm* must ensure that an undertaking to make good any such valid claim is made by its *group* and:

(a) this undertaking is legally enforceable by any *person* with a valid claim to the *safe custody asset* in question; and

(b) there is suitable information available for relevant *clients* to identify the *group* granting the undertaking;

(3) the undertakings in this *rule* must be authorised by the *firm's governing body* where (1) applies or the *governing body* of the *group* where (2) applies.

6.2.12 R (1) If a *firm* liquidates unclaimed *custody assets* and pays the proceeds to charity under *CASS* 6.2.9R it must make and/or retain records of all *safe custody assets* liquidated. Such records must include:

(a) details of the liquidation value of the assets in question and the *client* to whom the asset was allocated; and

(b) all relevant documentation (including charity receipts).

(2) If a *firm's group* has provided an undertaking under *CASS* 6.2.11R(2) then records in (1) must be readily accessible to that *group*.

6.2.13 G Where a *firm* or its *group* purchases insurance to cover any valid claims in respect of an undertaking it has made under *CASS* 6.2.11R it should pay for such insurance from its own funds.

## 6.3 Depositing assets and ~~arranging for assets to be deposited with third parties~~ using third party custody services

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*;

(1A) the financial soundness of the third party;

…

(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 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 under *CASS* 6.3.1R. 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*.

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) Subject to (2), ~~A~~ 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 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*]

Third-party custody agreements

6.3.4B R A *firm* must have a written agreement with any third party with which it deposits *clients' safe custody assets*, or with whom it *arranges safeguarding and administration of assets* which are *clients' safe custody assets*. This agreement must set out the terms of the arrangement between both parties, and, at minimum, clearly set out the custody service(s) that the third party is contracted to provide.

6.3.4C G A *firm* should consider carefully the terms of any agreements entered into under *CASS* 6.3.4BR. The following terms are examples of the issues that should be addressed in these agreements:

(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 *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.

…

## 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

…

6.5.1A G In complying with *CASS* 6.5.1R, a *firm* should maintain its records and accounts as necessary to enable it at any time, and without delay, to identify each *safe custody asset* held for a particular *client.*

…

6.5.2B R A *firm* must make a record of each *internal custody record check*, each *physical asset reconciliation*, and each *external custody reconciliation* it undertakes.

…

Policies and procedures

6.5.3A G *Firms* should, in line with *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 concerning the frequency of its checks and reconciliations required under this section.

~~Internal reconciliation of safe custody assets held for clients~~ Internal custody record checks

6.5.4 G (1) ~~Carrying out internal reconciliations of the *safe custody assets* held for each *client* with the *safe custody assets* held by the *firm* and third parties is an important step in the discharge of the *firm's* obligations under *CASS* 6.5.2R (Records and accounts) and, where relevant, *SYSC* 4.1.1R (General requirements) and *SYSC* 6.1.1R (Compliance).~~ [deleted]

(1A) ~~For a *firm acting as trustee or depositary of an AIF* that is an *authorised AIF*, carrying out internal reconciliations of the *safe custody assets* held for each *client* with the *safe custody assets* held by the *firm* and third parties is an important step in the discharge of the *firm's* obligations under article 89(1)(b) (Safekeeping duties with regard to assets held in custody) of the *AIFMD level 2 regulation* and, where relevant, *SYSC* 4.1.1R (General requirements) and *SYSC* 6.1.1R (Compliance).~~ [deleted]

(2) ~~A *firm* should perform such internal reconciliations:~~

~~(a) as often as is necessary; and~~

~~(b) as soon as reasonably practicable after the date to which the reconciliation relates;~~

~~to ensure the accuracy of the *firm's* records and accounts.~~ [deleted]

(3) ~~Reconciliation methods which can be adopted for these purposes include the 'total count method', which requires that all *safe custody assets* be counted and reconciled as at the same date.~~ [deleted]

(4) ~~If a *firm* chooses to use an alternative reconciliation method (for example the 'rolling stock method') it needs to ensure that:~~

~~(a) all of a particular *safe custody asset* are counted and reconciled as at the same date; and~~

~~(b) all *safe custody assets* are counted and reconciled during a period of six months.~~ [deleted]

6.5.4A G An *internal custody record check* is one of the steps a *firm* takes to satisfy its obligations under:

(1) *Principle* 10 (Clients' assets);

(2) *CASS* 6.2.2R (Requirement to have adequate organisational

arrangements);

(3) *CASS* 6.5.1R to *CASS* 6.5.2R (Records and accounts); and

(4) where relevant, *SYSC* 4.1.1R (General requirements) and *SYSC* 6.1.1R (Compliance);

to ensure that 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 assets and using third party custody services)) correspond with the *firm's* obligations to its *clients* to hold those *safe custody assets*.

6.5.4B R (1) A *firm* must perform an *internal custody record check*:

(a) subject to (2), as regularly as is necessary, bearing in mind *CASS* 6.5.8BR but, in any case, no less than once every 25 *business days*; 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, bearing in mind *CASS* 6.5.8BR but, in any case, no less often than its *physical asset reconciliations* under *CASS* 6.5.4KR.

6.5.4C R A *firm* must perform its *internal custody record checks* using either the *internal custody reconciliation method* or, subject to *CASS* 6.5.4IR, the *internal system evaluation method*.

The internal custody reconciliation method for internal custody record checks

6.5.4D G The *internal custody reconciliation method* can only be used where a *firm* separately maintains records and accounts of:

(1) the *safe custody assets* held by a *firm* for each particular *client*; and

(2) the *safe custody assets* held by a *firm* (including, for example, those deposited with third parties under *CASS* 6.3 (Depositing assets and using third party custody services)) in aggregate;

which are independent and capable of being compared.

6.5.4E R The *internal custody reconciliation method* requires a *firm* to:

(1) perform a comparison, as at the date of the *internal custody record check*, between:

(a) its records and accounts of the *safe custody assets* held by the *firm* for each particular *client*; and

(b) its records and accounts of the *safe custody assets* held by a *firm* in aggregate;

in either case, including those *safe custody assets* that the *firm* has deposited with third parties under *CASS* 6.3 (Depositing assets and using third party custody services) and any *physical safe custody assets* held by the *firm*; and

(2) promptly investigate and resolve any discrepancies in either set of records and accounts, and any differences between the two sets of records and accounts.

The internal system evaluation method for internal custody record checks

6.5.4F G The *internal system evaluation method* is available to *firms* that are not able to use the *internal custody reconciliation method*, for example, because they only keep one set of records and accounts of the *safe custody assets* that they hold, or because the two sets records and accounts referred to in *CASS* 6.5.4ER(1) are not maintained separately and independently of each other.

6.5.4G R The *internal system evaluation method* requires a *firm* to:

(1) establish a process that evaluates the completeness and accuracy of its records and accounts of *safe custody assets* held by the *firm*, in particular whether:

(a) the *safe custody assets* held by the *firm* for each particular *client*; and

(b) the *safe custody assets* held by a *firm* in aggregate;

are being completely and accurately recorded (in either case including those safe custody assets that the *firm* has deposited with third parties under *CASS* 6.3 (Depositing assets and using third party custody services), and any *physical safe custody assets* held by the *firm)*; and

(c) the *firm's* systems correctly identify and resolve all discrepancies in such records and accounts;

(2) run the evaluation process established under (1) on the date of each *internal custody record check*; and

(3) promptly investigate and resolve any discrepancies that the evaluation process reveals.

6.5.4H G The sorts of discrepancies that the *internal system evaluation method* should be verifying are correctly identified and resolved under *CASS* 6.5.4GR(1)(c) include:

(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 (for example, omissions and unauthorised system entries); and

(5) IT errors (for example, software issues that could lead to inaccurate records).

6.5.4I R If a *firm* is required to use the *internal system evaluation method* to perform its *internal custody record checks* it must, before using that method, send the *FCA* a written report prepared by an auditor of the *firm* on the basis of a *reasonable assurance engagement*, stating:

(1) whether in the auditor's opinion the *firm's* proposal for using the *internal system evaluation method* is adequately designed to enable the *firm* to evaluate the matters in *CASS* 6.5.4GR(1); and

(2) whether in the auditor's opinion the *firm's* systems and controls are adequately designed to enable the *firm* to operate effectively the *internal system evaluation method.*

6.5.4IA R A *firm* that uses the *internal system evaluation method* must, within three months of any change in its use of that method send the *FCA* a revised written report prepared by an auditor of the *firm* on the basis of a *reasonable assurance engagement*, stating the matters set out at *CASS* 6.5.4IR.

Physical asset reconciliations

6.5.4J G (1) A *physical asset reconciliation* is a separate process to the *internal custody record check*. *Firms* that hold *physical safe custody assets* are required to perform both processes.

(2) The purpose of a *physical asset reconciliation* is to check that a *firm's* records and accounts of the *physical safe custody assets* kept by the *firm* are accurate and complete, and to ensure any discrepancies are investigated and resolved.

6.5.4K R A *firm* that holds *physical safe custody assets* must perform a *physical asset reconciliation* for all its *physical safe custody assets*:

(1) as regularly as is necessary bearing in mind *CASS* 6.5.8BR but, in any case, no less than once every six months; and

(2) as soon as reasonably practicable after the date to which the *physical asset reconciliation* relates.

6.5.4L R When performing a *physical asset reconciliation* a *firm* must:

(1) carry out a count of the relevant *physical safe custody assets* held by the *firm* at the date of the *physical asset reconciliation*;

(2) compare the count in (1) against what the *firm's* records and accounts state as being in the *firm's* possession at the same date; and

(3) promptly identify, investigate and resolve any discrepancies in either the count in (1) or the *firm's* records in (2), and any differences between the two.

6.5.4M R A *firm* must perform its *physical asset reconciliations* under *CASS* 6.5.4LR using the *total count methodology* or, subject to *CASS* 6.5.4RR, the *rolling stock methodology*.

6.5.4N G The relevant *physical safe custody assets*, for the purposes of *CASS* 6.5.4LR, will depend on whether the *firm* is using the *total count methodology* or *rolling stock methodology* to perform its *physical asset reconciliation*.

6.5.4O R Under the *total count methodology*, the relevant *physical safe custody assets* for *CASS* 6.5.4LR are all the *physical safe custody assets* held by the *firm*.

6.5.4P R Under the *rolling stock methodology*, the relevant *physical safe custody assets* for *CASS* 6.5.4LR are all the *physical safe custody assets* held by the *firm* that are of a particular stock line or group of stock lines.

6.5.4Q G The *rolling stock methodology* allows a *firm* to perform *physical asset reconciliations* 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'). A *firm* should ensure that all *safe custody assets* held by the *firm* as *physical safe custody assets* are subject to a *physical asset reconciliation* with the frequency required under *CASS* 6.5.4KR.

6.5.4R R If a *firm* wishes to use the *rolling stock methodology* to perform its *physical asset reconciliations* it must first send the *FCA* a written report prepared by an auditor of the *firm* on the basis of a *reasonable assurance engagement*, stating whether in the auditor's opinion the *firm's* proposal for using the *rolling stock methodology*:

(1) is adequately designed to enable the *firm* perform its *physical asset reconciliations* under *CASS* 6.5.4LR; and

(2) is adequately designed to appropriately mitigate the risk of 'teeming and lading'.

6.5.4RA R A *firm* that uses the *rolling stock methodology* must, within three months of any change in its use of that methodology, send the *FCA* a revised written report prepared by an auditor of the *firm* on the basis of a *reasonable assurance engagement*, stating the matters set out at *CASS* 6.5.4RR.

6.5.4S G To meet the requirement to have adequate organisational arrangements

under *CASS* 6.2.2R, a *firm* should, from time to time, perform random "spot checks" as to whether title to a sample of *physical safe custody assets* that it holds is registered under *CASS* 6.2.3R (Registration and recording of legal title).

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]

~~Reconciliations with external records~~ External custody reconciliations

6.5.5A G The purpose of an *external custody reconciliation* is to ensure the completeness and accuracy of a *firm's* internal accounts and records against those of relevant third parties.

…

6.5.6A R In *CASS* 6.5.6R, the third parties whose accounts and records a *firm* is required to reconcile its own internal accounts and records with include:

(1) third parties with which *firm* has deposited *safe custody assets*, and

(2) where the *firm* has not deposited a *safe custody assets* with a third party, third parties responsible for the registration of legal title to *safe custody assets* (for example, and as appropriate: central securities depositaries, *operators* of *collective investment schemes*, and administrators of offshore funds).

6.5.6B R A *firm* must conduct *external custody reconciliations:*

(1) subject to (2) as regularly as necessary bearing in mind *CASS* 6.5.8BR but, in any case, no less than once every 25 *business days*; and

(2) in all cases, as soon as reasonably practicable after the date to which the *external custody reconciliation* relates.

6.5.6C G For *safe custody assets* held electronically with a Central Securities Depositary (such as *CREST*), a *firm* should conduct *external custody reconciliations* each *business day*.

6.5.7 G Where a *firm* deposits *safe custody assets* belonging to a *client* with a third party, in complying with the requirements of *CASS* 6.5.6R, the *firm* should seek to ensure that the third party will deliver to the *firm* 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 statement is delivered in adequate time to allow the *firm* to carry out ~~the periodic reconciliations required in *CASS* 6.5.6R~~ its *external custody reconciliations* under *CASS* 6.5.6BR.

…

6.5.7B G *External custody reconciliations* must be performed for each *safe custody asset* held by the *firm*, 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* 6.5.6R.

Frequency of ~~external reconciliations~~ checks and reconciliations under this section

6.5.8 G ~~A *firm* should perform the reconciliation required by *CASS* 6.5.6R:~~

~~(1) as regularly as is necessary; and~~

~~(2) as soon as reasonably practicable after the date to which the reconciliation relates;~~

~~to ensure the accuracy of its internal accounts and records against those of third parties by whom *safe custody assets* are held.~~ [deleted]

6.5.8A 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) subject to (2) as regularly as is necessary bearing in mind the frequency, number and value of transactions which the *firm* undertakes in respect of *safe custody assets* but, in any case, no less than once every 25 *business days*; and

(2) in all cases, as soon as reasonably practicable after the date to which the reconciliation relates;

…

6.5.8B R When a *firm* is determining the frequency of its *internal custody checks* under *CASS* 6.5.4BR, *physical asset reconciliations* under *CASS* 6.5.4KR, and *external custody reconciliations* under *CASS* 6.5.6BR, the *firm* must consider the frequency, number and value of transactions which the *firm* undertakes in respect of *safe custody assets*.

6.5.8C R (1) A *firm* must, at least annually, review the frequency of its *internal custody checks*, *physical asset reconciliations* and *external custody reconciliations* to ensure that it continues to comply with *CASS* 6.5.4BR, *CASS* 6.5.4KR and *CASS* 6.5.6BR, respectively, and has given due consideration to the matters in *CASS* 6.5.8BR.

(2) A *firm* must record any decision it makes regarding the frequency of its *internal custody checks*, *physical asset reconciliations* and *external custody reconciliations*, and the reasons behind each decision.

Independence of person ~~conducting~~ performing checks and reconciliations

6.5.9 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.

~~Reconciliation~~ Resolution of discrepancies

6.5.10 R ~~A *firm* must promptly correct any discrepancies which are revealed in the reconciliations envisaged by this section, and make good, or provide the equivalent of, any unreconciled *shortfall* for which there are reasonable grounds for concluding that the *firm* is responsible.~~ [deleted]

6.5.10A G In this section, a discrepancy should not be considered to be resolved until is fully investigated and resolved and any associated *shortfall* is made good.

6.5.10B R If:

(1) discrepancies in a *firm's internal custody record checks* or *physical asset reconciliations* are as a result of, or reveal, a *shortfall*; and/or

(2) discrepancies in a *firm's external custody reconciliations* are as a result of, or reveal, a *shortfall*;

the *firm* must make good the *shortfall*. If the *firm* is not able to make good the *shortfall* immediately, it must either provide the equivalent of the *shortfall* from the *firm's* own assets of equivalent value, or segregate an amount of the *firm's money* equivalent to the *shortfall* as *client money*.

6.5.11 G Items recorded or held within a suspense or error account fall within the scope of discrepancies in this section.

6.5.11A 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.

6.5.12 G ~~A~~ If a *firm* ~~may~~, where justified, ~~conclude~~ concludes that another *person* is responsible for ~~an irreconcilable~~ a *shortfall* despite the existence of a dispute with that other *person* about the ~~unreconciled item~~ relevant discrepancy~~. In those circumstances~~, the *firm* ~~is not required to make good the *shortfall* but~~ is expected to take reasonable steps to resolve the position promptly with the other *person*. Until the position is resolved and the *shortfall* is made good, the *firm* should consider, in line with its obligations under the *client's best interests rule*, whether it should notify the affected *clients* of the situation.

6.5.12A G Where a *firm* segregates an amount of *client money* equivalent to any unresolved *shortfall*, to ensure the segregation has the intended effect, it should first confirm that the relevant *clients* affected by the *shortfall* are entitled to protection under the *client money rules*.

Notification requirements

6.5.13 R A *firm* must inform the *FCA* in writing without delay if:

(1) ~~if~~ its internal records and accounts of the *safe custody assets* held by the *firm* are materially out of date or materially inaccurate or invalid so that the *firm* is no longer able ~~it has not complied with, or is unable, in any material respect,~~ to comply with the requirements in *CASS* 6.5.1R~~;~~ or *CASS* 6.5.2R ~~or *CASS* 6.5.6R~~; ~~or~~

…

(2) ~~if,~~ after having carried out a check or reconciliation under this section, it materially fails to comply ~~has not complied~~ with, or ~~is~~ will be unable~~, in any material respect,~~ to comply with ~~*CASS* 6.5.10R~~ *CASS* 6.5.10BR;

(3) it will be unable to or materially fails to conduct an *internal custody record check* in compliance with *CASS* 6.5.4BR to *CASS* 6.5.4IAR;

(4) it will be unable to or materially fails to conduct a *physical asset reconciliation* in compliance with *CASS* 6.5.4KR to *CASS* 6.5.4RAR; or

(5) it will be unable to or materially fails to conduct an *external custody reconciliation* in compliance with *CASS* 6.5.6R to *CASS* 6.5.6BR.

…

6.5.15 G *Firms* that use ~~an alternative reconciliation method~~ the *internal system evaluation method* or the *rolling stock methodology* are reminded that the *firm's* auditor must ~~confirm to~~ first have given the *FCA* ~~in writing that the *firm* has in place systems and controls which are adequate to enable it to use another method effectively~~ a written opinion on certain matters (see *CASS* 6~~.5.5R~~ 6.5.4IR and *CASS* 6.5.4RR).

## 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*.

7.1.1B G A *firm* should ensure that when *CASS* 7.1.1AR applies it:

(1) holds relevant sums in a *client bank account* in its name in line with the *CASS* 7.4.11AR;

(2) places these sums into *qualifying money market funds* under *CASS* 7.4.1R(4); or

(3) allows another *person* to hold these sums as *client money* under *CASS* 7.5.2R.

…

7.1.3R …

(3) This *rule* is subject to *CASS* 1.2.11R.

…

7.1.7B R ...

7.1.7BA G *Firms* are reminded that, under *CASS* 1.2.11R, a *firm* subject to the *client money chapter* and the *insurance client money chapter* must ensure segregation between *money* held under each chapter.

…

7.1.8 R ~~The *client money rules* do not apply to a *BCD credit institution* in relation to deposits within the meaning of the *BCD* held by that *institution*.~~ ~~[**Note:** article 13(8) of *MiFID* and article 18(1) of the *MiFID implementing Directive*]~~ [deleted]

7.1.8A R Subject to *CASS* 7.1.8BR, the *client money rules* do not apply to:

(1) a *BCD credit institution* for deposits within the meaning of the *BCD*

held by that *institution*; or

**Note:** article 13(8) of *MiFID* and article 18(1) of the *MiFID implementing Directive*

(2) an *approved bank* that is not a *BCD credit institution* when it carries on *designated investment business* for its *clients* and holds any *money* relating to that business on its balance sheet and reflected in its underlying books and records.

7.1.8B R A *firm* referred to in *CASS* 7.1.8AR:

(1) will not, subject to (2), be subject to the *client money rules* to the extent it holds sums under that *rule*; and

(2) must comply, as relevant, with *CASS* 7.1.8DR to *CASS* 7.8.10G.

7.1.8C G In the *FCA's* view, if a *firm* does not hold *money* on its balance sheet it is unlikely to be holding that *money* under *CASS* 7.1.8AR(1).

7.1.8D R *A firm* holding *money* under *CASS* 7.1.8AR must, before providing *MiFID business* and/or *designated investment business* services to the *client* in respect of those sums, notify the *client*:

(1) that 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*.

7.1.8E R A *firm* holding *money* under *CASS* 7.1.8AR in respect of a *client* and providing the services to it referred to in *CASS* 7.1.8DR must:

(1) explain to its *clients* the circumstances, if any, under which it will cease to hold any *money* in respect of those services under *CASS* 7.1.8AR and will hold the *money* as trustee in line with *client money rules*; and

(2) set out the circumstances in (1) 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 (1) ~~Pursuant to *Principle* 10'(Clients' assets), a *credit institution* that holds *money* as a deposit with itself~~ When holding *money* under *CASS* 7.1.8AR, the *firm* should be able to account to all of its *clients* for ~~amounts held on their behalf~~ sums held for them at all times. ~~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.~~

(2) Where a *firm* receives *money* that would otherwise be held as *client money* but for *CASS* 7.1.8AR, that *money* should, pursuant to *Principle* 10, be allocated to the relevant *client* promptly. The *FCA* would expect this to be done no later than five *business days* after the *firm* has received the *money*.

7.1.10A R If a *BCD credit institution* or an *approved bank* that is not a *BCD credit institution* wishes to hold *client money* for a *client* (rather than under *CASS* 7.1.8AR) it must, before providing *MiFID business* and/or *designated investment business* services to the *client*, disclose the following information to the *client*:

(1) that the *money* held for that *client* is being held by the *firm* under the *client money rules*;

(2) the sums covered by the *client money rules*;

(3) that on *failure of* the *firm* the *client money distribution rules* will apply to these sums.

7.1.10C 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).

7.1.10D R A *BCD credit institution* or an *approved bank* that is not a *BCD 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) .

7.1.10E G *Firms* are reminded of their obligation to provide *clients* with a *client assets disclosure document*.

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 *BCD 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]

…

7.1.15 R …

(2) The relevant rules are:

(a) if the *firm* is regulated by the Law Society (of England and Wales)~~:~~

~~(i)~~ the ~~Solicitors' Accounts Rules 1998~~ SRA Accounts Rules 2011; ~~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~~ Law Society of Scotland Practice Rules 2011; and

…

…

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~~ to *CASS* 7.1.15KG | Trustee firms ~~(other than trustees of unit trust schemes)~~ |
| … | |
| ~~*CASS* 7.7.2R to *CASS* 7.7.4G~~ | ~~Requirement~~ |
| … | |
| *CASS* 7.6.6G to *CASS* 7.6.16R | … |
| *CASS* 7.6A | The standard methods of internal client money reconciliation |
| *CASS* 7.7.2R to *CASS* 7.7.4G | Requirement |

…

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) all the *client money rules* in *CASS* 7.6 (Records, accounts and reconciliations); and/or

(c) *CASS* 7.8 (Acknowledgment 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.

7.1.15H G A *firm* may wish to make the election under *CASS* 7.1.15GR if it is a *firm* that is also subject to the *client money rules* other than in its capacity as a *trustee firm*, and it wishes to use the same segregation and reconciliation systems and controls for all the *client money* it receives and holds.

7.1.15I R (1) A *trustee firm* may elect that the applicable provisions of *CASS* 7.4 (Segregation of client money) and *CASS* 7.6 (Records, accounts and

reconciliations) are to be construed as applying 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 keep that record for five years from the date that decision is made that it is to be effective.

7.1.15J G A *trustee firm* may wish to make the election under *CASS* 7.1.15IR 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, for example, establish and maintain adequate internal controls to conduct internal and external reconciliations for each trust individually.

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

…

## 7.2 ~~Definition~~ 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 a *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) The agreement in (1) must cover the *client's* agreement to the transfer of their full ownership of *money* to the *firm*, as well as any terms under which the ownership of *money* is to transfer from the *firm* back to the *client* (for example if the arrangement is not in effect from time to time, or is terminated).

(3) A *firm* must record the written agreement in this *rule*. The *firm* must keep the record from the date the agreement is entered into and for five years after the arrangement is terminated.

…

Termination of title transfer collateral arrangements

7.2.7A R (1) If a *client* asks a *firm* to terminate an arrangement relating to the transfer of full ownership of a *client's money* to a *firm* for the purposes set out in *CASS* 7.2.3R(1) and *CASS* 7.2.3AR(1), and such request was not made to the *firm* in writing, the *firm* must make a written record of the *client's* request.

(2) A *firm* must keep a *client's* written request or a written record of the *client's* request in (1) for a period of five years starting from the date the request was made.

(3) If a *firm* agrees to terminate an arrangement relating to the transfer of full ownership of a *client's money* to a *firm*, the *firm* must notify the *client* in writing of its agreement, and the *firm's* notification must state when the termination is to take effect.

(4) A *firm* must keep a written record of any notification it makes to the *client* under (3) for a period of five years, starting from the date the notification was given.

7.2.7B G When a *firm* notifies a *client* under *CASS* 7.2.7AR(3) of when the termination of an arrangement relating to the transfer of full ownership of a *client's money* to a *firm* is to take effect, it should take into account the period of time it reasonably requires to return the *money* to the client, or to update its records under *CASS* 7.6 (Records, accounts and reconciliations) and to segregate the *money* under *CASS* 7.4 (Segregation of client money), as appropriate.

7.2.7C 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* 7.2.3R(1) and *CASS* 7.2.3AR(1) does not have effect from time to time, or is terminated (in either case such that ownership of *money* transfers from the *firm* back to the *client*) then, unless permitted under the *client money rules*, the *firm* must treat that *money* as *client money* from one *business day* after the time the arrangement stops having effect. Where the *firm* made a notification under *CASS* 7.2.7R(3) but did not state a time for the termination of the arrangement, the *firm* must treat that *money* as *client money* from one *business day* after the date on which the *firm's* notification was made.

7.2.7D G A *firm* to which *CASS* 7.2.7CR applies should, for example, update its records under *CASS* 7.6 (Records, accounts and reconciliations) and segregate the *money* under *CASS* 7.4 (Segregation of client money), from the relevant time at which the *firm* is required to treat the *money* as *client money*.

…

7.2.8 R ~~*Money*~~ Where required by the very nature of the transaction 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~~ *commercial settlement system* if it is intended that either:

…

~~unless~~ but if 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*~~ the *firm* makes use of the exemption in this *rule*, the *firm* must stop using the exemption in this *rule*.

…

7.2.8AA G If a transaction for which a *firm* uses the exemption under *CASS* 7.2.8R is settled before the end of the three *business day* period in that *rule*, the *client money rules* or the *custody rules* (as appropriate) will apply to any *money* or *asset* it receives upon settlement.

7.2.8B R ~~*Money* need not be treated as *client money* 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*, if:~~

~~(1) the *authorised fund manager* receives it from a *client* in relation to the *authorised fund manager's* obligation to issue *units*, in an *AUT* or to arrange for the issue of *units* in an *ICVC*, in accordance with *COLL*, unless the *price* of those *units* has not been determined by the close of business on the next *business day*:~~

~~(a) following the date of the receipt of the *money* from the *client*; or~~

~~(b) if the *money* was received by an *appointed representative* of the *authorised fund manager*, in accordance with *CASS 7.4.24 G*, following the date of receipt at the specified business address of the *authorised fund manager*; or~~

~~(2) 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*; when an *authorised fund manager* draws a cheque or other payable order within these time frames the provisions of *CASS* 7.2.17R and *CASS* 7.2.9R(2) will not apply.~~ [deleted]

…

7.2.9A G *Money* will not become properly due and payable to the *firm* if the *firm* has just held 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* 7.2.15R (discharge of fiduciary duty) or, if the balance is unclaimed *client money*, *CASS* 7.2.19R or *CASS* 7.2.26R (De minimis amounts of unpaid client money).

…

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 (1) A *firm* must pay a *retail client* any interest earned on *client money* held for that *client* unless it has notified him in writing that no such interest will be payable.

(2) Where interest on *client money* held by a *firm* is payable to a *client* this must be allocated to that *client* as follows:

(a) where there is a written agreement between the *firm* and the *client* that sets out the frequency of payments, in accordance with that agreement;

(b) in all other cases within one *business day* of receipt by the *firm*.

(3) Any interest received or paid on *client money* must be treated as *client money* by the *firm* and segregated in line with *CASS* 7.4 (Segregation of client money).

…

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* 7.5.2 R (Transfer of client money to a third party); or

(c) paid to a third party further to an obligation on the *firm* under any applicable law; or

(d) transferred in line with *CASS* 7.2.17BR; or

(e) transferred in line with *CASS* 7.2.17DR; or

(3) it is paid into a bank account of the *client* (not being an account which is also in the name of the *firm*) on the instruction, or with the specific consent, of the *client*; or

…

(10) it is segregated into *units* in a *qualified money market fund* under *CASS* 7.4.1R(4); or

(11) it is paid under *CASS* 7.2.26R.

…

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]

…

Transfer of business

7.2.17A G If a *firm* transfers *client money* to a third party while transferring all or part of its business to another *firm*, it continues to be responsible under *CASS* for the sums transferred unless it either:

(1) obtains the consent or instruction of each *client* with an interest in the *client money* that is sought to be transferred; or

(2) complies with *CASS* 7.2.17BR or *CASS* 7.2.17DR (see *CASS* 7.2.15R(2)(d) or (e)).

7.2.17B R Subject to *CASS* 7.2.17DR, *money* ceases to be *client money* of the *firm* if it is transferred in the following circumstances:

(1) as part of a transfer of business where the *client money* relates to the business being transferred;

(2) the terms of the transfer of *client money* in the circumstances in (1) are set out in a written agreement between the *firm* and its *clients*;

(3) the written agreement in (2) must provide that:

(a) the *firm* may transfer the *client's client money* to another *investment firm*;

(b) the sums transferred will either:

(i) continue to be held in line with the *client money rules* for the *clients*; or

(ii) if the *investment firm* to which *client money* is transferred is not subject to *CASS*, the transferor *firm* will use best endeavours to ensure that the transferee will apply adequate measures to protect the sums

being transferred;

(c) the *client* must be notified within seven *days* after the transfer:

(i) how the sums transferred will be held by the transferee;

(ii) the relevant applicable compensation scheme the sums transferred will be protected by; and

(iii) that the *client* may opt to have sums transferred to be returned to him as soon as practicable.

7.2.17C R The *firm* must notify the *FCA* of its intention to effect a transfer under *CASS* 7.2.17BR at least seven *days* before it commences the transfer.

Transfer of business: de minimis

7.2.17D R *Client money* of less than or equal to £10 for each *client* ceases to be *client money* of the *firm* if it is transferred in the following circumstances:

(1) it is transferred along with other *client money* that is being transferred under *CASS* 7.2.17BR; and

(2) the requirements in *CASS* 7.2.17BR(3)(c) are met for these sums;

and where the *firm* has notified the *FCA* of its intention to affect such a transfer at least seven *days* before it is completed.

7.2.17E G Sums transferred under *CASS* 7.2.17D do not require a written agreement as set out in *CASS* 7.2.17B(2) and (3)(a) and (b).

…

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 balances, allocated to an individual *client*, when those balances remain unclaimed.

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.~~

(1) the *firm* held the balance concerned for at least six years following the last movement on the account (disregarding any payment or receipt of interest, charges or similar items);

(2) it can demonstrate that it has taken reasonable steps to trace the *client* concerned and to return the balance;

(3) this is consistent with the *firm's* agreement with that *client*; and

(4) any *money* so treated is subsequently paid away to a registered charity.

7.2.19A G Where the *client money* balance held by a *firm* for a *client* is, in aggregate, £10 or less, the *firm* may comply with *CASS* 7.2.26R instead of *CASS* 7.2.19R.

7.2.20 E (1) Reasonable steps in *CASS* 7.2.19R(2) should include the following 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 possible, current 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 or using other means to inform him of the *firm's* intention to no longer treat the *client money* balance as *client money* and giving the *client* 28 *days* in which to make a claim;

(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) the *firm* should:

(i) place an advertisement in local media; and

(ii) attempt to communicate on at least three further occasions with the *client* by any other means including by post, electronic mail or telephone;

(d) ~~making and retaining records of all balances released from *client bank accounts*; and~~ after 28 *days* from the last communication under (c), the *firm* should write again to the *client* at the last known address to confirm that, as the *firm* did not receive a claim for the relevant *client money* balance, it will pay this balance to a registered charity.

(e) ~~undertaking to make good any valid claim against any released balances.~~ [deleted]

…

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 Where a *firm* ceases to treat balances as *client money* in line with *CASS* 7.2.19R it must satisfy either (1) or (2) and, in either case, (3):

(1) the *firm* unconditionally undertakes to make good any valid claim for those balances; or

(2) the *firm* has ensured that an undertaking to make good any such valid claim is made by its *group* and:

(a) this undertaking is legally enforceable by any *person* with a valid claim to the balances in question; and

(b) there is suitable information available for *clients* with such claims to identify the *group* granting the undertaking;

(3) the undertakings in this *rule* must be authorised by the *firm's governing body* where (1) applies or the *governing body* of the *group* where (2) applies.

7.2.23 R (1) If a *firm* pays away *client money* under *CASS* 7.2.19R(4) it must make and/or retain records of:

(a) all balances released from *client bank* accounts (including details of the amounts and the *client* to whom the *money* was allocated); and

(b) all relevant documentation (including charity receipts).

(2) If a *firm's group* has provided an undertaking under *CASS* 7.2.22R(2) then records in (1) must be readily accessible to that *group*.

7.2.24 G Where a *firm* or its *group* purchases insurance to cover any valid claims for an undertaking it has made under *CASS* 7.2.22R, it should pay for such insurance from its own funds.

De minimis amounts of unclaimed client money

7.2.25 G The purpose of *CASS* 7.2.26R is to allow a *firm* to pay away to charity *client money* balances of £10 or less when those balances remain unclaimed. In doing so, the *firm* will also be deemed to have discharged its fiduciary obligation to *clients* for those balances.

7.2.26 R Provided the conditions in (1) to (4) are met, a *firm* may pay away to a registered charity *client money* balances which are allocated to *clients* and if it does so the released balances will cease to be client money under *CASS*

7.2.15R(11):

(1) the balances in question are for sums which are, in aggregate, £10 or less for each *client*;

(2) there has been no movement on the *client's* balance for a period of at least six years (disregarding any payment or receipts of charges, interest 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; and

(4) the *firm* makes and/or retains records of all balances released from *client bank* accounts in according with this *rule*. Such records must include the information in *CASS* 7.2.23(1)(a) and (b).

…

## 7.4 Segregation of client money

Purpose

7.4.-1 G The segregation of *client money* from a *firm*'s own *money* is an important safeguard for its protection.

…

7.4.1A R Unless a *firm* is using the alternative approach, it should ensure that all *client money* it receives is paid directly into a *client bank account* at an institution in *CASS* 7.4.1R(1) to (3), rather than being first received into the *firm's* own account and then segregated.

7.4.1B G (1) *Firms* should arrange for *clients* and third parties to make transfers and payments of any *money* which will be *client money* directly into the *firm's client bank accounts*.

(2) Any placements of *client money* into *qualifying money market funds* under *CASS* 7.4.1R(4) should be made using *money* that has first been cleared into the *firm's client bank accounts.*

7.4.2 G ~~An account with a central bank, a *BCD credit institution* or a bank authorised in a third country in which *client money* is placed is a *client bank account*.~~ [deleted]

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 units in that fund should be held in line with *CASS* 6.
[**Note:** recital 23 to the *MiFID implementing Directive*]

7.4.3B R Where a *firm*, as a result of depositing *client money* with a *qualifying money market fund* under *CASS* 7.4.1R(4), holds units in that fund in line with *CASS* 6 it must ensure that:

(1) the *firm's* records and accounts maintained under *CASS* 6.5 (Records, accounts and reconciliations) record that those units are to be realised in line with *CASS* 7A.2.3CR (Failure of the authorised firm: primary pooling event); and

(2) those units are clearly identifiable from any units in that fund that belong to the *firm* itself and from any other units in that fund that the *firm* is holding for *clients* other than as a result of segregating *client money* under *CASS* 7.4.1R(4).

…

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 will be held as *safe custody assets* in accordance with the *custody rules* and;

(3) on the occurrence of a *primary pooling event*, the units will not be returned to the *client* but will be liquidated and distributed to the *firm's clients* under the *client money distribution rules*.

~~A firm's selection of a credit institution, bank or money market fund~~ Selection, appointment and review of third parties

7.4.7 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 *BCD 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*]

7.4.7A G *Firms* should ensure that their consideration of a *BCD credit institution*, bank or *qualifying money market fund* under *CASS* 7.4.7R focuses on the specific legal entity in question and not simply that *person's* group as a whole.

7.4.8 R When a *firm* makes the selection, appointment and conducts the periodic review of a *BCD credit institution*, a bank or a *qualifying money market fund*, it must take into account:

…

7.4.9 G In ~~discharging its obligations when selecting, appointing and reviewing the appointment of a *credit institution*, a bank or a *qualifying money market fund*,~~ complying with *CASS* 7.4.7R and *CASS* 7.4.8R, a *firm* should ~~also~~ consider, as appropriate, together with any other relevant matters:

(1) ~~the need for diversification of risks;~~ [deleted]

(1A) the financial soundness of the third party;

(2) the capital of the *BCD credit institution* or bank;

(3) the amount of *client money* placed, as a proportion of the *BCD 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;

(3A) the percentage of the *firm's* overall *client money* holdings that it deposits or holds with any *BCD credit institution* or bank incorporated outside the *UK*, and the extent to which such holdings would be protected under a deposit protection scheme in the relevant jurisdiction;

(4) the ~~credit rating~~ credit-worthiness of the *BCD 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 *BCD credit institution* or bank and *affiliated companies*.

Diversification of client money

7.4.9A R A *firm* must appropriately diversify the third parties with which it deposits *client money* in a manner that is proportionate to the total amount of *client money* that the *firm* holds. In particular, ~~A~~ 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:

(1) ~~all of its *general client bank accounts* considered in aggregate~~ all the *client money* held by the *firm* in its *client bank accounts*; plus

(2) ~~each of its *designated client bank accounts*; and~~ the value of the units in *qualifying money market funds* held by the *firm* as a result of *client money* being deposited under *CASS* 7.4.1R(4)

~~(3) each of its *designated client fund accounts*~~.

7.4.9B R For the purpose of *CASS* 7.4.9AR an entity is a relevant group entity if it is:

(1) a *BCD credit institution*, a bank authorised in a third country, ~~a *qualifying money market fund*~~, or the entity operating or managing a *qualifying money market fund*; and

…

7.4.9BA G In complying with the general requirement in *CASS* 7.4.9AR for appropriate diversification, a *firm* should give consideration to:

(1) whether it would be appropriate to deposit *client money* in *client bank accounts* opened at a number of different third parties; and

(2) whether it would be appropriate to limit the amount of *client money* it holds with third parties that are in the same group as each other.

…

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) the *firm* is able to make withdrawals of *client money* promptly and, in any event, within one *business day* of a request for withdrawal.

7.4.11B G *Firms* are prohibited, under *CASS* 7.4.11AR(2)(b), from depositing *client money* on terms under which withdrawals are subject to the expiry of a fixed term or a notice period of longer than one *business day*. This 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).

7.4.11C G *Firms* are reminded of their obligations under *CASS* 7.8 (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.

7.4.12 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) apply for each type of *client bank account*.

7.4.12A 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*.

7.4.13 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.*

~~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* 7.6.2 R). 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]

7.4.17 G Under the normal approach, a *firm* that receives *client money* should either:

(1) ~~pay it promptly, and in any event no later than the next *business day* after receipt,~~ ensure it is deposited into a *client bank account* or a *qualifying money market fund* in line with *CASS* 7.4.1R and *CASS* 7.4.1AR; 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).

7.4.17A G (1) In exceptional circumstances, use of the normal approach in relation to a particular business line of a *firm* could lead to significant operational risks to *client money* protection. This may include a business line under which *clients'* transactions are complex, closely related to the *firm's* proprietary business and/or involve a number of currencies and time zones, in each case where a period of time is required to identify and allocate *client money* receipts and calculate individual client entitlements. In such exceptional circumstances, subject to meeting the relevant criteria and fulfilling the relevant notification requirements, a *firm* may use the alternative approach for that business line.

(2) The alternative approach is only suitable for use where the *firm* uses *client bank accounts* for segregation purposes in the relevant business line and not where the *firm* places *client money* into a *qualifying money market fund*.

(3) 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 calculating accurately *clients' client money* entitlements to ensure the correct amounts are segregated. 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* with the records and accounts of the *client money* the *firm* holds in *client bank accounts* and *client transaction accounts* in order to determine what the *client money* requirement was at the close of the previous *business day*.

7.4.17B R A *firm* that wishes to adopt the alternative approach for a particular business line must, by the time of its notification under *CASS* 7.4.17DR, 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, in the way proposed (including the proposal for operating the cash buffer under *CASS* 7.4.18BR), would not result in undue risk to *client money* protection;

(3) the alternative approach is appropriate for use with the business line; and

(4) the *firm* has adequate systems and controls 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 a record of its reasons for adopting the alternative approach under *CASS* 7.4.17BR from the date it documents those reasons until five years after the date it ceases to use the alternative approach in connection with the relevant business line.

7.4.17D R At least three months prior to adopting the alternative approach for a business line, a *firm* must provide the *FCA* with a written confirmation of its intention to adopt the alternative approach and must make its records retained under *CASS* 7.4.17CR available to the *FCA* for inspection.

7.4.17E R Prior to adopting the alternative approach a *firm* must send a written report prepared by an auditor of the *firm* on the basis of a *reasonable assurance engagement*, stating:

(1) whether, in the auditor's opinion, the *firm's* systems and controls are adequately designed to enable the *firm* to use the alternative approach effectively under *CASS* 7.4.18AR; and

(2) whether, in the auditor's opinion, the *firm's* proposal for how it will calculate and maintain a cash buffer under *CASS* 7.4.18BR is adequately designed to enable the *firm* to comply with *CASS* 7.4.18AR.

7.4.17F R (1) A *firm* that uses the alternative approach must, at least on an annual basis and following any material change in business and/or systems change, review whether its reasons for the matters in *CASS* 7.4.17BR continue to be valid or whether the circumstances reported by the auditor to the *FCA* under *CASS* 7.4.17ER(3) have arisen.

(2) If a *firm* that uses the alternative approach finds that its reasons for the matters in *CASS* 7.4.17BR are no longer valid, it must stop using the alternative approach within three months.

(3) If a *firm* changes the way it uses the alternative approach it must, within three months of that change, send the *FCA* a revised written report prepared by an auditor of the *firm* on the basis of a *reasonable assurance engagement*, stating the matters in *CASS* 7.4.17ER.

7.4.17G G Prior to any anticipated material business and/or systems changes, a *firm* using the alternative approach should consider any resulting impact on the validity of its reasons for the matters set out in *CASS* 7.4.17BR.

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 must, for the relevant business line:

(1) receive any *money* from and pay any *money* to (or, in either case, on behalf of) *clients* into and out of its own accounts;

(2) perform the necessary reconciliations of records and accounts required under *CASS* 7.6 (Records, accounts and reconciliations), and, where relevant, *SYSC* 4.1.1R (General requirements) and *SYSC* 6.1.1R (Compliance);

(3) adjust the balance in *client bank accounts* which are not also used in relation to the normal approach (by effecting transfers between its own accounts and those *client bank accounts*) so that the correct amount reflected in the reconciliations under (2) is segregated in those *client bank accounts*; and

(4) subject to (a) and (b), below, keep segregated in those *client bank accounts* the amount under (3) until it performs a reconciliation on the next *business day* and subsequently undertakes further adjustments under (3).

(a) If, in respect of the business line for which it is using the alternative approach and, during the period between the adjustment in (3) and the next reconciliations in (2), a *firm* reasonably expects the *client money* requirement to increase, it may increase the balance held in its relevant *client bank accounts* by making intra-day transfers from its own accounts.

(b) If, in respect of the business line for which it is using the alternative approach and during the period between the adjustment in (3) and the next reconciliations in (2), a *firm* reasonably expects the *client money* requirement to decrease, it may reduce the balance held in its relevant *client bank accounts* by making intra-day transfers to its own accounts. 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.

7.4.18B R (1) A *firm* that uses the alternative approach must, in addition to *CASS* 7.4.18AR, pay into its *client bank accounts money* of its own and subsequently retain that *money* in those accounts as a cash buffer. The cash buffer maintained by a *firm* under this *rule* will be *client money* for the purposes of the *client money rules* and the *client money distribution rules*.

(2) The amount of *money* that a *firm* is required to pay into and maintain in its *client bank accounts* under (1) as a cash buffer must be sufficient to cover the risk that the *firm* may not have, at any given point in time, segregated an adequate amount of *money* in its *client bank accounts* to meet its *client money* requirement, as further set out in (3).

(3) The specific risks that a *firm* must take into account when calculating the amount required in (2) are:

(a) the intra-day risk arising as a result of identified *client money* being received and held by the *firm* in its own account in the period prior to the reconciliations under *CASS* 7.4.18AR(2) being performed and the subsequent adjustments under *CASS* 7.4.18AR(3) being made; and

(b) the risk arising as a result of *money* being received and held by the *firm* in its own account which the *firm* is not able, for a period of time, to correctly identify as *client money*.

(4) A *firm* must use its records for the previous three months trading (or if it has not been trading for three months, then it should use the trading records that are available to it, plus a reasonable trading forecast) to ascertain the amount by which it needs to protect against the risks in (3) by maintaining the cash buffer in (1). It must review this amount periodically, at least quarterly, and must make the necessary adjustments to the amount of the cash buffer promptly after its periodic review reveals a change to the amount required under this *rule*.

(5) If a *firm* using the alternative approach expects to receive large amounts of *client money* which risks falling under either of the scenarios in (3)(a) and (3)(b), it must increase the cash buffer under this *rule* to cover the expected aggregate risk.

(6) 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 any cash buffer maintained under this *rule* at least annually.

(7) A *firm* must make a record of each periodic review undertaken under (4) on the date it completes the review, and must keep it from that date until five years after the *firm* ceases to use the alternative

approach.

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]

7.4.20 G ~~Pursuant to the *client money segregation requirements*, a~~ A *firm* should ensure that any money other than *client money* deposited in a *client bank account* is promptly paid out of that account unless it is a minimum sum required to open the account, or to keep it open.

7.4.21 R If it is prudent to do so to ensure that *client money* is protected, a *firm* may, subject to *CASS* 7.4.21AR, pay into a *client bank account money* of its own ~~, and that *money*~~ and subsequently retain that *money* in that account. *Money* retained in that account under this *rule* will ~~then become~~ be *client money* for the purposes of ~~this chapter~~ the *client money rules* and the *client money distribution rules*.

7.4.21A R Before a *firm* pays its own *money* into a *client bank account* under *CASS* 7.4.21R it must first:

(1) establish a written policy that is approved by its *governing body* detailing the types of risks for which it would be prudent for the *firm* to protect *client money* using such a payment;

(2) for each payment that is to be made under *CASS* 7.4.21R, demonstrate that the payment relates to a specific anticipated risk within the scope of the policy under (1);

(3) make, and retain for a period of five years following the payment, a written record that explains why the amount paid is a reasonable estimate (or reflects an increase in a previous estimate) of the specific risk to which it relates; and

(4) in the same record in (3), clearly document that the *money*, having been paid by the *firm* in accordance with *CASS* 7.4.21R, will be *client money*.

7.4.21B G Examples of the types of risks that a *firm* may wish to provide protection for under *CASS* 7.4.21R 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*. A *firm* may also include in its policy under *CASS* 7.4.21AR(1) payments under *CASS* 7.4.21R to cover the

potential costs of distributing *client money* following a *primary pooling event*.

7.4.21C R If a *firm*, having made a payment under *CASS* 7.4.21R, considers that the risk for which that payment was made to cover has changed to the extent that the *firm* no longer considers that the amount it is prudently maintaining in its *client bank account* is required, then the *firm* must:

(1) make, and retain for a period of five years following the *firm's* next internal *client money* reconciliation, a written record that explains the relevant change in circumstances and the amount by which it considers that the balance on the *client bank account* should be reduced; and

(2) update its records to reflect that the relevant amount in its *client bank account* is no longer *client money*.

7.4.21D G If a *firm* undertakes the step in *CASS* 7.4.21CR(2) it should, as part of its next reconciliation, withdraw the relevant amount from its *client bank account* as an excess under *CASS* 7.6.13R(2).

~~Automated transfers~~

7.4.22 G ~~Pursuant to the *client money segregation requirements*, a *firm* operating the normal approach that receives *client money* in the form of an automated transfer should take reasonable steps to ensure that:~~

~~(1) the *money* is received directly into a *client bank account*; and~~

~~(2) if *money* is received directly into the *firm's* own account, the *money* is transferred into a *client bank account* promptly, and in any event, no later than the next *business day* after receipt.~~ [deleted]

Receipts of client money

7.4.22A R A *firm* must not carry on any *designated investment business* for a *client* using *client money* that it has received until that *money*, in whatever form it is paid to the *firm*, has been cleared into a *client bank account*.

7.4.22B G The statutory trust under *CASS* 7.7 (Statutory trust) does not permit a *firm*, in its capacity as trustee, to use *client money* to make advances of credit to the *firm's clients*.

7.4.22C R Where a *firm* receives *client money* in the form of cash, a cheque or other payable order, it must:

(1) unless the money is received under a business line for which the *firm* uses the alternative approach, pay the money in accordance with *CASS* 7.4.1AR, promptly, and no later than on the *business day* after it receives the *money*;

(2) if the *firm* holds the *money* overnight, hold it in a secure location in line with *Principle* 10; and

(3) record the receipt of the *money* in the *firm's* books and records under the applicable requirements of *CASS* 7.6 (Records, accounts and reconciliations).

Mixed remittance

7.4.23 G ~~Pursuant to the *client money segregation requirements*, a *firm* operating the normal approach that receives a *mixed remittance* (that is part *client money* and part other *money*) should:~~

~~(1) pay the full sum into a *client bank account* promptly, and in any event, no later than the next *business day* after receipt; and~~

~~(2) pay the *money* that is not *client money* out of the *client bank account* promptly, and in any event, no later than one *business day* of the day on which the *firm* would normally expect the remittance to be cleared.~~ [deleted]

7.4.23A R Where a *firm* using the normal approach receives a *mixed remittance* it should:

(1) in line with *CASS* 7.4.1AR, take necessary steps to ensure it 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*.

Appointed representatives, tied agents, field representatives and other agents

7.4.24 G (1) ~~Pursuant to the *client money segregation requirements*, a *firm* operating the normal approach should establish and maintain procedures to ensure that *client money* received by its *appointed representatives*, *tied agents*, *field representatives* or other agents is:~~

~~(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*, so as 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*.~~ [deleted]

(2) ~~For the purposes of 1(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 promptly, and in any event, no later than the next *business day* after receipt, would be in line with 1(b).~~ [deleted]

7.4.24A 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*; 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*.

7.4.24B G Under *CASS* 7.4.24AR(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* 7.4.24AR(2)(b).

7.4.25 G ~~The *firm* should ensure that its *appointed representatives*, *tied agents*, *field representatives* or other agents keep *client money* separately identifiable from any other *money* (including that of the *firm*) until the *client money* is paid into a *client bank account* or sent to the *firm*.~~ [deleted]

…

~~Client entitlements~~

7.4.27 G ~~Pursuant to the *client money segregation requirements*, a *firm* operating the normal approach that receives outside the *United Kingdom* a *client* entitlement on behalf of a *client* should pay any part of it which is *client money*:~~

~~(1) to, or in accordance with, the instructions of the *client* concerned; or~~

~~(2) into a *client bank account* promptly, and in any event, no later than five *business days* after the *firm* is notified of its receipt.~~ [deleted]

7.4.28 G ~~Pursuant to the *client money segregation requirements*, a *firm* operating the normal approach should allocate a client entitlement that is *client money* to the individual *client* promptly and, in any case, no later than *ten business* days after notification of receipt.~~ [deleted]

Allocation of client money receipts

7.4.28A R (1) A *firm* must allocate any *client money* it receives to an individual *client* promptly and, in any case, no later than five *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* 7.4.28CR, no later than five *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".

7.4.28B 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 "unallocated client money" while it performs the necessary steps under (1).

7.4.28C G If a *firm* is unable to allocate *client money* that it has received to an individual client under *CASS* 7.4.28AR, or is unable to identify *money* that it has received as either *client money* or its own *money* under *CASS* 7.4.28BR, it should consider whether it would be appropriate to return the *money* to the person who sent it (or, if that is not possible, to the source from where it was received, for example, the banking institution). A *firm* should have regard to its fiduciary duties when considering such matters.

Money due to a client from a firm

7.4.29 G ~~Pursuant to the *client money segregation requirements*, a *firm* operating the normal approach that 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*.~~ [deleted]

7.4.29A R Where in respect of a *firm's designated investment business* carried on with

that *client*:

(1) a liability of the *firm* to pay *money* of its own to a *client* becomes due and payable; and

(2) the *firm* is not able to pay the *money* (or part of it) to, or to the order of, the *client* in line with any agreement with or instruction of the *client*;

the *firm* must pay the *money* (or the balance of it) into a *client bank account*. *Money* paid under this *rule* into a *client bank account* will be *client money* for the purposes of the *client money rules* and the *client money distribution rules*.

7.4.29B G The requirement in *CASS* 7.4.29AR applies where, for example, the *firm's* agreement with the *client* is silent on how the *firm* is to discharge its liability to pay *money* to the *client*, no payment instructions are received from the *client*, or the agreed arrangements cannot be followed in practice.

Segregation in different currency

7.4.30 R A *firm* may segregate *client money* in a different currency from that ~~of receipt~~ 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.

7.4.31 G ~~The *rule* on segregation of *client money* in a different currency (*CASS* 7.4.30 R) does not apply where the *client* has instructed the *firm* to convert the *money* into and hold it in a different currency.~~ [deleted]

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.~~ Under the *Part 30 exemption order* for *firms* authorised under the *Act*, eligible *firms* may apply for confirmation of exemptive relief from Part 30 of the General Regulations under the US Commodity Exchange Act. In line with this system, both the applicant *firm* and the *FCA* must make certain written representations to the CFTC.

7.4.33 G A *firm* with ~~a~~ exemptive relief under the *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:

(1) the opt-out arrangements in *CASS* 7.1.7BR to *CASS* 7.1.7FR;

(2) the exemption for credit institutions and approved banks in *CASS* 7.1.8R to *CASS* 7.1.10EG; or

(3) the exemptions for title transfer collateral arrangements in *CASS* 7.2.3R and *CASS* 7.2.3AR;

in relation to that business.

LME bond arrangements

7.4.33A 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.

7.4.34 R A *firm* must not reduce the amount of, or cancel a letter of credit issued under, an ~~LME bond arrangement~~ *LME bond arrangement* where this will cause the *firm* to be in breach of ~~its~~ the conditions of the *Part 30 exemption order*.

7.4.35 R A *firm* must notify the *FCA* immediately if it arranges the ~~*issue*~~ issue of ~~an individual~~ a letter of *credit* for a specified *client* who is the named beneficiary under an *LME bond arrangement*.

7.4.36 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*.

## 7.5 ~~Transfer of client~~ Client money ~~to~~ held by 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 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'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*:

…

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

7.5.2A G The *FCA* expects that *client money* held under *CASS* 7.5.2R:

(1) will only be held for transactions which are likely to occur; and

(2) will be recorded in *client transaction accounts* by the *person* to whom they are transferred.

7.5.3 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~~ 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*~~.

Client money arising from, or in connection with, safe custody assets

7.5.4 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.

7.5.5 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* as appropriate.

7.5.6 G The *client bank account* referred to in *CASS* 7.5.5R may be an account with the third party holding the *safe custody assets*.

## 7.6 Records, accounts and reconciliations

…

~~Client entitlements~~

7.6.3 G ~~Pursuant to *CASS* 7.6.2R (Records and accounts), and where relevant *SYSC* 4.1.1R (General requirements) and *SYSC* 6.1.1R (Compliance), a *firm* should take reasonable steps to ensure that it is notified promptly of any receipt of *client money* in the form of a *client* entitlement.~~ [deleted]

Record keeping

7.6.3A R A *firm* must maintain records so that at any time and without delay it is able to determine the total amount of *client money* it should be holding for each *client*.

7.6.4 R Unless otherwise stated, ~~A~~ a *firm* must ensure that all records made under ~~*CASS* 7.6.1R and *CASS* 7.6.2R~~ this section are retained for a period of five years after they were made.

7.6.5 G ~~A *firm* should ensure that it makes proper records, sufficient to show and explain the *firm's* transactions and commitments in respect of its *client money*.~~ [deleted]

7.6.5A R A *firm* must ensure that its records are sufficient to show and explain its transactions and commitments for its *client money*.

7.6.5B R A *firm* must ensure that it records:

(1) each *internal client money reconciliation* and *external client money reconciliation* it conducts; and

(2) every review it undertakes under its arrangements for complying with this section.

7.6.5C 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.

Receipts of client money

7.6.5D 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 is not yet deposited in a *client bank account* (see *CASS* 7.4.22CR(3)).

7.6.5E G *Firms* are also reminded that they must not carry on any *designated investment business* for a *client* using *client money* that it has received until that *money*, in whatever form it was paid to the *firm*, has been cleared into a *client bank account*. This includes *client money* received in the form of cash, cheques, payment orders and credit card receipts (see *CASS* 7.4.22AR to *CASS* 7.4.22CR).

Payments made to discharge fiduciary duty

7.6.5F 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, has cleared.

7.6.5G G *Firms* are reminded that, under *CASS* 7.2.17R, when a *firm* draws a cheque or other payable order on a *client bank account* to discharge its fiduciary duty to its *clients*, it must continue to treat the sum concerned as *client money* until the cheque or order is presented and paid by the bank.

Internal client money reconciliations ~~of client money balances~~

7.6.6 G (1) ~~Carrying out internal reconciliations 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* should be one of the steps a *firm* takes to satisfy its obligations under *CASS* 7.6.2R, and where relevant *SYSC* 4.1.1R and *SYSC* 6.1.1R.~~ [deleted]

(2) ~~A *firm* should perform such internal reconciliations:~~

~~(a) as often as is necessary; and~~

~~(b) as soon as reasonably practicable after the date to which the reconciliation relates;~~

~~to ensure the accuracy of the *firm's* records and accounts.~~ [deleted]

(3) ~~The *standard method of internal client money reconciliation* sets out a method of reconciliation of client money balances that the *FCA* believes should be one of the steps that a *firm* takes when carrying out internal reconciliations of *client money*.~~ [deleted]

7.6.6A 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* 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*.

7.6.6B 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* 7.6.2R and, where relevant, *SYSC* 4.1.1R and *SYSC* 6.1.1R, to ensure the accuracy of the *firm's* records and accounts;

(3) other than for *firms* applying the alternative approach to segregating *client money* (*CASS* 7.4.17BR), act as a check that the amount of *client money* recorded in the *firm's* records as being segregated in *client bank accounts* is sufficient to meet the *firm's* obligations to its *clients* on a daily basis; and

(4) for the alternative approach to segregating *client money* (*CASS* 7.4.17BR), calculate the amount of *client money* to be segregated in *client bank accounts* which is sufficient to meet a *firm's* obligations to its *clients* on a daily basis.

7.6.6C 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* 7.6A.

(3) A *firm* proposing to follow a *non-standard method of internal client money reconciliation* must comply with the requirements in *CASS* 7.6.6ER to *CASS* 7.6.6FR.

Non-standard method of internal client money reconciliation

7.6.6D 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* 7.6A.

7.6.6E R (1) Prior to 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* the *firm* proposes to use will afford an equivalent degree of protection to that afforded by the *standard methods of internal client money reconciliation*;

(b) notify the *FCA*; and

(c) send a written report to the *FCA* from the *firm's* auditor stating the matters set out in *CASS* 7.6.6ER(2) and prepared

in line with a *reasonable assurance engagement*.

(2) The written report in (1)(c) must state:

(a) whether, in the auditor's opinion, the *non-standard method of internal client money reconciliation* which the *firm* proposes to use is adequately designed to enable it to afford an equivalent degree of protection to the *firm*'s *clients* to that afforded by the *standard methods of internal client money reconciliation* in *CASS* 7.6A; and

(b) whether, in the auditor's opinion, the *firm's* systems and controls are adequately designed to enable it to operate effectively the *non-standard method of internal client money reconciliation* the *firm* proposes to use.

(3) If a *firm* changes its *non-standard method of internal client money reconciliation* it:

(a) will be undertaking a *revised non-standard method of internal client money reconciliation*; and

(b) must, prior to undertaking a *revised non-standard method of internal client money reconciliation* ensure it complies with the requirements in (1) and (2) in respect of that revised method.

7.6.6F G (1) In the *FCA*'s view, a *non-standard method of internal client money reconciliation* will provide an equivalent degree of protection to the *firm's clients* to that afforded by the *standard methods of internal client money reconciliation* when it achieves each of the purposes of an *internal client money reconciliation* (*CASS* 7.6.6BG).

(2) 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 7.6.2 R* 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 'end 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]

~~Reconciliation with external records~~ External client money reconciliations

…

7.6.9A G The purpose of an *external client money reconciliation* is to ensure the accuracy of a *firm's* internal accounts and records against those of any third parties by whom *client money* is held.

Frequency of external client money reconciliations

7.6.10 G (1) ~~A *firm* should perform the required reconciliation of *client money* balances with external records:~~

~~(a) as regularly as is necessary; and~~

~~(b) as soon as reasonably practicable after the date to which the reconciliation relates;~~

~~to ensure the accuracy of its internal accounts and records against those of third parties by whom *client money* is held.~~ [deleted]

(2) ~~In determining whether the frequency is adequate, the *firm* should consider the risks which the business is exposed, such as the nature, volume and complexity of the business, and where and with whom the *client money* is held.~~ [deleted]

7.6.10A R A *firm* must perform an *external client money reconciliation*:

(1) as regularly as is necessary but at least once a month; and

(2) as soon as reasonably practicable after the date to which the *external client money reconciliation* relates.

7.6.10B R When determining the frequency to undertake an *external client money reconciliation*, a *firm* must take into account:

(1) the frequency, number and value of transactions which are undertaken for *clients* and give rise to *client money*; and

(2) the risks to which the business is exposed, such as the nature, volume and complexity of the business and where and with whom *client*

*money* is held.

7.6.10C R (1) A *firm* must make and retain records sufficient to show and explain the decision it has taken under *CASS* 7.6.10BR.

(2) The records in (1) must be retained for a period of at least five years after the decision taken no longer stands.

7.6.10D G The *FCA* expects *firms* which often undertake transactions on a daily basis to conduct an *external client money reconciliation* on a daily basis.

7.6.10E R A *firm* must periodically review its policies and methodologies for complying with *CASS* 7.6.10AR to *CASS* 7.6.10CR.

Method of external client money reconciliations

7.6.11 G ~~A method of reconciliation of *client money* balances with external records that the *FCA* believes is adequate is when a *firm* compares:~~

~~(1) the balance on each *client bank account* as recorded by the *firm* with the balance on that account as set out on the statement or other form of confirmation issued by the bank with which those accounts are held; and~~

~~(2) the balance, currency by currency, on each *client transaction account* as recorded by the *firm*, with the balance on that account as set out in the statement or other form of confirmation issued by the *person* with whom the account is held;~~

~~and identifies any discrepancies between them.~~ [deleted]

7.6.11A R An *external client money reconciliation* requires a *firm* to compare:

(1) the balance, currency by currency, on each *client bank account* as recorded by the *firm*, with the balance on that account as set out on the statement or other form of confirmation issued by the bank with which those accounts are held; and

(2) the balance, currency by currency, on each *client transaction account* as recorded by the *firm*, with the balance on that account as set out in the statement or other form of confirmation issued by the *person* with whom the account is held;

and identify and resolve any discrepancies between them under *CASS* 7.6.14R and *CASS* 7.6.15R.

7.6.12 R ~~Any *approved collateral* held in accordance with the *client money rules* must be included in within this reconciliation.~~ [deleted]

7.6.12A R A *firm* must ensure it includes the following items within its *external client money reconciliation*:

(1) any *client approved collateral* a *firm* holds which secures an individual negative *client equity balance* (see *CASS* 7.6A.30R);

(2) any of its own *approved collateral* a *firm* holds which is used to meet the total *margin transaction requirement* in *CASS* 7.6A.31R; and

(3) any *units* in a *qualifying money market fund* a *firm* holds under *CASS* 7.4.1R(4).

Reconciliation differences and discrepancies

7.6.13 R When ~~any discrepancy~~ a difference arises between a *firm's client money resource* and its *client money requirement* as a result of a *firm's* ~~internal reconciliations~~ *internal client money reconciliations*, the *firm* must identify the reason for the ~~discrepancy~~ difference and ensure that:

…

(2) any excess is withdrawn from a *client bank account* within the same time period ~~(but see *CASS* 7.4.20G and *CASS* 7.4.21R)~~.

7.6.14 R When any discrepancy arises as a result of ~~the reconciliation between a *firm's* internal records and those of third parties that hold *client money*~~, an *external client money reconciliation*, the *firm* must identify the reason for the discrepancy and correct it as soon as possible, 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*.

7.6.15 R While a *firm* is unable to resolve a ~~difference~~ discrepancy arising from ~~a reconciliation between a *firm's* internal records and those of third parties that hold *client money*~~ *an external client money reconciliation*, and one record or a set of records examined by the *firm* during its ~~reconciliation~~ *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 in fact the case, the *firm* must assume, until the matter is finally resolved, that the record or set of records is accurate and pay its own *money* into a relevant account.

Notification requirements

7.6.16 R A *firm* must inform the *FCA* in writing without delay if:

(1) ~~if it has not complied with, or is unable, in any material respect,~~ its *client money* records 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* 7.6.1R, *CASS* 7.6.2R or ~~*CASS* 7.6.9R~~ *CASS* 7.6.3AR;

(2) ~~if~~ after having carried out ~~a reconciliation it has not complied with, or is unable, in any material respect,~~ an *internal client money*

*reconciliation* it will be unable 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* 7.6.13R to *CASS* 7.6.15R~~.~~;

(3) having carried out an *internal client money reconciliation* it 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* 7.6.13R;

(4) after having carried out an *external client money reconciliation* it will be unable to identify and correct any discrepancies under *CASS* 7.6.14R to *CASS* 7.6.15R;

(5) having carried out an *external client money reconciliation* it materially fails to identify or correct any discrepancies under *CASS* 7.6.14R to *CASS* 7.6.15R;

(6) it will be unable to or materially fails to conduct an *internal client money reconciliation* in compliance with *CASS* 7.6.6AR and *CASS* 7.6.6CR;

(7) it will be unable to or materially fails to conduct an *external client money reconciliation* in compliance with *CASS* 7.6.9R to *CASS* 7.6.12R; and

(8) 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*.

~~Audit~~ Annual audit of compliance with the ~~MiFID~~ *client money rules*

…

7.6.18 G ~~*Firms* that do not adopt the 'normal alternative approach' to segregating *client money* are reminded that the *firm's* auditor must confirm to the *FCA* in writing that the *firm* has in place systems and controls which are adequate to enable it to operate the 'alternative approach' (see *CASS* 7.4.15R).~~ [deleted]

7.6.19 G ~~*Firms* that do not use the *standard method of internal client money reconciliation* are reminded that the *firm's* auditor must confirm to the *FCA* in writing that the *firm* has in place systems and controls which are adequate to enable it to use another method effectively (see *CASS* 7.6.8 R).~~ [deleted]

After CASS 7.6 insert the following new chapter. The text is not underlined.

## 7.6A The standard methods of internal client money reconciliation

7.6A.1 G *Firms* are required to carry out an *internal client money reconciliation* each *business day* (*CASS* 7.6.6AR and *CASS* 7.6.6CR). This chapter sets out the methods of reconciliation that the *FCA* believes are appropriate for these purposes (the *standard methods of internal client money reconciliation*).

7.6A.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 chapter.

(2) Where a *firm* uses a *non-standard method of internal client money reconciliation* it is reminded that it must also comply with the requirements in *CASS* 7.6.6ER.

7.6A.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 at any time and without delay it can calculate the total amount of *client money* it should be holding for each *client* (see *CASS* 7.6.3AR).

7.6A.4 G *Firms* are reminded that the *internal client money reconciliation* should achieve the purposes set out at *CASS* 7.6.6BG.

7.6A.5 R A *firm* must, unless it has adopted the alternative approach to segregating *client money* (see *CASS* 7.4.17BR and *CASS* 7.6A.7R) use the methods in this chapter or, if using a *non-standard method of internal client money reconciliation* that method, to check whether its *client money resource,* as at the close of business on the previous *business day*, was at least equal to its *client money requirement* at the close of business on that previous day.

7.6A.6 G All *firms*, unless they have adopted the alternative approach to segregating *client money* (see *CASS* 7.4.17BR and *CASS* 7.6A.7R), are reminded that they are required to receive all *client money* receipts directly into a *client bank account* (see *CASS* 7.4.1AR). A *firm* will be using the methods in this chapter or, if using a *non-standard method of internal client money reconciliation*, that method, to check that it has correctly segregated *client money* in its *client bank accounts*.

7.6A.7 R A *firm* that adopts the alternative approach to segregating *client money* (see *CASS* 7.4.17BR) must use the methods in this chapter or, if using a *non-standard method of internal client money reconciliation* that method, to ensure that its *client money resource* as at the close of business on that *business day* is at least equal to its *client money requirement* at the close of business on the previous *business day*.

7.6A.8 G A *firm* that adopts the 'alternative approach' to segregating *client money* will be using the methods in this chapter to calculate how much *money* it either needs to withdraw from, or place in, *client bank accounts* as a result of any difference arising between its *client money requirement* and its *client money resource* at the close of business on the previous *business day*.

7.6A.9 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).

7.6A.10 G (1) 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* under *CASS* 7.4.1AR (for example into a *client bank account*) and no later than on the *business day* after it receives the *money* (see *CASS* 7.4.22CR). Once deposited into a *client bank account*, that receipt of *client money* should form part of the *firm's client money resource* (see *CASS* 7.6A.11R) and the obligation arising from the receipt should be recorded as forming part of the *firm's client money requirement* (compare *CASS* 7.6A.24R(4) (receipts not yet deposited into a *client bank account*)).

(2) However, a *firm* is reminded that it must not carry on any *designed investment business* for a *client* using *client money* that it has received until that *money*, in whatever form it was paid to the *firm*, has been cleared into a *client bank account* (see *CASS* 7.4.22AR).

Client money resource

7.6A.11 R The *client money resource* is the aggregate balance on the *firm's client bank accounts*.

Client money requirement

7.6A.12 G 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*.

7.6A.13 R Subject to *CASS* 7.6A.14R, the *client money requirement* must be calculated by one of two methods:

(1) the *individual client balance method* (*CASS* 7.6A.16R); or

(2) the *negative add-back method* (*CASS* 7.6A.17R).

7.6A.14 R The following types of *firms* must not use the *negative add-back method*:

(1) a *firm* which undertakes *margined transactions* for, or on behalf of, *clients*;

(2) a *firm* which is not an *investment management firm*.

7.6.14A G *Firms* in *CASS* 7.6A.14R are not prevented from adopting a *negative add-back method* as part of a *non-standard method of internal client money reconciliation*.

7.6A.15 R If a *firm* places *client money* in a *qualifying money market fund* under *CASS* 7.4.1R(4) it must, after calculating its *client money requirement* in line with this chapter, reduce its *client money requirement* by the value of the units it holds in *qualifying money market funds* as based on its records at the close of business on the previous *business day*.

Client money requirement calculation: Individual client balance method

7.6A.16 R Under this method, the *client money requirement* (subject to *CASS* 7.6A.24R and *CASS* 7.6A.35R) must be calculated by taking the sum of, for all *clients*:

(1) the *individual client balances* calculated under *CASS* 7.6A.21R, excluding:

(a) *individual client balances* which are negative (ie, debtors); and

(b) *clients' equity balances*;

(2) the total *margined transaction requirement* (calculated under *CASS* 7.6A.30R); and

(3) any amounts segregated under *CASS* 7.4.21R (Prudent segregation) and/or *CASS* 7.4.17BR (Alternative approach buffer).

Client money requirement calculation: Negative add-back method

7.6A.17 R Under this method, the *client money requirement* (subject to *CASS* 7.6A.24R) must be calculated by taking the sum of:

(1) for each *client bank account*:

(a) the amount which the *firm's* records show as held on that account; and

(b) an amount that offsets each negative net amount which the *firm's* records show attributed to that account for an individual *client*; and

(2) any amounts segregated under *CASS* 7.4.21R (Prudent segregation) and/or *CASS* 7.4.17BR (Alternative approach buffer).

7.6A.18 G A *firm* which utilises the *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 and without delay, the *firm* is able to determine the amount of *client money* it should be holding for each *client* (see *CASS* 7.6.3AR).

7.6A.19 G A *firm* which utilises the *negative add-back method* may calculate its *client money requirement* and *client money resource* on a bank account by bank account basis.

Non-margined transactions (eg securities): Individual client balance

7.6A.20 G The *individual client balance* for each *client* should represent the total amount of *client money* a *firm* is required under the *client money rules* to segregate in a *client bank account* for *non-margined transactions*.

7.6A.21 R A *firm* must calculate a *client's individual client balance* in a way which captures the total balance of all *money* the *firm* should be holding as *client money* in a *client bank account* for that *client* in respect of *non-margined transactions*.

7.6A.22 E (1) The *individual client balance* for each *client* should be calculated in accordance with this table:

| Individual client balance calculation | | | | |
|---|---|---|---|---|
| | Free *money* and | | | A |
| | sale proceeds due to the *client*: | | | |
| | (a) | for *principal deals* when the *client* has delivered the *designated investments*; and | | B |
| | (b) | for agency *deals*, when either: | | |
| | | (i) | the sale proceeds have been received by the *firm* and the *client* has delivered the *designated investments*; or | C1 |
| | | (ii) | the *firm* holds the *designated investments* for the *client*; and | C2 |
| | the cost of purchases: | | | |
| | (c) | for *principal deals*, paid for by the *client* but the *firm* has not delivered the *designated investments* to the client; and | | D |
| | (d) | for agency *deals*, paid for by the *client* when either: | | |
| | | (i) | the *firm* has not remitted the *money* to, or to the order of, the counterparty; or | E1 |
| | | (ii) | the *designated investments* have been received by the *firm* but have not been delivered to the *client*; | E2 |
| Less | | | | |
| | *money* owed by the *client* for unpaid purchases by or | | | F |

| | | |
|---|---|---|
| | for the *client* if delivery of those *designated investments* has been made to the *client*; and | |
| | proceeds remitted to the *client* for sales transactions by or for the *client* if the *client* has not delivered the *designated investments*. | G |
| *Individual client balance* 'X' = (A+B+C1+C2+D+E1+E2)-F-G | | X |

(2) When calculating an *individual client balance*, a *firm* must:

(a) ensure it includes:

(i) *client money* consisting of dividends received and interest earned and allocated (see *CASS* 7.2.14A);

(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); and

(iii) *client money* the *firm* segregates to meet an unresolved *shortfall* it identifies during a custody reconciliation and/or records check under *CASS* 6.5.10BR which is attributable to an individual *client*; and

(b) deduct any amounts owed by the *client* which are due and payable to the *firm* (see *CASS* 7.2.9R).

(3) Compliance with (1) and (2) may be relied on as tending to establish compliance with *CASS* 7.6A.21R.

7.6A.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 contractual entitled to receive or contractually obligated to pay.

Other requirements for calculating the client money requirement

7.6A.24 R In determining the *client money requirement* under either of the methods in *CASS* 7.6A.13R, a *firm* must:

(1) take into account any *client money* arising from *CASS* 7.6.13R (Reconciliation differences and discrepancies); and

(2) include any unallocated *client money* (see *CASS* 7.4.28AR) and unidentified receipts of *money* it considers prudent to segregate as *client money* under *CASS* 7.4.28BR;

(3) include any *client money* the firm segregates to meet an unresolved shortfall it identifies during a custody reconciliation and/or records check under *CASS* 6.5.10BR which is not attributable or cannot be

attributed to an individual *client*;

(4) exclude any *client money* received as cash, cheques or payment orders but not yet deposited into a *client bank account* under *CASS* 7.4.2CR; and

(5) if it has drawn any cheques, or other payable orders, to discharge its fiduciary duty to its *clients*, 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 (subject to *CASS* 7.6A.25G).

7.6A.25 G *Firms* are reminded that under *CASS* 7.4.22CR and *CASS* 7.6.5DR, they 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 accounts and records, even though the sums represented do not form part of the *firm's client money requirement*.

Margined transactions (eg derivatives): Equity balances

7.6A.26 R A *client's equity balance* is the amount which a *firm* would be liable to pay to the *client* (or the *client* to the *firm*) 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.

7.6A.27 R A *firm's equity balance*, whether with an exchange, c*learing house*, *intermediate broker* or *OTC* counterparty, 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 the *firm's clients* 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 the exchange, *clearing house*, *intermediate broker* or *OTC* counterparty were closed.

7.6A.28 G *Firms* are reminded that the '*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 *margined transaction*.

Margined transactions (eg derivatives): margined transaction requirement

7.6A.29 G The *margined 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 *margined transactions*. The calculation in *CASS* 7.6A.30R 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 held at exchanges, *clearing houses*, *intermediate brokers* and *OTC* counterparties for *margined transactions* and the amount due to *clients* for those same *margined transactions*. With this calculation, a *firm's margined transaction requirement* should be sufficient, if positions were unwound, to meet the *firm's* gross liabilities to clients for *margined transactions*.

7.6A.30 R The total *margined 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.

7.6A.31 R (1) To meet the total *margin transaction requirement*, a *firm* may use its own *approved collateral* provided it meets the requirements in (2).

(2) The *firm* must hold the *approved collateral*:

(a) in a way which ensures it is clearly identifiable as separate from the *firm's* own property;

(b) on terms evidenced in writing and specifying when the *approved collateral* is to be realised for the benefit of *clients*;

(c) on terms that ensure that the *approved collateral* will be liquidated on the occurrence of a *primary pooling event* and the proceeds paid into a *client bank account*.

7.6A.32 G Where *CASS* 7.6A.31R applies, the *firm* will, in effect, be reducing the requirement arising from *CASS* 7.6A.16R(2) and, as such, simultaneously reducing its overall *client money requirement* (ie, the amount of money it is required to have segregated in *client bank accounts*).

7.6A.33 R If a *firm's* total *margined transaction requirement* is negative, the *firm* must treat it as zero for the purposes of calculating its *client money requirement*.

LME bond arrangements

7.6A.34 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 balance*s for transactions undertaken on the *LME* on behalf of those US-resident investors from the calculation of the *margined transaction requirement*, to the extent those transactions are provided for by an *LME bond arrangement*.

Reduced client money requirement option

7.6A.35 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* 7.6A.21R for that *client*;

(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* 7.6A.26R) for that *client*.

7.6A.36 G The effect of *CASS* 7.6A.35R 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* 7.6A.21R and *CASS* 7.6A.30R and, by so doing, reduce the amount of money the *firm* is required to segregate in *client bank accounts*.

Amend the following provisions as shown.

**7.7 Statutory trust**

7.7.1 G Section 137B(1) of the ~~Act~~ *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

7.7.2 R ~~A~~ Subject to *CASS* 7.7.3R, for a *trustee firm*, a *firm* receives and holds *client money* as trustee (or in Scotland as agent) on the following terms:

…

7.7.3 R A *trustee firm* which is subject to the *client money rules* by virtue of *CASS* 7.1.1R(4)~~:~~ 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.

## 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 transferred to such *person*;

(2) to ensure that the *client bank account* or *client transaction account* has been opened in the correct form (eg, depending on whether the *client bank account* being opened is 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 liability of the *firm* to such *person* (or *person* connected to such *person*).

~~Banks~~ Client bank account acknowledgment letters

7.8.1 R (1) When (or before) a *firm* opens a *client bank account*, the *firm* must ~~give or have given written notice~~, in accordance with *CASS* 7.8.4R, complete and sign a *client bank account acknowledgement letter* clearly identifying the actual *client bank account(s)* to be opened at that time, and send it to the bank with whom the *client bank account* is to 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* 7.8.6R, a *firm* must not deposit any *client money* 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 and clearly identifies the relevant *client bank account(s)* to be opened at that time.

~~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:~~ When (or before) a *firm* opens a *client transaction account*, the *firm* must, in accordance with *CASS* 7.8.4R, complete and sign a *client transaction account acknowledgement letter* clearly identifying the actual *client transaction account(s)* to be opened at that time and send it to the *person* with whom the *client transaction account* is to be opened, requesting such *person* to acknowledge and agree to the terms of the letter by countersigning it and returning it to the *firm*.

~~(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*.~~ Subject to *CASS* 7.8.6R, a *firm* must not transfer any *client money* into a *client transaction account* unless it has received a duly countersigned *client transaction account acknowledgement letter* from the relevant

*person* that has not been inappropriately redrafted and clearly identifies the relevant *client transaction account(s)* to be opened at that time.

Acknowledgement letters in general

7.8.3 G In drafting *acknowledgement letters* under *CASS* 7.8.1R or *CASS* 7.8.2R a *firm* is required to use the relevant template in *CASS* 7 Annex 2R or *CASS* 7 Annex 3R.

7.8.4 R When completing an *acknowledgment letter* under *CASS* 7.8.1R(1) or *CASS* 7.8.2R(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*.

7.8.5 G *CASS* 7 Annex 4G contains *guidance* on using the template *acknowledgment letters*, including on when and how *firms* should amend the *acknowledgement letter variable text* that is in square brackets.

7.8.6 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*; and/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(2) (as applicable to the *firm*).

(2) Subject to (1), if, on countersigning and returning the *acknowledgement letter* to a *firm*, the relevant *person* has also made amendments to any of the *acknowledgement letter variable text* other than in a way described in (1)(b), the *acknowledgement letter* will be appropriately redrafted for the purposes of *CASS* 7.8.1R(2) or *CASS* 7.8.2R(2) (as applicable to the *firm*) if the *person's* amendments have been specifically agreed with the *firm* and do not cause the *acknowledgement letter* to be inaccurate.

7.8.7 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 by the relevant *person*.

7.8.8 R A *firm* must retain each countersigned *acknowledgement letter* it receives, starting from the date it receives it, and must continue to retain it for a period of five years starting from the date the *client bank account* or *client transaction account* to which the *acknowledgement letter* relates is closed.

7.8.9 G A *firm* should 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* that has been returned to the *firm* was authorised to countersign the letter on behalf of the relevant *person*).

7.8.10 R (1) A *firm* must, periodically (at least annually, and whenever it becomes aware that something referred to in an *acknowledgement letter* has changed) review each of its countersigned *acknowledgement letters* to ensure that they remain accurate and up to date.

(2) Whenever a *firm* finds a countersigned *acknowledgement letter* to be inaccurate or out of date, the *firm* must promptly draw up a new replacement *acknowledgement letter* under *CASS* 7.8.1R or *CASS* 7.8.2R, as applicable, and ensure that the new *acknowledgement letter* is duly countersigned by the relevant *person*.

7.8.11 G A *firm* should update an *acknowledgement letter* when there has been a change in any of the parties' names or addresses or a change in any of the details of the relevant account(s) as set out in the letter.

7.8.12 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 or *CASS* 7.8.2R, as applicable, and ensure that the new *acknowledgement letter* is duly countersigned by the relevant *person* within 20 *business days* of the *firm* sending it to that *person*.

CASS 7 Annex 1G is deleted in its entirety. The deleted text is not shown.

After CASS 7 Annex 1G (deleted) 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***]**, authorised and regulated by the Financial Conduct Authority (Firm Reference Number **[***FRN***]**), ("us", "we" or "our") **[**have opened or will open**] [**and/or**] [**have deposited or will deposit**]** with **[***Name of Bank***]** ("you" or "your"):

**[*Insert the account title[s], the account unique identifier[s] (such as sort code and account number, deposit number, 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**]**").

You acknowledge that you are 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 the Client Bank Account**[**s**]** for the purpose of depositing money on behalf of our clients; and
(c) we hold all money standing to the credit of the Client Bank Account**[**s**]** in our capacity as trustee (or, if relevant, as agent) under the laws applicable to us.

You agree that:

(d) in relation to **[**each of**]** the Client Bank Account**[**s**]** above and in respect of any sum owed to you, or to any third party, on any other account, you do not have any recourse or right against money in the Client Bank Account**[**s**]**, including but not limited to any right to combine the Client Bank Account**[**s**]** with any other account and any right of set-off or counterclaim against money in the Client Bank Account**[**s**]**;
(e) the title of **[**the/each**]** Client Bank Account**[**s**]** is as stated above and sufficiently distinguishes **[**the/each**]** account from 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 Accounts**[**s**]**, 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.

We acknowledge that you are not responsible for ensuring compliance by us with our own obligations, including as trustee (or, if relevant, as agent), in respect of the Client Bank Account**[**s**]**.

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. 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. 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. 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.

This letter shall be governed by the laws of **[**England and Wales/Scotland/Northern Ireland**]** without regard to principles of choice of law.

The courts of **[**England and Wales/Scotland/Northern Ireland**]** shall have 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.

**[***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:

**[***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 client transaction account**[**s**]** which **[***Name of CASS firm***]**, authorised and regulated by the Financial Conduct Authority (Firm Reference Number **[***FRN***]**), ("we" or "our") have opened or will open with **[***Name of Counterparty***]** ("you" or "your"):

***[Insert the account title[s], the account unique identifier[s] (such as sort code and 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**]**").

You acknowledge that you are 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 the Client Transaction Account**[**s**]** for the purpose of placing money on behalf of our clients in connection with carrying out a transaction with or through you; and

(c) we have instructed you to promptly credit to **[**this/these**]** Client Transaction Account**[**s**]** any money you receive in respect of any transaction that we have notified to you as being carried out on behalf of our clients.

You agree that:

(d) all money standing to the credit of the Client Transaction Account**[**s**]** is payable to us in our capacity as trustee (or, if relevant, as agent) under the laws applicable to us**[**, except where you are required to make payment other than to us in accordance with article 48(7) of Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories**]**;

(e) in relation to **[**each of**]** the Client Transaction Account**[**s**]** above and in respect of any sum owed to you, or to any third party, on any other account, you do not have any recourse or right against money credited to the Client Transaction Account**[**s**]**, including but not limited to any right to combine the Client Transaction Account**[**s**]** with any other account (including any firm account) and any right of set-off or counterclaim against money in the Client Transaction Account**[**s**]**; and

(f) the title of **[**the/each**]** Client Transaction Account**[**s**]** is as stated above and sufficiently distinguishes **[**the/each**]** account from any other account containing money that is payable to us in a capacity other than as trustee (or, if relevant, as agent) or is payable to any third party.

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. 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. 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. 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.

This letter shall be governed by the laws of **[**England and Wales/Scotland/Northern Ireland**]** without regard to principles of choice of law.

The courts of **[**England and Wales/Scotland/Northern Ireland**]** shall have 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 Transaction Account**[**s**]** to place any money belonging to our clients with you until you have acknowledged and agreed to the terms of this letter.

**[***Name of CASS Firm***]**

x_____

Authorised Signatory

Print Name:

Title:

ACKNOWLEDGED AND AGREED:

**[***Name of Counterparty***]**

x_____

Authorised Signatory

Print Name:

Title:

Contact Information: **[***Insert signatory's phone number and email address***]**

Date:

## 7 Annex 4G 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 and *CASS* 7 Annex 3R.

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; and

(b) in the context of a *client transaction account acknowledgement letter* (and *CASS* 7 Annex 3R), to the relevant exchange, *clearing house*, *intermediate broker*, *OTC* counterparty or other *person* (as the case may be).

General

3 Under *CASS* 7.8.1R and *CASS* 7.8.2R, *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 place *client money* in the account.

4 Before (or at the same time) a *firm* opens a *client bank account* or *client transaction account*, a *firm* is required to complete, sign and send to the counterparty an *acknowledgement letter* in relation to that account and in the form set out in *CASS* 7 Annex 2R (Client bank account acknowledgment letter template) and *CASS* 7 Annex 3R (Client transaction account acknowledgment letter template), as appropriate.

5 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 required information, in either case as appropriate. The notes below give further guidance on this.

Clear identification of relevant accounts

6 A *firm* is reminded that for each *client bank account* and *client transaction account* it needs to have in place an *acknowledgment letter*. As a result, 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 and *CASS* 7 Annex 3R require that the *acknowledgment letter* include the full title and a 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.

7 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;

(i) the account may continue to be appropriately identified in line with the requirements of *CASS* 7 (for example, '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

(ii) when completing an *acknowledgment letter*, such letter must include both the long and short versions of the account title.

8 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*.

9 In the space provided in the template letters for setting out the account title and a unique identifier 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 [*name of bank*] systems |
|---|---|---|
| [*Investment Firm Client Bank Account*] | [*00-00-00 12345678*] | [INV *FIRM CLIENT A/C*] |
| | | |
| | | |
| | | |

Signature and countersignatures

10 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).

11 Where an *acknowledgment letter* is signed or countersigned electronically, a *firm* should 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 signature or any associated communication.

Completing an acknowledgment letter

12 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.

13 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).

14 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).

15 A *firm* should similarly ensure that no square brackets remain in the text of each *acknowledgement letter* (eg, 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 and *CASS* 7 Annex 3R).

16 A *firm* should complete an *acknowledgement letter* so that no part of the letter can be easily altered (eg, the letter should be signed in ink rather than pencil).

17 In respect of the *acknowledgement letter's* governing law and choice of forum, a *firm* should agree with its counterparty and reflect in the letter that either the laws of England and Wales, Scotland or Northern Ireland, as appropriate, will govern the *acknowledgment letter* and that the courts of that same jurisdiction will have exclusive jurisdiction to settle any disputes arising out of, or in connection with, the *acknowledgment letter*, its subject matter or formation.

Authorised signatories

18 A *firm* is required, under *CASS* 7.8.7R, 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.

19 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.

20 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*.

21 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

22 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 *acknowledgement letter* was signed by the TPA on behalf of the *firm*.

23 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 *acknowledgment letter* continues to be drafted on letter-headed paper belonging to the *firm*.

Designated client bank accounts & designated client fund accounts

24 A *firm* must ensure that each of its *client bank accounts* follows the naming conventions prescribed in *CASS* 7.4 and the *Glossary*. This includes ensuring that *designated client bank accounts* or *designated client funds accounts* include, as appropriate, the terms 'designated' or 'designated fund' in their title.

25 All references to the term "Client Bank Account[s]" in a *client bank account acknowledgment letter* should also be made in either the singular or plural, as appropriate.

Omnibus client accounts & individual client account

26 For use with *client transaction accounts* which are either an *omnibus client account* or an *individual client account*, the term "Client Transaction Account[s]" in the template letter in *CASS* 7 Annex 3R may be replaced with either "Individual Client Account[s]" or "Omnibus Client Account[s]", as appropriate. All references to the account in a *client transaction acknowledgment letter* should also be made in either the singular or plural, as appropriate.

27 The square-bracketed text in clause (d) of the template letter in *CASS* 7 Annex 3R should remain in the letter when the relevant *client transaction account* is maintained at an *authorised central counterparty*.

Money market deposits

28 The *client bank account acknowledgment letter* in *CASS* 7 Annex 2R may be used with money market deposits identified as being *client money*.

29 A *firm* should ensure that *client money* placed in a money market deposit is clearly identified as *client money* (see *CASS* 7.4.11BG).

30 Before a *firm* places *client money* in a money market deposit, it must have a *client bank account acknowledgement letter* in place 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)]**

31 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, for a *firm* operating the 'alternative approach to *client money* segregation, 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 provisions as shown.

## 7A Client money distribution

### 7A.1 Application and purpose

Application

7A.1.1 R ~~This~~ Subject to 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.

7A.1.1B G As a result of *CASS* 7A.1.1R, 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 and/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*.

Purpose

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

(1) a *firm* suffers a *failure*, the *rules* in *CASS* 7A.2 (Primary pooling

events) facilitate the prompt transfer or return of *client money*; and

(2) a third party at which the *firm* holds *client money* suffers *failure*, the *rules* in *CASS* 7A.3 (Secondary pooling events) allocate any loss of *client money* among the *firm's clients*.

7A.1.3 G The *guidance* in *CASS* 7A, Annex 1 explains, in broad outline, how the *rules* in *CASS* 7A.2 may apply in the event of the *failure* of a *firm* subject to the *client money distribution rules*.

## 7A.2 Primary pooling events

Failure of the authorised firm: primary pooling event

7A.2.1 G (1) ~~A *firm* can hold *client money* in a *general client bank account*, a *designated client bank account* or a *designated client fund account*.~~ [deleted]

(2) ~~A *firm* holds all *client money* in *general client bank accounts* for its *clients* as part of a common pool of *money* so those particular *clients* do not have a claim against a specific sum in a specific account; they only have a claim to the *client money* in general.~~ [deleted]

(3) ~~A *firm* holds *client money* in *designated client bank accounts* or *designated client fund accounts* for those *clients* that requested their *client money* be part of a specific pool of *money*, so those particular *clients* do have a claim against a specific sum in a specific account; they do not have a claim to the *client money* in general unless a *primary pooling event* occurs. A *primary pooling event* triggers a notional pooling of all the *client money*, in every type of *client money* account, and the obligation to distribute it.~~ [deleted]

(4) ~~If the *firm* becomes insolvent, and there is (for whatever reason) a *shortfall* in *money* held for a *client* compared with that *client's entitlements*, the available funds will be distributed in accordance with the *client money distribution rules*.~~ [deleted]

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

(1) on the *failure* of the *firm*; or

(2) on the vesting of assets in a *trustee* in accordance with an 'assets *requirement*' imposed under section 55P(1)(b) or (c) (as the case may be) of the *Act* where such a *requirement* is imposed in respect of all *client money* held by the *firm*.~~;~~

(3) ~~on the coming into force of a *requirement* for all *client money* held by the *firm*; or~~ [deleted]

(4) ~~when the *firm* notifies, or is in breach of its duty to notify, the *FCA*, in accordance with *CASS 7.6.16 R* (Notification requirements), that it is unable correctly to identify and allocate in its records all valid claims arising as a result of a *secondary pooling event*.~~ [deleted]

7A.2.3 R ~~*CASS* 7A.2.2R(4) does not apply so long as:~~

~~(1) the *firm* is taking steps, in consultation with the *FCA*, to establish those records; and~~

~~(2) there are reasonable grounds to conclude that the records will be capable of rectification within a reasonable period.~~ [deleted]

7A.2.3A R If both a *primary pooling event* and a *secondary pooling event* occur, the provisions of this section relating to a *primary pooling event* apply.

7A.2.3B R Only the following *client money rules* continue to apply to a *firm* when it suffers a *primary pooling event*:

(1) *CASS* 7.3 (Organisational requirements);

(2) *CASS* 7.6 (Records, accounts and reconciliations);

(3) *CASS* 7.7 (Statutory trust); and

(4) *CASS* 7.8 (Notification and acknowledgement of trust).

7A.2.3C R If a *primary pooling event* occurs in circumstances where the *firm*:

(1) had, before the *primary pooling event*, segregated all or part of its *client money requirement* as *units* in a *qualifying money market fund* under *CASS* 7.4.1R(4), it must immediately liquidate those *units* and place the proceeds in a *client bank account*; and

(2) had, before the *primary pooling event*, reduced its *margined transaction requirement* by utilising *approved collateral* under *CASS* 7.6A.30R, it must immediately liquidate this *approved collateral* and place the proceeds in a *client bank account*.

7A.2.3CA R *CASS* 7A.2.7AR to *CASS* 7A.2.7CR (Client money received by the firm after the failure of the firm) do not apply to the proceeds under *CASS* 7A.2.3CR (1) or (2).

7A.2.3D G The proceeds of the assets realised under *CASS* 7A.2.3CR:

(1) will form part of the notional pool of *client money* (see *CASS* 7A.2.4R (Pooling) and *CASS* 7.2.4UR (Combined client money pool)); and

(2) must be distributed or transferred in line with this chapter.

Pooling ~~and distribution~~

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

(1) subject to (1A), all *client money*: ~~held in a *client bank account* or a *client transaction account* of the *firm* is treated as pooled (forming a notional pool) except for *client money* held in a *client transaction account* that is an *individual client account* or an *omnibus client account* at an *authorised central counterparty*~~;

(a) held in a *client bank account* or a *client transaction account*; and

(b) resulting from the liquidation of *approved collateral* or *units* in a *qualifying money market fund* pursuant to *CASS* 7A.2.3CR;

is treated as pooled, forming the *initial pool*.

(1A) Subject to *CASS* 7A.2.6AR(2), *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 *regulated clearing arrangement* does not form part of the *initial pool*.

(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~~ [deleted]

(2A) any other *client money* held by the *firm*, including *client money* that is identifiable in the *firm*'s own accounts and any *client money* that has not been transferred or distributed from the *initial pool*, is treated as pooled, forming the notional *residual pool*.

(3) ~~if *client money* is remitted directly to the *firm* from an *authorised central counterparty*, then:~~

~~(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);~~

~~(b) subject to (3)(c), any such remittance in respect of a *client transaction account* that is an *omnibus client account* must form part of the notional pool under *CASS* 7A.2.4R(1) and be subject to distribution in accordance with *CASS* 7A.2.4R(2); and~~

~~(c) any such remittance in respect of a *client transaction account* that is an *omnibus client account* must be distributed to the *clients* for whom that *omnibus client account* is held if:~~

(i) no *client money* in excess of the amount recorded in that *omnibus client account* is held by the *firm* as margin in relation to the positions recorded in that *omnibus client account*; and

(ii) the amount of such remittance attributable to each *client* of the *omnibus client account* is readily apparent from information provided to the firm by the *authorised central counterparty*;

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* subject to *CASS* 7.7.2R(4). [deleted]

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

(a) *port client* positions where possible; and

(b) after the completion of the default management process:

(i) return any balance due directly to those *clients* for whom the positions are held, if they are known to the *authorised central counterparty*; or

(ii) remit any balance to the *firm* for the account of its *clients* if the *clients* are not known to the *authorised central counterparty*. [deleted]

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

(a) transfer the positions and assets either to another *clearing member* of the relevant *authorised central counterparty* or to another *firm* willing to act for the *indirect client*; or

(b) liquidate the assets and positions of the *indirect clients* and remit all monies due to the *indirect clients*. [deleted]

(1B) For the avoidance of doubt, 'relevant *clients*' in the case of *CASS 7A.2.4A R (3)(a)* and *(3)(c)* includes a *client* who is also an *indirect client*. [deleted]

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

(3) ~~Remittances received by the *firm* falling within *CASS* 7A.2.4R (3)(a) and *CASS* 7A.2.4R(3)(c) should not be pooled with *client money* held in any *client bank account* operated by the *firm* at the time of the *primary pooling event*. Those remittances should be segregated and promptly distributed to each *client* on whose behalf the remittance was received.~~ [deleted]

(4) ~~For the avoidance of doubt, any *client money* remitted by the *authorised central counterparty* to the *firm* pursuant to *CASS* 7A.2.4R(3) should not be treated as *client money* received after the failure of the *firm* under *CASS* 7A.2.7R.~~ [deleted]

Client money reconciliations of the initial pool after a primary pooling event

7A.2.4B R (1) Subject to *CASS* 7A.2.4CR, where a *firm* holding *client money* suffers a *failure* it must, for *client money* constituting the *initial pool*, promptly repeat its *internal client money reconciliation* and *external client money reconciliation* using the same methodology it used immediately before the *primary pooling event*.

(2) The reconciliations carried out in (1) will:

(a) update the *firm*'s *client money* records up to the point of the *primary pooling event*; and

(b) determine each *client's initial pool entitlement* under *CASS* 7A.2.4GR.

(3) The reconciliations must be repeated, as necessary, to reflect:

(a) any amount paid by an *authorised central counterparty* to a clearing member, other than the *firm*, in connection with a *porting* arrangement under *CASS* 7.2.15R(6) for that *client*;

(b) any amount paid by an *authorised central counterparty* directly to that *client* under *CASS* 7.2.15R(7);

(c) any amount that must be distributed to that *client* by the *firm* under *CASS* 7A.2.6AR(1) or (3).

7A.2.4C R The *firm* is not required to comply with *CASS* 7.6.13R to *CASS* 7.6.15R (Reconciliation issues) after it performs the *client money* reconciliations in *CASS* 7A.2.4BR(1).

7A.2.4D R The valuation of a *clients'* position for the purposes of determining their *initial pool entitlement* will be:

(1) the final liquidation values in the case of *margined transactions* where *client money* was held in a *client transaction account* at a *clearing house* under *CASS* 7.5.2R; or

(2) the value of the positions as at the *primary pooling event* for all other transactions.

7A.2.4E G (1) Under *CASS* 7A.2.4DR(1), *margined transactions* which were undertaken by the *firm* for *clients* through a *clearing house* and which were open at the time of the *primary pooling event* will be valued using final liquidation values for those trades.

(2) Under *CASS* 7A.2.4DR(2), any *margined transactions* not cleared through a *clearing house* will be valued as at the *primary pooling event.*

Entitlements to the initial pool

7A.2.4F R Only *clients* that have an *initial pool entitlement* determined under *CASS* 7A.2.4GR will be eligible for a distribution from the *initial pool*.

7A.2.4G R (1) Subject to (2), a *client's initial pool entitlement* is the sum that the most recently repeated reconciliation carried out under *CASS* 7A.2.4BR records that the *firm* holds for a particular *client*.

(2) Each *client's initial pool entitlement* must be reduced to reflect any sums held for that *client* in a *client transaction account* that is an *individual client account* or an *omnibus client account*.

Transfer of client money to another firm after a primary pooling event

7A.2.4H R (1) Subject to *CASS* 7A.2.4LAR, if after a *primary pooling event*, the *firm* ('Firm A') seeks to transfer all or part of its business to another *firm* ('Firm B') then Firm A may transfer the *initial pool* and any *residual pool* to Firm B where the conditions in *CASS* 7A.2.4IR are met.

(2) If *client money* is transferred under (1), Firm A must comply with the *client* notification requirements in *CASS* 7A.2.4JR.

7A.2.4I R The conditions in *CASS* 7A.2.4HR(1) are:

(1) the decision to transfer is made within 15*business days* of the occurrence of the *primary pooling event*; and

(2) subject to *CASS* 7A.2.4LAR, the amount transferred constitutes the entirety of the *initial pool* and any *residual pool* held by the *firm.*

7A.2.4J R The *client* notification requirements in *CASS* 7A.2.4HR(2) are that Firm A requires Firm B to undertake to notify to each *client* entitled to *client money* which is transferred within 7 *days* of the transfer:

(1) the applicable regulatory regime under which the *client money* will be held;

(2) the relevant compensation scheme limits that are applicable for the transferred funds; and

(3) that the *client* has the option of having its *client money* returned to it by the transferee, otherwise the transferee will conduct relevant business for the *client* and hold its *client money* in connection with that business.

7A.2.4K R Provided the undertaking in *CASS* 7A.2.4JR is made, *client money* transferred under *CASS* 7A.2.4HR(1) ceases to be *client money* of Firm A.

7A.2.4L R Firm A must comply with *CASS* 7A.2.4WR to *CASS* 7A.2.4ZAR as if a reference to:

(1) the *combined pool* is to the *initial pool* and any *residual pool*; and

(2) the *combined pool entitlement* is to the *transfer entitlement*.

7A.2.4LA R The amounts transferred under *CASS* 7A.2.4HR(1) must not exceed the total of all *transfer entitlements*.

7A.2.4M R A transfer in line with *CASS* 7A.2.4HR(1) must take place as soon as reasonably practicable following a *primary pooling event*.

7A.2.4N R Firm B must keep a record of the undertaking referred to in *CASS* 7A.2.4HR(1) for a period of five years.

Distribution of the initial pool

7A.2.4O R Where there is no transfer of *client money* under *CASS* 7A.2.4HR(1):

(1) the *firm* must distribute the *initial pool* so that:

(a) each *client* receives; or

(b) a third party receives on behalf of the *client*;

a sum which is rateable to its *initial pool entitlement* calculated under *CASS* 7A.2.4GR;

(2) the *firm* must distribute from the *initial pool* promptly, prudently provisioning, if relevant, as a result of *CASS* 7A.2.6AR(2) and *CASS* 7A.2.4DR(1);

(3) in considering whether to distribute to a *client* or to a third party in line with (1)(a) or (1)(a), the *firm* must have regard to any applicable legislation;

(4) after all *initial pool entitlements* determined under *CASS* 7A.2.4GR have been allocated, any sums remaining in the *initial pool* must form or form part of the *residual pool*;

(5) the *firm* should not carry out a claims process to verify *clients' entitlement* to the *initial pool*.

Distribution of the residual pool

7A.2.4P R The *firm* must distribute any sums constituting the notional *residual pool* in line with *CASS* 7.7.2R, so that:

(1) each *client* receives; or

(2) a third party receives on behalf of the *client*;

a sum which is rateable to its *residual pool entitlement* determined under the process established in *CASS* 7A.2.4RR.

7A.2.4Q R In considering whether to distribute under *CASS* 7A.2.4PR(1) or (2), the *firm* must have regard to any applicable legislation.

7A.2.4R R (1) Having regard to any applicable insolvency law procedures, the *firm* must set up a process by which *clients* may:

(a) establish a *residual pool entitlement*; and

(b) make claims on the *residual pool* on the basis of this entitlement.

(2) A *residual pool entitlement* may only be established in line with the claims process in (1).

7A.2.4S G The *FCA* would expect the following sorts of claims to be made in line with the process in *CASS* 7A.2.4RR:

(1) from a *client* that claims it should have received *client money* protection under *CASS* 7 but was not eligible for a distribution under *CASS* 7A.2.4GR (Entitlements to the initial pool)); or

(2) from a *client* that was eligible to claim under *CASS* 7A.2.4GR but who did not receive its full *initial pool entitlement* due to a *shortfall* in the *initial pool*.

7A.2.4T R *Clients* who were eligible for a distribution from the *initial pool* will not be permitted to claim on the residual pool for any *shortfall* in the amount of that distribution unless they establish a *residual pool entitlement* under *CASS* 7A.2.4RR.

Combined client money pool

7A.2.4U R The *initial pool* (and any *residual pool*) forms a notional single *combined pool* if:

(1) the *firm* cannot perform reconciliations under *CASS* 7A.2.4BR

because of a systems failure; or

(2) the difference between the amount the reconciliation carried out under *CASS* 7A.2.4BR produces and the amount the *firm* actually segregated in *client bank accounts* immediately prior to the occurrence of the *primary pooling event* is more than 10%; or

(3) the *firm* cannot reasonably determine *initial pool entitlements* on the basis of the reconciliation carried out under *CASS* 7A.2.4BR.

7A.2.4V E (1) The *firm* is unlikely to be able to reasonably determine *initial pool entitlements* if the *firm* had not carried out any form of reconciliation in compliance (or purported compliance) with *CASS* 7.6.6R and *CASS* 7.6.9R for at least five *business days* prior to the occurrence of a *primary pooling event*.

(2) Compliance with (1) may be relied upon as tending to establish compliance with *CASS* 7A.2.4UR(3).

(3) Contravention of (1) may be relied upon as tending to establish contravention of *CASS* 7A.2.4UR(3).

Reconciliation of the combined pool

7A.2.4W R Promptly following the formation of the notional *combined pool*, the *firm* must carry out an *internal client money reconciliation* and an *external client money reconciliation* under *CASS* 7.6 (Records, accounts and reconciliations).

7A.2.4X R (1) Under *CASS* 7A.2.4WR, the *firm* is not required to use the same reconciliation methodology used by it prior to the occurrence of the *primary pooling event*.

(2) The purposes of the reconciliations carried out under *CASS* 7A.2.4WR are:

(a) to update the *firm*'s *client money* records to the point of the *primary pooling event*; and

(b) to determine each *client's combined pool entitlement* under *CASS* 7A.2.4YR(1).

(3) Subsequently, the reconciliation may need to be repeated to reflect amounts of client money that:

(a) are paid by an *authorised central counterparty* to a clearing member other than the *firm* in connection with a *porting* arrangement under *CASS* 7.2.15R(6) for that *client*;

(b) are paid by an *authorised central counterparty* directly to that *client*, under *CASS* 7.2.15R(7); and

(c) are paid by a *clearing member* to another *clearing member* or *firm* (other than the *firm*) in connection with a transfer in line with *CASS* 7.2.15R(8);

(d) are paid by a *clearing member* directly to an *indirect client* in line with *CASS* 7.2.15R(9);

(e) must be distributed to that *client* by the *firm* under *CASS* 7A.2.6AR(1) or (3).

7A.2.4Y R The valuation of a *client's* position for the purposes of determining their *combined pool entitlement* will be:

(1) the final liquidation values for *margined transactions* where *client money* was held in a *client transaction account* at a *clearing house* under *CASS* 7.5.2R; or

(2) the value of the positions as at the *primary pooling event* for all other transactions.

7A.2.4Z G (1) Under *CASS* 7A.2.4YR(1), *margined transactions* which were undertaken by the *firm* for *clients* through a *clearing house* and which were open at the time of the *primary pooling event* will be valued using final liquidation values for those trades.

(2) Under *CASS* 7A.2.4YR(2), any *margined transactions* not cleared through a *clearing house* will be valued as at the *primary pooling event.*

Entitlement to the combined pool

7A.2.4ZA R (1) Subject to (2), the *combined pool entitlement* is the amount of *client money* that the *firm* should have been holding for a particular *client* according to the most recently repeated reconciliation carried out under *CASS* 7A.2.XR.

(2) Each *client's initial pool entitlement* must be reduced to reflect any sums held for that *client* in a *client transaction account* that is an *individual client account* or an *omnibus client account*.

Distribution of the combined client money pool

7A.2.4ZB R The *firm* must distribute any sums constituting the *combined client money pool* under *CASS* 7.7.2R, so that:

(1) each *client* receives; or

(2) a third party receives on behalf of the client;

a sum which is rateable to its *client money* entitlement determined under *CASS* 7A.2.4ZDR.

7A.2.4ZC R In considering whether to distribute in line with *CASS* 7A.2.4ZB(1) or (2), the *firm* must have regard to any application legislation.

7A.2.4ZD (R) (1) Having regard to any applicable insolvency law procedures, the *firm* must set up a process by which *clients* may:

(a) establish a *combined pool entitlement*; and

(b) make claims on the basis of this entitlement.

(2) A *combined pool entitlement* may only be established in line with the claims process referred to in (1).

7A.2.5 R (-1) ~~Each *client's client equity balance* must be reduced by:~~

~~(a) any amount paid by:~~

~~(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) 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 line with *CASS* 7.2.15R(8);~~

~~(b) any amount paid by:~~

~~(i) an *authorised central counterparty* directly to that *client*, in accordance with *CASS* 7.2.15R(7); and~~

~~(ii) a *clearing member* directly to an *indirect client* in line with *CASS* 7.2.15R(9); and~~

~~(c) any amount that must be distributed to that *client* by the *firm* in accordance with CASS 7A.2.4R(3)(a) or (c).~~ [deleted]

(1) ~~When, in respect of a *client*, there is a positive individual *client* balance and a negative *client equity balance*, the credit must be offset against the debit reducing the individual *client* balance for that *client*.~~ [deleted]

(2) ~~When, in respect of a *client*, there is a negative individual *client* balance and a positive *client equity balance*, the credit must be offset against the debit reducing the *client equity balance* for that *client*.~~ [deleted]

…

Distribution of remittance from a client transaction account at an authorised central counterparty

7A.2.6A R If *client money* has not formed part of the *notional client money pool* under *CASS* 7A.2.4R(1A) and is remitted directly to the *firm* from an *authorised central counterparty*, then:

(1) any such remittance for a *client transaction account* that is an *individual client account* must be distributed to the relevant *client*, subject to *CASS* 7.7.2R(4);

(2) subject to (3)(c), any such remittance for a *client transaction account* that is an *omnibus client account* must form part of the relevant *notional pool* under *CASS* 7A.2.4R (1) or *CASS* 7A.2.4KR, and be subject to distribution in line with relevant distribution *rules* for that *notional pool*; and

(3) any such remittance for a *client transaction account* that is an *omnibus client account* must be distributed to the *clients* for whom that *omnibus client account* is held if:

(a) no *client money* in excess of the amount recorded in that *omnibus client account* is held by the *firm* as margin for the positions recorded in that *omnibus client account*; and

(b) the amount of such remittance attributable to each *client* of the *omnibus client account* is readily apparent from information provided to the *firm* by the *authorised central counterparty*, in which case the amount of such remittance must be distributed to each such *client* in line with the information provided by the *authorised central counterparty* subject to *CASS* 7.7.2R(4).

7A.2.6B G (1) Under *EMIR*, where a *firm* that is a clearing member of an *authorised central counterparty* defaults, the *authorised central counterparty* may:

(a) *port client* positions where possible; and

(b) after the completion of the default management process:

(i) return any balance due directly to those *clients* for whom the positions are held, if they are known to the *authorised central counterparty*; or

(ii) remit any balance to the *firm* for the account of its *clients* if the *clients* are not known to the *authorised central counterparty*.

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

(a) transfer the positions and assets to another *clearing member* of the relevant *authorised central counterparty* or another *firm* willing to act for the *indirect client*; or

(b) liquidate the assets and positions of the *indirect clients* and remit all monies due to the *indirect clients*.

(1B) 'Relevant *clients*' in *CASS* 7A.2.4AR(3)(a) and (3)(c) includes a *client* who is also an *indirect client*.

(2) Where any balance remitted from an *authorised central counterparty* to a *firm* is *client money*, *CASS* 7A.2.6AR(3) provides for the distribution of remittances from either an *individual client account* or an *omnibus client account*.

(3) Remittances received by the *firm* under *CASS* 7A.2.6AR(1) and *CASS* 7A.2.6AR(3) should not be pooled with *client money* held in any *client bank account* operated by the *firm* at the time of the *primary pooling event*. Those remittances should be segregated and promptly distributed to each *client* on whose behalf the remittance was received.

(4) For the avoidance of doubt, any *client money* remitted by the *authorised central counterparty* to the *firm* under *CASS* 7A.2.6AR should not be treated as *client money* received after the failure of the *firm* under *CASS* 7A.2.7R .

Interest on client money following a primary pooling event

7A.2.6C R Any interest earned on *client money* following a *primary pooling event* must be used to reduce any *shortfall* (including any *shortfall* caused by the deduction of reasonable costs under *CASS* 7.7.2R(4)).

Currencies

7A.2.6CA R (1) Sums compromising a *notional pool* must be converted to the most common currency in the relevant *notional pool*.

(2) The rate of any currency conversion in (1) should be the relevant currency value on the *day* of the *primary pooling event*.

Allocated but unclaimed client money balances on a primary pooling event

7A.2.6D R A *firm* may use any unclaimed *client money* arising from an unclaimed *client money* entitlement to make good any *shortfall* in the *initial pool*, *residual pool* or *combined pool* if it can demonstrate that it has taken reasonable steps to trace the *client* concerned and distribute any balance.

7A.2.6E E (1) Reasonable steps under *CASS* 7A.2.6DR include the following course of conduct:

(a) determining, as far as possible, current contact details for the relevant *client*;

(b) writing to the *client* at his last known address, either by post or by electronic mail, or using other means to inform him of the *firm's* intention to no longer treat the *client money* balance as *client money* and giving the *client* 28 *days* in which to make a claim;

(c) if the *firm* is unable to contact the *client* by post or electronic mail, the *firm* should:

(i) place an advertisement in the local media; and

(ii) attempt to communicate on at least three further occasions with the *client* by any other means;

(d) three months in advance of the final distribution from the relevant *client money* pool, the *firm* must contact the *client* again confirming that it has not received a communication from the *client* and stating that the *firm* will cease to hold a client money entitlement for the client.

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

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

7A.2.6G G *CASS* 7A.2.6DR does not apply where there is a transfer of *client money* under *CASS* 7A.2.4HR (Transfer of client money to another firm after a primary pooling event).

De minimis client money balances after a primary pooling event

7A.2.6H R Provided the conditions in (1) to (4) are met a *firm* may use *client money* to make good any s*hortfall* in the *initial pool*, *residual pool* or *combined pool*:

(1) the balances in question are for sums which are, in aggregate, £10 or less for each *client*;

(2) there has been no movement on the *client's* balance for a period of at least six years (disregarding any payment or receipts of charges, interested 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;

(4) the *firm* makes and/or retains records of all balances released from *client bank* accounts in line with this *rule*.

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

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

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

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

7A.2.7A R (1) *Client money* received by the *firm* after a *primary pooling event* must not be pooled with *money* held in any *client bank account* or *client transaction account* operated by the *firm* at the time of the *primary pooling event*.

(2) *Client money* received by the *firm* after a *primary pooling event* must:

(a) be placed in one or more *client bank accounts* that have been opened after the *primary pooling event*; or

(b) be placed in one or more *client bank accounts* open at the time of the *primary pooling event*, provided such accounts do not also contain any *client money* held by the *firm* prior to the *primary pooling event*;

(c) be handled in line with the *client money rules* in *CASS* 7;

(d) subject to (3), be returned promptly to each relevant *client*.

(3) To the extent that the *client money* received by the *firm* under *CASS* 7A.2.7R(1):

(a) is *client money* relating to a transaction that has not settled at the time of the *primary pooling event,* the *firm* should use that *client money* to settle that transaction;

.(b) is *client money* relating to a *client* for which the *firm* had open *margined transactions* at the time of the *primary pooling event* and those transactions were subsequently closed at a value resulting in the *client* owing *money* to the *firm* for those transactions, the *firm* may retain that *client money* to the value of the amount due to it from that *client* for those *margined transactions*.

7A.2.7B G *Firms* are reminded of their obligation to obtain adequate acknowledgement letters under *CASS* 7.8 whenever they open client bank accounts.

7A.2.7C R The *firm* may retain costs properly attributable to the distribution of *client money* it received after the *primary pooling event*, from that *money*.

7A.2.8 G ~~*Client money* received after the *primary pooling event* relating to an unsettled transaction should be used to settle that transaction. Examples of such transactions include:~~

~~(1) an equity transaction with a trade date before the date of the *primary pooling event* and a settlement date after the date of the *primary pooling event*; or~~

~~(2) a *contingent liability investment* that is 'open' at the time of the *primary pooling event* and is due to settle after the *primary pooling event*.~~ [deleted]

…

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

## 7A.3 Secondary pooling events

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

7A.3.1 R A *secondary pooling event* occurs on the *failure* of a third party to which *client money* held by the *firm* has been transferred under *CASS* 7.4.1R(1) to *CASS* 7.4.1R(3) (Depositing client money) or *CASS* 7.5.2R (~~Transfer of client money to a third party~~ Client money held by a third party).

…

7A.3.3 G When a *firm* places *client money* ~~is transferred to~~ with a third party under *CASS* 7.4 or allows a third party to hold *client money* under *CASS* 7.5, ~~a *firm*~~ it continues to owe fiduciary duties to the *client*. ~~Whether a *firm* is liable for a *shortfall* in *client money* caused by a third party failure will depend on whether it has complied with its duty of care as agent or trustee.~~

~~Failure of a bank~~

7A.3.4 G When a ~~bank~~ third party, as described in *CASS* 7A.3.1R, *fails* and the *firm* decides not to make good the *shortfall* in the amount of *client money* held at that ~~bank~~ third party, in line with *CASS* 7A.3.2R, 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~~ third party in its records of the entitlement of *clients* and of *money* held with third parties it maintains

under *CASS* 7.6 (Records, accounts and reconciliations) and, in particular, *CASS* ~~7.6.3R~~ 7.6.3A.

…

7A.3.5A G On the occurrence of a *secondary pooling event*, *clients* may be eligible to claim compensation from the *FSCS*.

Failure of a bank: pooling

7A.3.6 R If a *secondary pooling event* occurs as a result of the *failure* of a bank where one or more *general client bank accounts* are held and/or where one or more *designated client bank accounts* or *designated client fund accounts* are held, then:

…

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

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, then:~~

~~(1) in relation to every *designated client bank account* held by the *firm* with the *failed* bank, 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, the provisions of *CASS* 7A.3.11R, *CASS* 7A.3.13R and *CASS* 7A.3.14R will apply.~~ [deleted]

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

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

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

(1) any *shortfall* in *client money* held, or which should have been held, in *general client bank accounts* and *client transaction accounts*, that has arisen as a result of the *failure* of the bank, exchange, *clearing house*, *intermediate broker*, *settlement agent* or *OTC* counterparty, must be borne by all the *clients* whose *client money* is held in either a

*general client bank account* or *client transaction account* of the *firm*, rateably in accordance with their entitlements as set out in the *firm's* records maintained under *CASS* 7.6.3A;

(2) a new *client money* entitlement must be calculated for each *client* 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~~ *interests*, calculated in accordance with (2), for the purposes of reconciliations pursuant to *CASS* 7.6.2R (Records and accounts), and where relevant *SYSC* 4.1.1R (General organisational requirements) and *SYSC* 6.1.1R (Compliance).

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

(1) any *money* held in a *client transaction account* that is an *individual client account* at an *authorised central counterparty* is not pooled by the *firm* with all its other *client money* and

(2) a new *client money* entitlement must be calculated for the relevant *client* and reflected in the *firm's* books and records.

7A.3.9 G The term "which should have been held" is a reference to the *failed* ~~bank's~~ third party's failure to hold the *client money* at the time of ~~the pooling event~~ its *failure*.

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

…

…

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

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

(1) must not be transferred to the *failed* ~~bank~~ third party unless specifically instructed by the *client* in order to settle an obligation of that *client* to the *failed* ~~bank~~ third party; and

(2) must be, subject to (1), placed in a ~~separate~~ *client bank account* or *client transaction account*, other than one operated at the *failed* third

party. ~~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*, the provisions of *CASS* 7A.3.17R and *CASS* 7A.3.18R will apply.~~ [deleted]

7A.3.17 R ~~*Money* held in each *general client bank account* and *client transaction account* of the *firm* 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*, 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;~~

~~(3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed intermediate broker*, *settlement agent* or *OTC* counterparty until the *client* is repaid; and~~

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

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

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

~~(1) must not be transferred to the *failed* third party unless specifically instructed by the *client* in order to settle an obligation of that *client* to~~

~~the *failed intermediate broker*, *settlement agent* or *OTC* counterparty; and~~

~~(2) must be, subject to (1), placed in a separate *client bank account* that has been opened after the *secondary pooling event* and either:~~

~~(a) on the written instruction of the *client*, transferred to a third party other than the one that has *failed*; or~~

~~(b) returned to the *client* as soon as possible.~~ [deleted]

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

7A.3.19 R ~~On the *failure* of a third party with which *money* is held, a *firm* must notify the *FCA*:~~

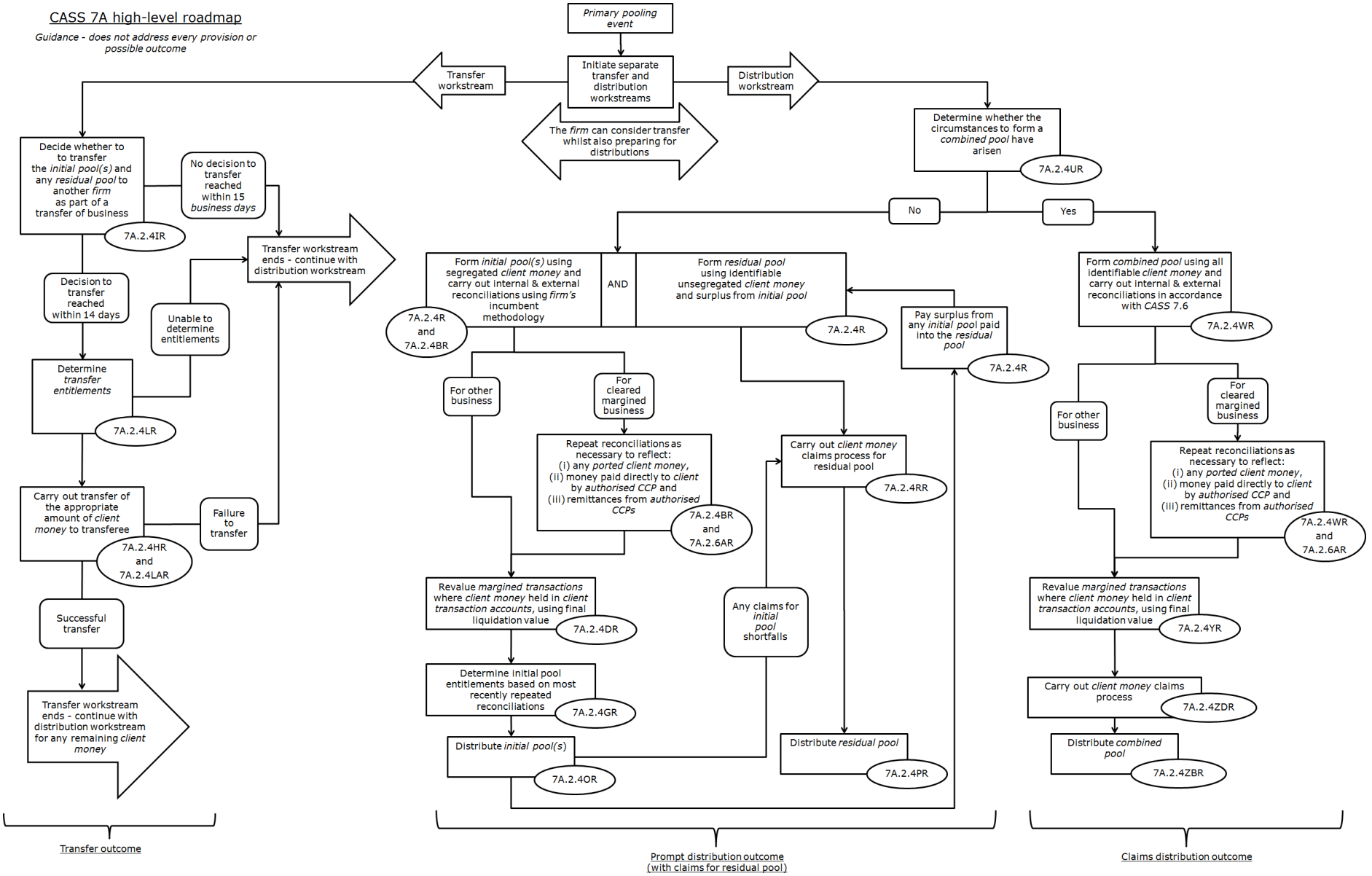
~~(1) as soon as it becomes aware of the *failure* of any bank, *intermediate broker*, *settlement agent*, *OTC* counterparty or other entity with which it has placed, or to which it has passed, *client money*; and~~

~~(2) as soon as reasonably practical, whether it intends to make good any *shortfall* that has arisen or may arise and of the amounts involved.~~ [deleted]

## 7A Annex 1G CASS 7A high-level roadmap

1 The *guidance* in this Annex, in the form of a high-level road map, describes in broad outline how the rules in *CASS* 7A.2 (Primary Pooling Events) may work in the event of the *failure* of a *firm* subject to the *client money distribution rules*.

2 This is a guide only and should not be used as a substitute for legal advice in individual cases.


CASS 7A high-level roadmap
Guidance - does not address every provision or possible outcome
Primary pooling event
Initiate separate transfer and distribution workstreams
Transfer workstream
Distribution workstream
The firm can consider transfer whilst also preparing for distributions
Decide whether to to transfer the initial pool(s) and any residual pool to another firm as part of a transfer of business
7A.2.4IR
No decision to transfer reached within 15 business days
Transfer workstream ends - continue with distribution workstream
Decision to transfer reached within 14 days
Unable to determine entitlements
Determine transfer entitlements
7A.2.4LR
Carry out transfer of the appropriate amount of client money to transferee
7A.2.4HR and 7A.2.4LAR
Failure to transfer
Successful transfer
Transfer workstream ends - continue with distribution workstream for any remaining client money
Transfer outcome
Determine whether the circumstances to form a combined pool have arisen
7A.2.4UR
No
Yes
Form initial pool(s) using segregated client money and carry out internal & external reconciliations using firm's incumbent methodology
7A.2.4R and 7A.2.4BR
AND
Form residual pool using identifiable unsegregated client money and surplus from initial pool
7A.2.4R
Pay surplus from any initial pool paid into the residual pool
7A.2.4R
For other business
For cleared margined business
Repeat reconciliations as necessary to reflect: (i) any ported client money, (ii) money paid directly to client by authorised CCP and (iii) remittances from authorised CCPs
7A.2.4BR and 7A.2.6AR
Carry out client money claims process for residual pool
7A.2.4RR
Revalue margined transactions where client money held in client transaction accounts, using final liquidation value
7A.2.4DR
Any claims for initial pool shortfalls
Determine initial pool entitlements based on most recently repeated reconciliations
7A.2.4GR
Distribute initial pool(s)
7A.2.4OR
Distribute residual pool
7A.2.4PR
Prompt distribution outcome (with claims for residual pool)
Form combined pool using all identifiable client money and carry out internal & external reconciliations in accordance with CASS 7.6
7A.2.4WR
For other business
For cleared margined business
Repeat reconciliations as necessary to reflect: (i) any ported client money, (ii) money paid directly to client by authorised CCP and (iii) remittances from authorised CCPs
7A.2.4WR and 7A.2.6AR
Revalue margined transactions where client money held in client transaction accounts, using final liquidation value
7A.2.4YR
Carry out client money claims process
7A.2.4ZDR
Distribute combined pool
7A.2.4ZBR
Claims distribution outcome

## 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):

…

(2) ~~they are in written form at the time they are obtained from the client;~~ [deleted]

…

~~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 or conferring a certain authority on the *firm*;

(2) a specific provision within a document or agreement that also relates to other matters;

(3) a combination of provisions within a number of documents which together meet the conditions in *CASS* 8.2.1R; and

(4) information retained in the *firm's* systems or records (including information stored electronically, paper records and telephone recordings), having been obtained from the *client* (including 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* retains it (for example by not destroying the relevant document or information):

…

…

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 it is in the form of a paperless direct debit would not in itself 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~~ on the *client's* credit card details.

…

## 8.3 Records and internal controls

…

8.3.2 R The record and *internal controls* required by *CASS* 8.3.1R must include:

…

(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*;

…

8.3.2A G To comply with *CASS* 8.3.2R(1), a *firm* should record each time it acquires a new *mandate,* including any *mandate* that was not received in written form (for example, a *mandate* received orally via the telephone).

…

# 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;

(2) ~~which is a *prime brokerage firm*~~ the remainder of this chapter applies to a *firm* to which:

(a) *CASS* 7 (Client money rules) applies; and/or

(b) *CASS* 6 (Custody rules) applies, but not a *firm* which only *arranges safeguarding and administration of assets*.

…

Insert the following section after *CASS* 9.3. The text is all new and is not underlined.

## 9.4 Reporting to clients

9.4.1 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* 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.

9.4.2 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 *client money*. *Firms* may choose to report to their *clients* more frequently.

9.4.3 R A *firm* must provide a *client* with

(1) statements of *client designated investments* or *client money* in a *durable medium* more frequently than is required under *COBS* 16.4 and, if appropriate, *COBS* 16.3 following a request to that effect made by that *client* or on its behalf;

(2) a copy of any statement of *client designated investments* or *client money* provided to him under *COBS* 16.4 and, if appropriate, *COBS* 16.3 in any *durable medium* within five *business days* following a request to that effect made by that *client* or on its behalf.

(3) A *firm* and a *client* may agree a charge for providing the statements in (1) and (2). Any such charge must reasonably correspond to the *firm's* actual costs.

9.4.4 G Consistent with the *fair, clear and not misleading rule*, a *firm* should ensure that in any statements of *client designated investments* or *client money* provided to its *clients*, it is clear from the statement which assets the *firm* reports as holding for the *client* are, or are not, protected under *CASS* 6 and/or *CASS* 7.

## 9.5 Information to clients concerning custody assets and client money

9.5.1 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 *designated investments* and *client money*.

9.5.2 R A *firm* that holds *client designated investments* must also provide the information in *COBS* 6.1.7R to each of its *clients* and for any *custody assets* the *firm* may hold for them which are not *designated investments*.

9.5.3 G The information requirement in *CASS* 9.5.2R will be for all the *firm's clients*, including a *retail client*, a *professional client* and an *eligible counterparty*.

9.5.4 G (1) *Firms* are reminded of their obligation, under *COBS* 4.1.1R, to be fair, clear and not misleading in their communications with *clients*.

(2) *Firms* are also reminded of the requirements in place for communications made to *retail clients* under *COBS* 4.5.

## 9.6 Client assets disclosure document

9.6.1 R (1) A *firm* must provide to each *client*, before providing services and on at least an annual basis, a *client assets disclosure document*.

(2) The *client assets disclosure document* must set out a summary of the key provisions within the *firm's client* agreements which modify rights or protections which would otherwise be available to the *client* under *CASS* 6 or *CASS* 7, including:

(a) a list of references to the relevant provisions (so that a *client* is able to easily identify the provision in the *client* agreement);

(b) any terms defined in a *client* agreement which a *client* will need to be aware of to understand a relevant provision; and

(c) a statement of the effect the provisions have on the treatment of *custody assets* and *client money,* including on the *failure* of the *firm*.

(3) A *firm* must ensure it promptly sends to the *client* an updated *client assets disclosure document* if the terms of any relevant *client* agreement are amended such that the *client assets disclosure document* last provided to the *client* no longer accurately records the key provisions of that amended agreement.

# CLIENT ASSETS SOURCEBOOK (MULTIPLE POOLS) INSTRUMENT 2013

## 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 (FCA's general rule-making power);
(2) section 137B (FCA's client money rules);
(3) section 137T (General supplementary powers); and
(4) section 139A (FCA's power to make 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 on [*date*].

## Amendments to the Handbook

D. The Glossary of definitions is amended in accordance with Annex A to this instrument.

E. The Client Assets sourcebook (CASS) is amended in accordance with Annex B to this instrument.

## Citation

F. This instrument may be cited as the Client Assets Sourcebook (Multiple Pools) Instrument 2013.

By order of the Board
[*date*]

## Annex A

## Amendments to the Glossary of definitions

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

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

| | |
|---|---|
| *general pool* | a discrete pool of *client money* held for all those *clients* of the *firm* for whom the *firm r*eceives or holds *client money* other than for a *sub-pool*. |
| *pool* | either a *sub-pool* or a *general pool*, as the context requires. |
| *residual pool* | the notional pool of *client money* established under *CASS* 7A.2.4R(2A). |
| *sub-pool* | a discrete pool of *client money* established under *CASS* 7.10. |
| *sub-pool disclosure document* | a document prepared by a *firm* containing the information required by *CASS* 7.10.13R. |

Amend the following as shown.

| | |
|---|---|
| *client money rules* | … |
| | (3) (in *CASS* 3, *CASS* 6, *CASS* 7, *CASS* 7A, *UPRU* and *COBS*) *CASS* 7.1 to 7.8 and 7.10. |
| *individual client account* | as the context requires, either:<br>(i) an a*ccount* maintained by a *firm* at an *authorised central counterparty* for a *client* of the *firm* in respect of which the *authorised central counterparty* has agreed with the *firm* to provide *individual client segregation*.; or<br>(ii) an a*ccount* maintained by a *firm* for an *indirect client* at a *clearing member* of an *authorised central counterparty* for which the *clearing member* has agreed with the *firm* to provide segregation under article 4(2)(b) of the *EMIR L2 Regulation*. |

| | |
|---|---|
| *omnibus client account* | as the context requires, either:<br>(i) an *account* maintained by a *firm* at an *authorised central counterparty* for more than one *client* of the *firm* in respect of which the *authorised central counterparty* has agreed with the *firm* to provide *omnibus client segregation*.; or<br>(ii) an a*ccount* maintained by a *firm* for more than one *indirect client* at a *clearing member* for which that *clearing member* has agreed to provide segregation under article 4(2)(a) of the *EMIR L2 Regulation*. |
| *port* | as the context requires, either:<br>(i) means, in respect of the assets and positions recorded in a *client transaction account* that is an *individual client account* or an *omnibus client account* at an *authorised central counterparty*, action taken by that *authorised central counterparty* to transfer those assets and positions in accordance with article 48 of *EMIR* to another clearing member designated by the individual *client* (in the case of an *individual client account*) or designated by all of the *clients* for whom the account is held (in the case of an *omnibus client account*).; or<br>(ii) for a *sub-pool* created by a *clearing member firm* to segregate *client money* for a specific group of *clients* that wish to clear positions through a net *omnibus client account*, any actions taken under (i) and any action taken by that *firm* to transfer that *client money* in the *sub-pool* that is not held in the *omnibus client account* at the *authorised central counterparty*. |

## Annex B

## Amendments to the Client Assets sourcebook (CASS)

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

[*Editor's note*: This Annex is drafted based on text as incorporated in the Client Assets Sourcebook (Amendment No 4) Instrument 2013, also included within this Consultation Paper.]

### 7 Client money rules

…

### 7.2 Definition of client money

…

Discharge of fiduciary duty

7.2.15 R *Money* ceases to be *client money* (having regard to *CASS* 7.2.17R where applicable) if:

…

(7) it is paid by an *authorised central counterparty* directly to the *client* in accordance with *CASS* 7.2.15BR; or

(8) it is transferred by the *firm* in connection with a *regulated clearing arrangement* and the *clearing member* with whom the *firm* has placed that *client money* remits payment to another *firm* or to another *clearing member* in line with *CASS* 7.2.15CR; or

(9) it is transferred by the *firm* in connection with a *regulated clearing arrangement* and the *clearing member* with whom the *firm* has placed that *client money* remits payment directly to the *indirect clients* of the *firm* in line with *CASS* 7.2.15DR; or

…

7.2.15A R *Client money* ~~received or held by~~ which the *firm* ~~and placed in a *client transaction account* that is an *individual client account* or an *omnibus client account*~~ 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*.

7.2.15B R *Client money* ~~received or held by~~ which the *firm* ~~and placed in a *client transaction account* that is an *individual client account* or an *omnibus client account*~~ 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*.

7.2.15C R *Client money* received or held by the *firm* and transferred to a *clearing member* in connection with a *regulated clearing arrangement* ceases to be *client money* for that *firm* and, if applicable, the *clearing member*, if the *clearing member* remits payment to another *firm* or *clearing member* under article 4(4) of the *EMIR L2 Regulation*.

7.2.15D R *Client money* received or held by the *firm* and transferred to a *clearing member* in connection with a *regulated clearing arrangement* ceases to be *client money* for that *firm* and, if applicable, the *clearing member*, if the *clearing member* remits payment directly to the *indirect clients* of the *firm* under article 4(5) of the *EMIR L2 Regulation*.

7.2.15E 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 part of *porting*.

…

## 7.4 Segregation of client money

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

…

## 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 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'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*:

…

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

7.5.3 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~~ 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*.~~[2] ~~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 G Where a *firm* establishes one or more *sub-pools*, the provisions of *CASS* 7.6 (Records, accounts and reconciliations) shall be construed as being applicable to the *firm's general pool* and each *sub-pool* individually in line with *CASS* 7.10.2R and *CASS* 7.10.3R.

…

## 7.7 Statutory trust

…

7.7.2 R Subject to *CASS* 7.7.3R in respect of a *trustee firm*, ~~A~~ 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 a *general pool* and only a *general pool* of *client money*, subject to (4), for the *clients* (other than *clients* which are *insurance undertakings* when acting as such ~~with~~ in respect of *client money* received in the course of *insurance mediation activity* and that was opted in to this chapter) for whom that *money* is held, according to their respective interests in it;

(b) where a *firm* has established one or more *pools* of *client money*, subject to (4):

(i) the *general pool* is for all the *clients* of the *firm* according to their respective interests (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), for whom the *firm* receives or holds *client money* which is not received or held for a *sub-pool*; and

(ii) each *sub-pool* is for the *clients* of the *firm* (according to their respective interests) who are beneficiaries of the *sub-pool* in question;

…

(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* 7.1.1R(4)~~:~~ 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 section. The text is not underlined.

## 7.10 Client money sub-pools

7.10.1 G (1) Under *CASS* 7.7.2R(2), a *firm* acts as *trustee* (or in Scotland, as agent) 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.

(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 an *omnibus client account* maintained by the *firm* at that *authorised central counterparty*, where that segregation might facilitate the *porting* of *client* positions recorded in that *omnibus client account*. To segregate *client money* (that would otherwise be held in a *general pool*) for a specific group of *clients* clearing positions through a particular *omnibus client account*, a *firm* may, in line with these rules, create a *sub-pool* of *client money*.

(3) Each *sub-pool* and the *general pool* are separate *pools* of *client money*. Upon the occurrence of a *primary pooling event*, the *client money* for:

(a) the *general pool* should be distributed rateably to the *clients* for whom the *firm* receives or holds *client money* in that *general pool* in line with *CASS* 7A; and

(b) a *sub-pool* should either be:

(i) transferred as part of *porting*; or

(ii) where *porting* is not effected, or *porting* of the *sub-pool* is only partially effected, distributed

rateably to the *clients* who are beneficiaries of that *sub-pool* according to their respective interests under *CASS* 7A.2.4OR.

(4) All *client money* is received or held by the *firm* as *trustee* (or in Scotland, as agent) for the *clients* of the *firm*, but a *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 *initial pool* of the *general pool* of *client money* following a *primary pooling event*.

Internal controls

7.10.2 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 each *general pool* and *sub-pool* that it may establish.

Records

7.10.3 R Where a *firm* establishes one or more *sub-pools*, *CASS* 7.6 (Records, accounts and reconciliations) is to be construed as being separately applicable for the *firm's general pool* and each *sub-pool* individually.

7.10.4 G A *firm* that establishes one or more *sub-pools* must establish and maintain adequate internal controls and records in line with *CASS* 7.6 (Records, accounts and reconciliations) to (i) conduct internal and external reconciliations for each *sub-pool* and the *general pool* individually, and (ii) ensure that the firm is able, in line with *CASS* 7.6.3A, at any time and without delay, to determine the total amount of *client money* it should be holding for each *client* beneficiary of each *sub-pool* and of the *general pool* individually.

7.10.5 R (1) The records maintained for a *sub-pool* under *CASS* 7.10.3 must identify all the *client* beneficiaries of that *sub-pool*.

(2) The beneficiaries of each *sub-pool* are those *clients* for whom:

(i) the *firm* maintains, or previously maintained, a *margined transaction* or *margined transactions* in the relevant *omnibus client account* at the *authorised central counterparty* but has not yet settled the amount owing to the *client* for those *margined transactions*; and

(ii) the *firm* has deposited *client money* in a *client bank account* or placed *client money* in a *client transaction account* maintained for the *sub-pool*.

(3) Upon the *failure* of the *firm*, the records are definitive for the

purposes of distributing the *client money* held or received for a *sub-pool*.

7.10.6 R For each *sub-pool* that the *firm* establishes it must maintain a record of:

(i) the particular *omnibus client account* at an *authorised central counterparty* to which the *sub-pool* relates;

(ii) each *client bank account* and each *client transaction account* (other than the *omnibus client account*) maintained for the *sub-pool*, including the unique identifying reference or descriptor under *CASS* 7.10.7R(2); and

(iii) the applicable *sub-pool disclosure document* for the sub-pool.

7.10.7 R The *firm* must maintain an up-to-date list of all the *sub-pools* it has created.

Sub-pool disclosure document

7.10.8 R (1) A *firm* wishing to establish a *sub-pool* must prepare a *sub-pool disclosure document* for each *sub-pool*.

R (2) In preparing a *sub-pool disclosure document* under *CASS* 7.10.8R(1) and *CASS* 7.10.9R(1), a *firm* is required to use the relevant template in *CASS* 7 Annex 4R.

7.10.9 R (1) The *sub-pool disclosure document* for each *sub-pool* must:

(a) identify the *omnibus client account* and *authorised central counterparty* to which the *sub-pool disclosure document* relates;

(b) state that the beneficiaries of the *sub-pool* are, at any time, only those *clients* of the *firm* identified in the records of the *firm* as beneficiaries for that *sub-pool*;

(c) contain a statement to the effect that, in the event of the *failure* of the *firm*, the beneficiaries of that *sub-pool* direct the *firm* to seek to use any *client money* held by the *firm* in the *sub-pool* to facilitate the *porting* of the positions recorded in that *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, the *client* beneficiaries of the *sub-pool* will be entitled to a distribution from the *client money* held for that *sub-pool* according to their respective interests to the extent shown in the records of the *firm*, but no claim on any other *pool*

of *client money* except to the extent that (i) the *client* is a beneficiary of another *pool*, or (ii) the *client* may be able to establish a claim to share in a *residual pool* of *client money* under *CASS* 7A 2.4R(2A), 7A2.4OR(1)(d), 7A2.4RP, 7A2.4UR, or 7A2.4ZAR.

Segregation

7.10.10 R Where a *firm* establishes one or more *sub-pools*, *CASS* 7.4 (Segregation of client money) is to be construed as being separately applicable for the *firm's general pool* and each *sub-pool* individually.

7.10.11 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 *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 *firm* must not transfer *client money* from a *client bank account* maintained for the *general pool* to a *client bank account* maintained for a *sub-pool*, unless the amount of *client money* held for the *general pool* is sufficient, immediately after that transfer, to satisfy the claims of all remaining beneficiaries of the *general pool*.

7.10.12 R Further to the requirements to segregate *client money* under *CASS* 7.4 a *firm* that receives *client money* to be credited in part to one *pool* and in part to another *pool* must:

(1) promptly pay the full sum into a *client bank account* maintained for one of the relevant *pools*; and

(2) pay the *money* that is not *client money* for that *pool* out of the *client bank account* promptly and, in any event, no later than one *business day* after remittance has cleared, into a *client bank account* maintained for the appropriate *pool*.

7.10.13 R Without prejudice to any claim a *client* might establish for *money* in a *residual pool*, 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 another *sub-pool*; or

(2) the *firm* receives or holds *client money* for that *client* for other

business but not for any other *sub-pool* (and thus the *client* is a beneficiary of the *firm's general pool*).

7.10.14 G A *client* for whom a *firm* receives or holds *client money* in more than one *pool* as described in either *CASS* 7.10.13R(1) or (2) may be entitled to a distribution from each *pool*, and each entitlement is separate and distinct .

7.10.15 R Before making a material amendment to the *sub-pool disclosure document*, a *firm* must notify the then current beneficiaries of that *sub-pool* in line with *CASS* **7**.10.21R.

7.10.16 G The *FCA* would normally consider the dissolution of a *sub-pool* such that the *firm* no longer operates a particular *omnibus client account* or a transfer of the business to another *CCP* to be examples of circumstances requiring a material amendment of the *sub-pool disclosure document*.

7.10.17 R A *firm* that wishes to establish a *sub-pool* of *client money* must notify the *FCA* in writing not less than two months prior to the date on which the *firm* intends to receive or hold *client money* for that *sub-pool*.

7.10.18 R If a *firm* wishes to dissolve a *sub-pool* with the effect that a *sub-pool* becomes part of the *firm's general pool*, the *firm* must notify the *FCA* in writing not less than two months prior to the date on which the *firm* intends to merge the *sub-pool* in question with the *general pool*.

7.10.19 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.*

7.10.20 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*;

(b) obtain a written acknowledgement from the *client* that it has received a copy of the applicable *sub-pool disclosure document*; and

(c) obtain the written consent of the *client* to the *firm* receiving and holding that *client's* money in the relevant *sub-pool*.

(2) A *firm* must provide the beneficiary of a *sub-pool* with a copy of the *sub-pool disclosure document* applicable to that *sub-pool* upon the beneficiary's request.

7.10.21 R (1) If a *firm* is required to give notice under *CASS* 7.10.15R (material amendment to sub-pool disclosure document), it must

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

(2) The notification under (1) must:

(a) explain the proposal fully, including, where the proposal is to dissolve a *sub-pool*, an explanation of the risks and consequences for the beneficiaries of that *sub-pool* becoming part of the *general pool*;

(b) state that the *client* will be deemed to have accepted the proposal and the proposal will be carried out by the *firm* if the *client* does not, before the proposed date of implementation of the amendments or the merging of pools, notify the *firm* that it wishes to terminate its *client* relationship with the *firm* for the relevant *pool* in line with (c); and

(c) state that the *client* has the right to terminate its *client* relationship with the *firm* for the relevant *pool*, immediately and without charge, before the proposed date of implementation of the proposals, but subject to settling any loss or gain on any *investments* held by the *firm* on the *client's* behalf to the extent that such *investments* are liquidated as part of terminating that *client* relationship.

7.10.22 R The records maintained under *CASS* 7.10.13R in this chapter and the *sub-pool disclosure documents* are a record of the *firm* that must be kept in a durable medium for a period of not less than five years following the date on which *client money* was last held by the *firm* for a *sub-pool* to which those terms applied.

7.10.23 R A *firm* must inform the *FCA* in writing, without delay, if it has not complied with the requirement to give notice under *CASS* 7.10.15R or has not complied with any of the requirements in *CASS* 7.10.20R.

…

Insert the following Annex after CASS 7 Annex 3R. The text is all new and is not underlined.

**7 Annex 4R Sub-pool disclosure document**

**[***Letterhead of firm, including full name and address of firm, firm reference number and FCA disclosure***]**

**[***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 or other identifier of sub-pool in firm's records*]

   (for the purposes of this document, the "sub-pool")

2. The omnibus client account relating to the sub-pool is held at [*Insert name of authorised CCP*] (the "CCP") and is designated as:

   [*Insert the account title[s], the account unique identifier[s] and (if applicable) any abbreviated name of the account[s] as reflected in the 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 **[***Name of CASS firm***]** in relation to the omnibus client account held by the firm at the "*CCP*";

   (b) obtain your consent to holding your money as part of the sub-pool; and

   (c) confirm your direction that upon the failure of **[***Name of CASS firm***]**, we are to seek to use any client money held by the firm in the sub-pool to facilitate porting.

4. The beneficiaries of the sub-pool are, at any time, only those clients of [*Name of CASS firm*] identified in the records of [*Name of CASS firm*] as beneficiaries of the sub-pool.

5. [*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.

6. In the event of the failure of **[***Name of CASS firm***]**, if porting is not effected, you and the other beneficiaries of the sub-pool will be entitled to a distribution from the client money held in respect of this sub-pool, according to your respective interests to the extent shown in the records of **[***Name of CASS firm***]**. Save to the extent that **[***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 **[***Name of CASS firm***]**. You may, however, be able to establish a claim for client money against **[***Name of CASS firm***]**.

7. In the event of the failure of the [*Name of CASS firm*], you hereby direct the [*Name of CASS firm*] to seek to apply any client money held by the [*Name of CASS firm*] in respect of the sub-pool to facilitate the porting of the positions recorded in omnibus client account.

8. 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*].

9. This letter shall be governed by the laws of [England and Wales/Scotland/Northern Ireland] without regard to principles of choice of law.
10. The courts of [*England and Wales/Scotland/Northern Ireland*] shall have 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.

**[***Name of CASS firm***]**

x_____

Authorised signatory

Print name:

Title:

ACKNOWLEDGED AND AGREED:

**[***Name of client***]**

x_____

Authorised signatory

Print name:

Title:

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

Date:

Amend the following provisions as shown.

## 7A Client money distribution

…

7A.2.3C R (1) If a *primary pooling event* occurs ~~in circumstances where~~ , then, for the *general pool* and each *sub-pool* maintained by the *firm*, if the *firm*:

(1) had, before the *primary pooling event*, segregated all or part of its *client money requirement* as *units* in a *qualifying money market fund* under *CASS* 7.4.1R(4), it must immediately liquidate those *units* and place the proceeds in a *client bank account* for the beneficiaries of the *general pool* or the particular *sub-pool* (as

applicable); and

(2) had, before the *primary pooling event*, reduced its *margined transaction requirement* by utilising *approved collateral* under *CASS* 7.6A.30R, it must immediately liquidate this *approved collateral* and place the proceeds in a *client bank account* for the beneficiaries of the *general pool* or the particular *sub-pool* (as applicable).

7A.2.3D G The proceeds of the assets realised under *CASS* 7A.2.3CR:

(1) will form part of ~~the~~ a single notional *pool* ~~of *client money* (see *CASS* 7A.2.4R(Pooling) and *CASS* 7.2.4UR (Combined client money pool))~~ (where the firm operates only a *general pool*) or more than one notional *pool* (where the firm operates a *general pool* and one or more *sub-pools*) of *client money* (see *CASS* 7A.2.4R); and

…

Pooling ~~and distribution~~

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

(1) Subject to (1A), in respect of the general pool and, if applicable, each sub-pool, all *client money* relating to that pool:

(a) held in a *client bank account* or a *client transaction account*; and

(b) resulting from the liquidation of *approved collateral* or *units* in a *qualifying money market fund* pursuant to *CASS* 7A2.3CR,

is treated as pooled, forming ~~the~~ an *initial pool* for the beneficiaries of the *general pool* and an *initial pool* for the beneficiaries of each particular *sub-pool*.

(1A) Subject to *CASS 7A.2.6AR(2)*, *client money* held in a *client transaction account* that is an *individual client account* or an *omnibus client account* at an *authorised central counterparty* does not form part of ~~the~~ an *initial pool*.

…

(2A) Any other *client money* held by the *firm*, including *client money* that is identifiable in the *firm*'s own accounts and any *client money* that has not been transferred or distributed from ~~the~~

an *initial pool*, is treated as pooled, forming a single notional *residual pool*.

…

…

7A.2.4A G (-1) Where a *firm* has established one or more *sub-pools*, then, following a *primary pooling event*, there will be an *initial pool* corresponding to each *sub-pool* and an *initial pool* corresponding to the *general pool*, but there can be only one residual pool formed of any *client money* that has not been transferred or distributed from an *initial pool.*

…

…

7A.2.4I R The conditions in *CASS* 7A.2.4HR(1) are:

(1) the decision to transfer is made within 15*business days* of the occurrence of the *primary pooling event*; and

(2) subject to *CASS* 7A.2.4LAR, the amount transferred constitutes the entirety of the *initial pool corresponding to the general pool* and any *residual pool* held by the *firm.*

…

7A.2.4O R

Where there is no transfer of *client money* under *CASS* 7A.2.4HR(1):

(1) the *firm* must distribute the *initial pool* in respect of the *general pool* or, if applicable, a *sub-pool* so that:

(a) each *client* who is a beneficiary of that *pool* receives; or

(b) a third party receives on behalf of the *client,*

a sum which is rateable to its *initial pool entitlement* calculated in accordance with *CASS* 7A.2.4GR;

(2) the *firm* must distribute from the *initial pool* corresponding to the *general pool* promptly, prudently provisioning, if relevant, as a result of *CASS* 7A.2.6AR(2) and *CASS* 7A.2.4DR(1);

…

…

Combined client money pool

7A.2.4U R ~~The *initial pool* (and any *residual pool*) forms a notional single *combined pool*~~ A *combined pool* will be formed of one (or more) *initial pools* together with the *residual pool* if:

(1) the *firm* cannot perform reconciliations under *CASS* 7A.2.BR for the *general pool* or the *sub-pool* in question because of a systems failure; or

(2) the difference between the amount the reconciliation carried out under *CASS* 7A.2.4BR produces and the amount the *firm* actually segregated for the relevant *pool* (ie the *general pool* or a *sub-pool*) in *client bank accounts* immediately prior to the occurrence of the *primary pooling event* is more than 10%; or

(3) the *firm* cannot reasonably determine *initial pool entitlements* for the relevant *pool* (ie the *general pool* or a *sub-pool*) on the basis of the reconciliation carried out under *CASS* 7A.2.4BR.

…

Distribution of remittance from a client transaction account at an authorised central counterparty

7A.2.6A R If *client money* has not formed part of the *notional client money pool* under *CASS* 7A.2.4R(1A) and is remitted directly to the *firm* from an *authorised central counterparty*, then:

…

(-2) any such remittance for a *client transaction account* that is an *omnibus client account* in relation to which the *firm* operates a *sub-pool* must be distributed to the relevant *clients* subject to CASS 7.7.2R(4);

(2) subject to (3)(c), any such remittance for a *client transaction*

*account* that is an *omnibus client account* (and for which the *firm* does not operate a *sub-pool*) must form part of the *notional pool* for the *firm's general pool* under *CASS* 7A.2.4R(1) or *CASS* 7A.2.4KR, and be subject to distribution in line with relevant distribution *rules* for that *notional pool*; and

(3) any such remittance for a *client transaction account* that is an *omnibus client account* (and for which the *firm* does not operate a *sub-pool*) must be distributed to the *clients* for whom that *omnibus client account* is held if:

…

…

## 7A.3 Secondary pooling events

…

7A.3.4 G When a third party, as described in *CASS* 7A.3.1R, *fails* and the *firm* decides not to make good the *shortfall* in the amount of *client money* held at that third party, in line with *CASS* 7A.3.2R, a *secondary pooling event* will occur. The *firm* would be expected to reflect the *shortfall* that arises at the *failed* third party in the *general pool* (where the as firm maintains only a *general pool*) or in a particular *sub-pool* (where the firm maintains both a *general pool* and one or more *sub-pools*) in its records of the clients' *client money interests* and of *money* held with third parties it maintains under *CASS* 7.6 (Records, accounts and reconciliations) and, in particular, *CASS* 7.6.3R.

…

Failure of a bank: pooling

7A.3.6 R If a *secondary pooling event* occurs as a result of the *failure* of a bank where one or more *general client bank accounts* are held and/or where one or more *designated client bank accounts* or *designated client fund accounts* are held for the *general pool* or a particular *sub-pool*, then:

(1) in relation to every *general client bank account* of the *firm* maintained for the relevant *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*; and

(5) any *money* held in a *designated client fund account* for the relevant 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*.

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

…

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

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

7A.3.8 R Subject to *CASS* 7A.3.8AR, if a *secondary pooling event* occurs as a result of the *failure* of a bank, exchange, *clearing house*, *intermediate broker*, *settlement agent* or *OTC* counterparty, *money* held in each *general client bank account* and *client transaction account* of the *firm* for the *general pool* or a particular *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* and *client transaction accounts* for the relevant pool, that has arisen as a result of the *failure* of the bank, exchange, *clearing house*, *intermediate broker*, *settlement agent* or *OTC* counterparty, must be borne by all the *clients* of that *pool* whose *client money* is held in either a *general client bank account* or *client transaction account* of the *firm*, rateably in accordance with their *client money interest* as set out in the *firm*'s records maintained under *CASS* 7.6.3;

(2) a new *client money interest* must be calculated for each *client*

of that *pool* by the *firm*, to reflect the requirements in (1), and the *firm's* records must be amended to reflect the reduced *client money interest*;

…

(4) the *firm* must use the new *client money interests*, 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).

…

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

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

(1) any *shortfall* 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 interests*;

(2) a new *client money interest* 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 interest*;

…

(4) the *firm* must use the new *client money interests*, 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 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* 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 *client*

*money interests*;

(2) a new *client money interests* 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 interest*;

…

(4) the *firm* must use the new *client money interests*, 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, exchange, clearing house, intermediate broker, settlement agent or OTC counterparty

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

…

…

# CLIENT ASSETS SOURCEBOOK (INDIRECT CLEARING) INSTRUMENT 2013

## 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:

(1) section 137A (FCA's general rule-making power);
(2) section 137B (FCA's client money rules);
(3) section 137T (General supplementary powers); and
(4) section 139A (FCA's power to make 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 on [*date*].

## Amendments to the Handbook

D. The Glossary of definitions is amended in accordance with Annex A to this instrument.

E. The Client Assets sourcebook (CASS) is amended in accordance with Annex B to this instrument.

## Citation

F. This instrument may be cited as the Client Assets Sourcebook (Indirect Clearing) Instrument 2013.

By order of the Board of the Financial Conduct Authority
[*date*]

## Annex A

### Amendments to the Glossary of definitions

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

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

| | |
|---|---|
| *clearing member* | in relation to an *authorised central counterparty*, as defined in article 2(14) of *EMIR*. |
| *EMIR L2 Regulation* | Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012, supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP. |
| *indirect client* | as defined in article (1)(a) of the *EMIR L2 Regulation*. |
| *regulated clearing arrangement* | as the context requires, either:<br>(i) an arrangement under which a *firm* directly places *client money* in a *client transaction account* that is an *individual client account* or an *omnibus client account* at an *authorised central counterparty*; or<br>(ii) an arrangement under which a *firm*, acting for a *client* who is also an *indirect client*, directly places *client money* of that *indirect client* in a *client transaction account* that is an *individual client account* or an *omnibus client account* at a *clearing member* for that *clearing member* to clear the positions of that *indirect client* through an *authorised central counterparty*. |

Amend the following definitions as shown.

| | |
|---|---|
| *individual client account* | as the context requires, either:<br>(i) an a*ccount* maintained by a *firm* at an *authorised central counterparty* for a *client* of the *firm* in respect of which the *authorised central counterparty* has agreed with the *firm* to |

provide *individual client segregation*; or

(ii) an a*ccount* maintained by a *firm* for an *indirect client* at a *clearing member* of an *authorised central counterparty* for which the *clearing member* has agreed with the *firm* to provide segregation under article 4(2)(b) of the *EMIR L2 Regulation*.

*omnibus client account* as the context requires, either:

(i) an *account* maintained by a *firm* at an *authorised central counterparty* for more than one *client* of the *firm* in respect of which the *authorised central counterparty* has agreed with the *firm* to provide *omnibus client segregation*; or

(ii) an a*ccount* maintained by a *firm* for more than one *indirect client* at a *clearing member* for which that *clearing member* has agreed with the *firm* to provide segregation under article 4(2)(a) of the *EMIR L2 Regulation*.

## Annex B

## Amendments to the Client Assets sourcebook (CASS)

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

### 7 Client money rules

…

Discharge of fiduciary duty

7.2.15 R *Money* ceases to be *client money* (having regard to *CASS* 7.2.17R where applicable) if:

…

(7) it is paid by an *authorised central counterparty* directly to the *client* in accordance with *CASS* 7.2.15BR; or

(8) it is transferred by the *firm* in connection with a *regulated clearing arrangement* and the *clearing member* with whom the *firm* has placed that *client money* remits payment to another *firm* or to another *clearing member* in line with *CASS* 7.2.15CR; or

(9) it is transferred by the *firm* in connection with a *regulated clearing arrangement* and the *clearing member* with whom the *firm* has placed that *client money* remits payment directly to the *indirect clients* of the *firm* in line with *CASS* 7.2.15DR.

7.2.15A R *Client money* ~~received or held by~~ which the *firm* ~~and placed in a *client transaction account* that is an *individual client account* or an *omnibus client account*~~ 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*.

7.2.15B R *Client money* ~~received or held by~~ which the *firm* ~~and placed in a *client transaction account* that is an *individual client account* or an *omnibus client account*~~ 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*.

7.2.15C R *Client money* received or held by the *firm* and transferred to a *clearing member* in connection with a *regulated clearing arrangement* ceases to be

*client money* for that *firm* and, if applicable, the *clearing member*, if the *clearing member* remits payment to another *firm* or to another *clearing member* in accordance with article 4(4) of the *EMIR L2 Regulation*.

7.2.15D R *Client money* received or held by the *firm* and transferred to a *clearing member* in connection with a *regulated clearing arrangement* ceases to be *client money* for that *firm* and, if applicable, the *clearing member*, if the *clearing member* remits payment directly to the *indirect clients* of the *firm* pursuant to article 4(5) of the *EMIR L2 Regulation*.

…

## 7A Client money distribution

…

Pooling and distribution

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

(1) all *client money* held in a *client bank account* or a *client transaction account* of the *firm* is treated as pooled (forming a notional pool) except for *client money* held in a *client transaction account* ~~that is an *individual client account* or an *omnibus client account*~~ at an *authorised central counterparty* or a *clearing member* which is, in either case, held as part of *regulated clearing arrangement*;

…

(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:

…

(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 by the *authorised central counterparty* or, in the case of *indirect clients*, the *clearing member*;

…

7A.2.4A G …

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

(a) transfer the positions and assets to another *clearing member* of the relevant *authorised central counterparty* or another *firm* willing to act for the *indirect client*; or

(b) liquidate the assets and positions of the *indirect clients* and remit all monies due to the *indirect clients*.

(1B) 'Relevant *clients*' in *CASS* 7A.2.4AR(3)(a) and (3)(c) includes a *client* who is also an *indirect client*.

(2) Where any balance remitted from an *authorised central counterparty* or, in the case of *indirect clients*, a *clearing member*, to a *firm* is *client money*, *CASS* 7A.2.4R(3) provides for the distribution of remittances from either an *individual client account* or an *omnibus client account*.

…

(4) For the avoidance of doubt, for a *regulated clearing arrangement*, any *client money* remitted by the *authorised central counterparty* or, in the case of *indirect clients*, the *clearing member*, to the *firm* pursuant to *CASS* 7A.2.4R(3) should not be treated as *client money* received after the failure of the *firm* under *CASS* 7A.2.7R.

7A.2.5 R (-1) Each *client's client equity balance* must be reduced by:

(a) any amount paid by:

(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) 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 line with *CASS* 7.2.15R(8);

(b) any amount paid by:

(i) an *authorised central counterparty* directly to that *client*, in accordance with *CASS* 7.2.15R(7); and

(ii) a *clearing member* directly to an *indirect client* in line

with *CASS* 7.2.15R(9); and

…

…

Financial Conduct Authority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