

CLIENT ASSETS SOURCEBOOK (MIFID BUSINESS) INSTRUMENT 2007**Powers exercised**

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making powers);
 - (2) section 139 (Miscellaneous ancillary matters);
 - (3) section 149 (Evidential provisions);
 - (4) section 156 (General supplementary powers);
 - (5) section 157(1) (Guidance); and
 - (6) section 340(1) (Auditors and actuaries).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force on 1 November 2007.

Amendments to the Handbook

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

(1)	(2)
Client Assets sourcebook (CASS)	Annex A
Senior Management Arrangements, Systems and Controls (SYSC)	Annex B
Supervision manual (SUP)	Annex C
Interim Prudential sourcebook for Investment Businesses (IPRU(INV))	Annex D

Citation

- E. This instrument may be cited as the Client Assets sourcebook (MiFID Business) Instrument 2007.

By order of the Board
25 January 2007

Annex A

Amendments to the Client Assets sourcebook (CASS)

In this Annex, underlining indicates new text and striking through indicates deleted text. Where new text is being inserted, the text is not underlined.

...

1.2.4 R ~~CASS 2 (Custody rules), CASS 3 (Collateral rules) and CASS 4 (Client money and mandates: designated investment business)~~ With the exception of this chapter and the *insurance client money chapter*, CASS does not apply to:

- (1) an *authorised professional firm* with respect to its *non-mainstream regulated activities*;
- (2) the *Society*.

1.2.5 R ~~CASS 5 (Client money and mandates: insurance mediation activity)~~ The *insurance client money chapter* does not apply to an *authorised professional firm* with respect to its *non-mainstream regulated activities*, which are *insurance mediation activities*, if:

- (1) ...

...

1.2.6 G ~~Authorised professional firms should be aware of *PROF 5.2 (Nature of non-mainstream regulated activities)*. [deleted]~~

General application: what?

1.2.7 G (1) ...

...

- (3) ~~CASS 2 (Custody rules), CASS 3 (Collateral rules)~~ The *non-directive custody chapter* and ~~CASS 4 (Client money and mandates: designated investment business)~~ the *non-directive client money chapter* apply in relation to *regulated activities*, conducted by *firms*, which fall within the definition of *designated investment business* other than *MiFID business*.

(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*).

- (4) ~~CASS 5 (Client money and mandates: insurance mediation activity)~~ The *insurance client money chapter* applies in relation to *regulated activities*, conducted by *firms*, which fall within the definition of

insurance mediation activities.

- (5) The MiFID custody chapter and the MiFID client money chapter apply in relation to regulated activities, conducted by firms, which fall within the definition of:
- (a) MiFID business; and
 - (b) designated investment business other than MiFID business, where the firm has, in accordance with those rules, opted to comply with the provisions of those rules with respect of this business.
- (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.

Application for ~~private customers, intermediate customers and market counterparties~~ retail clients, professional clients and eligible counterparties

- 1.2.8 G (1) CASS applies directly in respect of activities conducted with or for all categories of clients, market counterparties as well as with or for customers. The term client refers both to market counterparties and to customers.
- (2) In ~~CASS 2 (Custody rules), CASS 3 (Collateral rules) and CASS 4 (Client money and mandates: designated investment business),~~ except in the insurance client money chapter, MiFID custody chapter and MiFID client money chapter, the term customer refers to private customers retail clients and intermediate customers professional clients, but not market eligible counterparties. Where relevant, each of the provisions of CASS makes clear whether it applies to activities carried on with or for private customers retail clients or intermediate customers, professional clients, or both.
- (3) ~~CASS 5 (Client money and mandates: insurance mediation activity)~~ The insurance client money chapter does not generally distinguish between different categories of client. However, the term retail customer is used for those whom additional obligations are owed, rather than the term private customer retail client. This is to be consistent with the client categories used in relation to the obligations in ICOB in relation to insurance mediation activities.
- (4) Each provision in the MiFID custody chapter and the MiFID client money chapter makes it clear whether it applies to activities carried on or 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.

1.2.9 G ~~*Firms are reminded that the definition of inter-professional business does not include safekeeping and administration of assets or agreeing to carry on that activity: CASS will apply in this context (and will apply to the holding of money for clients in connection with inter-professional business).*~~
[deleted]

Investments and money held under different regimes

1.2.10 R Where a firm is subject to both the non-directive custody chapter and the MiFID custody chapter, it must ensure segregation between designated investments held under each chapter, including that designated investments held under different chapters with the same third party, are held in different, separately designated, accounts.

1.2.11 R Where a firm is subject to more than one of the non-directive client money chapter, the insurance client money chapter and the MiFID client money chapter, it must ensure segregation between money held under each chapter, including that money held under different chapters is held, in different, separately designated, client bank accounts or client transaction accounts.

1.2.12 G The purpose of the rules regarding the segregation of investments and money held under different regimes is to reduce the risk of confusion between assets held under different regimes either on an on-going basis or on the failure of a firm or a third party holding those assets.

1.2.13 G A firm may opt to hold under a single chapter designated investments that would otherwise be held under different chapters (see CASS 6.1.17R). A firm may also opt to hold under a single chapter money that would otherwise be held under different chapters (see CASS 4.1.1AR, CASS 5.1.1R(3) and CASS 7.1.3R(1)).

...

Stock lending activity with or for customers

1.4.2 G (1) The non-directive custody chapter and the non-directive client money chapter CASS 2 (Custody rules) to CASS 4 (Client money and mandates: designated investment business) apply in respect of any stock lending activity that is not MiFID business undertaken with or for a customer by a firm. If the stock lending activity involves MiFID business or if the firm has opted to comply with the MiFID custody chapter or the MiFID client money chapter with respect to its non-MiFID business, then the MiFID custody chapter and the MiFID client money chapter apply.

(2) The collateral rules apply, where relevant, in respect of stock lending activity, whether or not the activity amounts to MiFID business.

Corporate finance business

1.4.3 G (1) The non-directive custody chapter and the non-directive client money

chapter CASS 2 (Custody rules) to CASS 4 (Client money and mandates: designated investment business) apply in respect of *corporate finance business* that is not *MiFID business* undertaken by a *firm*. If the *corporate finance business* involves *MiFID business* or if the *firm* has opted to comply with the *MiFID custody chapter* or the *MiFID client money chapter* with respect to its *non-MiFID business*, then the *MiFID custody chapter* and the *MiFID client money chapter* apply.

- (2) The *collateral rules* apply, where relevant, in respect of *corporate finance business*, whether or not the activity amounts to *MiFID business*.

Oil market activity and energy market activity

- 1.4.4 G (1) The *non-directive custody chapter* and the *non-directive client money chapter* CASS 2 (Custody rules) to CASS 4 (Client money and mandates: designated investment business) apply in respect of *oil market activity* and other *energy market activity* that is not *MiFID business* undertaken by a *firm*. If the *energy market activity* (including *oil market activity*) involves *MiFID business* or if the *firm* has opted to comply with the *MiFID custody chapter* or the *MiFID client money chapter* with respect to its *non-MiFID business*, then the *MiFID custody chapter* and the *MiFID client money chapter* apply.
- (2) The *collateral rules* apply, where relevant, in respect of *energy market activity*, whether or not the activity amounts to *MiFID business*.

Appointed representatives

- 1.4.5 G (1) Although *CASS* does not apply directly to a *firm's appointed representatives*, a *firm* will always be responsible for the acts and omissions of its *appointed representatives* in carrying on business for which the *firm* has accepted responsibility (section 39(3) of the Act). In determining whether a *firm* has complied with any provision of *CASS*, anything done or omitted by a ~~firm's~~ *firm's appointed representative* (when acting as such) will be treated as having been done or omitted by the *firm* (section 39(4) of the ~~Act~~ Act).
- (2) ...

Depositories

- 1.4.6 R ~~CASS 4.1 to CASS 4.4~~ The *non-directive client money chapter* and the *MiFID client money chapter* do not apply to a *depository* when acting as such.
- 1.4.7 R The remainder of *CASS* applies to a *depository*, when acting as such, with the following general modifications:

- (1) except in ~~CASS 4.5~~ the mandate rules, 'client' means 'trustee', 'trust' or 'collective investment scheme' as appropriate; and
 - (2) in ~~CASS 4.5~~ the mandate rules, 'client' means 'trustee', 'collective investment scheme' or 'collective investment scheme instrument' as appropriate.
- 1.4.8 R In relation to a *trustee firm* which is not a *depository*, when acting as such, and which falls within COB 11.5.1R(1):
- (1) CASS does not apply, except for the MiFID custody chapter, the MiFID client money chapter and the mandate rules CASS 4.5 (Mandates); and
 - (2) in the MiFID custody chapter, the MiFID client money chapter and the mandate rules CASS 4.5, 'client' means 'trustee', 'trust', or 'trust instrument' or 'beneficiary', as appropriate.
- ...
- 2 ~~Client assets~~ Non-directive custody rules
- 2.1 Custody
- Application and purpose
- 2.1.1 R This ~~section~~ chapter (the custody rules) ~~apply~~ applies to a *firm* when it is safeguarding and administering investments other than:
- (1) when it is holding financial instruments belonging to a client in the course of conducting MiFID business; or
 - (2) subject to in the circumstances set out in CASS 2.1.9R.
- ...
- 2.1.2A G The MiFID custody chapter applies when a firm holds financial instruments belonging to a client in the course of its MiFID business.
- ...
- 2.1.4 G The term 'client' refers to an market eligible counterparty, a professional client ~~intermediate customer~~ or a retail client ~~private customer~~. However, the term 'customer' does not include an market eligible counterparty.
- ...
- 2.1.9 R The custody rules do not apply to:
- (1) ...
 - ...

- (3) ...
- (c) makes a record, which must then be retained for a period of 3 years after the record is made, of all the *designated investments* handled in accordance with (3)(a) and (b) together with the details of the *clients* concerned and of any action the *firm* has taken; ;
- (4) a MiFID investment firm that has opted to act in accordance with the MiFID custody chapter in respect of designated investments that it safeguards and administers which are subject to the opt-in to the MiFID custody chapter.

...

2.1.10A G Firms that safeguard and administer designated investments including financial instruments and that are subject to both sets of custody rules, should refer to CASS 6.1.17R (Opt-in to the MiFID custody rules) which contains a provision enabling these firms to opt to comply solely with the MiFID custody chapter.

...

- 2.2.10 R To the extent practicable, a *firm* must effect appropriate registration or recording of legal title to a *safe custody investment* in the name of:
- (1) ...
- ...
- (4) the *firm* if:
- (a) ...
- (b) the *firm* has notified the *client* in accordance with CASS 2.3.10R (Risk disclosures) if an ~~an~~ market eligible counterparty or an professional client ~~intermediate customer~~, or obtained his prior written consent if a retail client ~~private customer~~; or
- (5) any other *person*, in accordance with the *client's* specific written instruction, provided:
- (a) ...
- (b) in the case of a retail client ~~private customer~~, the other *person* is not an *associate* of the *firm*.

...

2.2.15 R A *firm* must hold any document of title to a *safe custody investment* either in the physical possession of the *firm* or:

(1) for a *retail client* ~~*private customer*~~, with a *custodian* in an account designated for *clients' safe custody investments*;

(2) for an ~~*market eligible counterparty*~~ or a *professional client* ~~*intermediate customer*~~, with one or more of the following:

(a) ...

...

(c) subject to CASS 2.3.11R (Risk disclosures) in accordance with the ~~*market eligible counterparty's*~~ or *professional client's* ~~*intermediate customer's*~~ specific written instructions.

...

2.2.19 R Before a *firm* recommends a *custodian* to a *retail client* ~~*private customer*~~, it must undertake an appropriate risk assessment of that *custodian*.

2.2.20 G A *firm* that holds *safe custody investments* with a *custodian* or recommends *custodians* to *retail clients* ~~*private customers*~~, is expected to establish and maintain a system for assessing the appropriateness of its selection of the *custodian* and to assess the continued appointment of that *custodian* periodically as often as is reasonable in the relevant market. In order to comply with SYSC 3.2.20R and SYSC 9 (Records), the *firm* is also expected to make and retain a record of the grounds on which it satisfies itself as to the appropriateness of its selection or, following a periodic assessment, continued appropriateness of the *custodian*.

...

2.3.2 R Before a *firm* provides safe custody services to a *client*, unless CASS 2.3.5R applies, the *firm* must notify the *client* as to the appropriate terms and conditions which apply to this service, including, where applicable, those covering:

(1) ...

...

(10) if the *firm* intends to pool a *safe custody investment* with that of one or more other *clients*, notification of its intention to the ~~*market eligible counterparty*~~ or *professional client* ~~*intermediate customer*~~ and if the *client* is a *retail client* ~~*private customer*~~, an explanation of the effects of pooling to that *retail client* ~~*private customer*~~.

- 2.3.3 G When explaining the meaning of pooling to a retail client ~~private customer~~, firms are expected to advise the retail client ~~private customer~~ that:
- (1) ...
- ...
- 2.3.4 R Unless CASS 2.3.5R or CASS 2.3.6R applies, the firm must obtain the written agreement of a retail client ~~private customer~~, or notify an market eligible counterparty or an professional client ~~intermediate customer~~, as to:
- (1) ...
- ...
- ...
- 2.3.6 R (1) A firm need not obtain the written agreement of a retail client ~~private customer~~, or give notice to an market eligible counterparty or an professional client ~~intermediate customer~~, as required by CASS 2.3.4R if:
- (a) ...
- ...
- ...
- 2.3.8 G The term "customer" does not include an market eligible counterparty.
- ...
- 2.3.10 R Before a firm registers or records legal title to a safe custody investment in the name of the firm, it must notify the client if an market eligible counterparty or an professional client ~~intermediate customer~~, and obtain his prior written consent if the client is a retail client ~~private customer~~, that:
- (1) ...
- ...
- ...
- 2.3.16 R If a firm provides a range of safe custody services for a retail client ~~private customer~~ which result in statements being generated from more than one system, it must ensure that all the statements in respect of those services are produced as at the same date and despatched within one week of each other, unless each statement makes clear that it relates to a particular service.

Content of client statements

2.3.17 R All statements produced by or on behalf of a *firm* in accordance with CASS 2.3.12R - CASS 2.3.14R and CASS 2.3.16R, must list all *custody assets* held for the *client* for which the *firm* is accountable and:

(1) ...

...

(4) for a *retail client* ~~*private customer*~~, base the statement on either trade date or settlement date information for cash balances and *safe custody investment* and notify the basis to the *retail client* ~~*private customer*~~.

...

2.5.2 R A *firm* must not use a *safe custody investment* for its own account unless the *client*:

(1) if a *retail client* ~~*private customer*~~, has given prior written consent to the *firm*; or

(2) if an ~~*an*~~ *professional client* ~~*intermediate customer*~~ or ~~*market*~~ *eligible counterparty*, has been notified by the *firm*.

Use of a safe custody investment: by another client

2.5.3 R A *firm* must not use, for the account of one *client*, the *safe custody investment* of any other *customer*, unless that other *customer*:

(1) if a *retail client* ~~*private customer*~~, has given prior written consent to the *firm*; or

(2) if an ~~*an*~~ *professional client* ~~*intermediate customer*~~, has been notified by the *firm*.

...

2.5.5 E (1) In the case of a *retail client* ~~*private customer*~~, the appropriate terms and conditions referred to in CASS 2.5.4R(2) include those specified in COB 4 Annex 2(18) (Content of terms of business provided to a customer: stock lending).

(2) ...

...

- 2.5.6 G *Firms* are reminded that the term "*customer*" does not include an ~~market~~ eligible counterparty.
- ...
- 2.5.8 R If a *safe custody investment* belonging to a *retail client* ~~*private customer*~~ is used for *stock lending activity*, the *firm* must ensure that:
- (1) ...
- ...

3.1 Application and Purpose

Application

- 3.1.1 R This chapter section applies to a *firm* when it receives or holds assets in connection with an arrangement to secure the obligation of a *client* in the course of, or in connection with, its *designated investment business*, including *MiFID business*.
- 3.1.2 G *Firms* are reminded that ~~under CASS 1.3.3R~~, this chapter section does not apply to an *incoming EEA firm*, other than an *insurer*, with respect to its *passport activities*. The application of this chapter section is also dependent on the location from which the activity is undertaken (see CASS 1.3.2R and CASS 1.3.3R).
- 3.1.3 R This chapter section does not apply to a *firm* that has only a bare security interest (without rights to hypothecate) in the *client's* asset. In such circumstances, the *firm* must comply with the *custody rules* or *client money rules* as appropriate.
- 3.1.4 G For the purpose of this chapter section only, a bare security interest in the *client's* asset gives a *firm* the right to realise the assets only on a *client's* default and without the right to use other than in default.

Purpose

- 3.1.5 G The purpose of this chapter section is to ensure that an appropriate level of protection is provided for those assets over which a *client* gives a *firm* certain rights. The arrangements covered by this chapter section are those under which the *firm* is given a right to use the asset, and the *firm* treats the asset as if legal title and associated rights to that asset had been transferred to the *firm* subject only to an obligation to return equivalent assets to the *client* upon satisfaction of the *client's* obligation to the *firm*. The rights covered in this chapter section do not include those arrangements by which the *firm* has only a bare security interest in the *client's* asset (in which case the *custody rules* or *client money rules* apply).

3.1.6 G Examples of the arrangements covered by this ~~chapter section~~ include the taking of collateral by a *firm*, under the ISDA English Law (transfer of title) and the New York Law Credit Support Annexes (assuming the right to rehypothecate has not been disapplied).

3.1.7 G This ~~chapter section~~ recognises the need to apply a differing level of regulatory protection to the assets which form the basis of the two different types of arrangement described in CASS 3.1.5G. Under the bare security interest arrangement, the asset continues to belong to the *client* until the *firm's* right to realise that asset crystallises (that is, on the *client's* default). But under a "right to use arrangement", the *client* has transferred to the *firm* the legal title and associated rights to the asset, so that when the *firm* exercises its right to treat the asset as its own, the asset ceases to belong to the *client* and in effect becomes the *firm's* asset and is no longer in need of the full range of *client* asset protection. The *firm* may exercise its right to treat the asset as its own by, for example, clearly so identifying the asset in its own books and records.

3.2 Requirements

Application

3.2.1 R ~~CASS 3.2 applies in accordance with CASS 3.1. [deleted]~~

3.2.2 R A *firm* that receives or holds a *client's* assets under an arrangement to which this ~~chapter section~~ applies and which exercises its right to treat the assets as its own must ensure that it maintains adequate records to enable it to meet any future obligations including the return of equivalent assets to the *client*.

...

3.2.4 G When appropriate, *firms* that enter into the arrangements covered in this ~~chapter section~~ with *retail clients* ~~private customers~~ will be expected to identify in the statement of *custody assets* sent to the *client* in accordance with CASS 2.3.12R (Production and despatch of client statements) details of the assets which form the basis of the arrangements. Where the *firm* utilises global netting arrangements, a statement of the assets held on this basis will suffice.

4 ~~Non-directive~~ Client money rules ~~and mandates: designated investment business~~

4.1 Application and Purpose

Application

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

(1) its *designated investment business* other than MiFID business; or

- (2) in the circumstances set out in CASS 4.1.1AR; (*insurance mediation activity*);

except where CASS 4.1.2R applies.

- 4.1.1A R A *firm* that receives or holds *money* to which this ~~chapter section~~ applies and *money* in respect of which ~~the insurance client money chapter CASS 5.1~~ applies, may elect to comply with the provisions of this ~~chapter section~~ ~~CASS 4~~ in respect of all such *money* and if it does so ~~CASS 4~~ this chapter applies as if all such *money* were *money* that the *firm* receives and holds in the course of or in connection with its *designated investment business*.

...

- 4.1.2 R ~~The client money rules~~ This chapter does not apply with respect to:

- (1) ...

...

- (3) ...

- (a) ...

- (b) as a result, the *money* will not be held in accordance with the *client money rules*; or

- (4) *money* held by *depositories* which are regulated by COB 11; or

- (5) *client money* held by a *firm* which:

- (a) receives or holds *client money* in relation to *contracts of insurance*; but which

- (b) in relation to such *client money* elects to act in accordance with the insurance client money chapter CASS 5.1 to 5.6. ; or

- (6) client money held by a firm which:

- (a) receives or holds client money in relation to designated investment business other than MiFID business; but which

- (b) in relation to such client money elects to act in accordance with the MiFID client money chapter under the opt-in to that chapter (CASS 7.1.3R(1)).

- 4.1.2B G (1) A *firm* which receives and holds *client money* in respect of life assurance business in the course of its *designated investment business* may:
- (a) in accordance with CASS 4.1.1A R elect to comply with the non-directive client money chapter CASS 4 in respect of such

client money and in doing so avoid the need to comply with the insurance client money chapter CASS 5.1 to 5.6 which would otherwise apply to the *firm* in respect of *client money* received in the course of its *insurance mediation activity*; or

(b) in accordance with CASS 4.1.2 R(5), elect to comply with the insurance client money chapter CASS 5.1 to 5.6 in respect of such *client money*.

(2) These options are available to a *firm* irrespective of whether it also receives and holds *client money* in respect of other parts of its *designated investment business*. A *firm* may not however choose to comply with the insurance client money chapter CASS 5.1 to 5.6 in respect of *client money* which it receives and holds in the course of any part of its *designated investment business* which does not involve an *insurance mediation activity*.

...

4.1.2C G Firms that hold client money in the course of, or in connection with, designated investment business that is not MiFID business and also in the course of, or in connection with, MiFID business (and are therefore subject to the non-directive client money chapter and the MiFID client money chapter), should refer to CASS 7.1.3R(1) (Opt-in to the MiFID client money rules) which contains a provision enabling these firms to opt to comply solely with the MiFID client money chapter.

...

Money that is not client money: 'opt outs' for any business (~~including ISD business~~) other than *insurance mediation activity*

4.1.8 G The 'opt out' provisions provide a *firm* with the option of allowing a professional client ~~intermediate customer~~ or ~~market~~ an eligible counterparty to choose whether their *money* is subject to the *client money rules* (unless the *firm* is conducting *insurance mediation activity*).

4.1.9 R Subject to CASS 4.1.11R, *money* is not *client money* when a *firm* (other than a *sole trader*) holds that *money* on behalf of, or receives it from, an ~~market eligible counterparty~~ or a professional client ~~intermediate customer~~, other than in the course of *insurance mediation activity*, and the *firm* has obtained written acknowledgement from the ~~market eligible counterparty~~ or professional client ~~intermediate customer~~ that:

(1) the *money* will not be subject to the protections conferred by the *client money rules*;

(2) as a consequence, this *money* will not be segregated from the *money* of the *firm* in accordance with the *client money rules* and will be used by the *firm* in the course of its own business; and

- (3) the *market eligible counterparty* or *professional client intermediate customer* will rank only as a general creditor of the *firm*.

'Opt-outs' for ~~non-ISD~~ or non-IMD business

- 4.1.10 G For a *firm* whose business is not governed by ~~the ISD~~ or the *IMD*, it is possible to 'opt out' on a one-way basis. However, in order to maintain a comparable regime to that applying to MiFID business, in the case of certain non-*ISD* investment firms that undertake '*ISD* type' business from a branch in the United Kingdom, article 5 of the *ISD* requires the *FSA* not to treat this business any more favourably than business of an *ISD* investment firm. Therefore all *ISD* and '*ISD* type'-all '*MiFID* type' business undertaken outside the scope of *MiFID*, should comply with the *client money rules* or be 'opted out' on a two-way basis.
- 4.1.11 R *Money* is not *client money* if a *firm*, in respect of *designated investment business* which is not an *investment service or activity, an ancillary service, core investment service, a non-core investment service, a listed activity or insurance mediation activity*:
- (1) holds it on behalf of or receives it from an *eligible market counterparty* who is not an *authorised person* or an *professional client intermediate customer* who is not an *authorised person*; and
 - (2) has sent a separate written notice stating the matters set out in *CASS* 4.1.9R (1) to (3).
- 4.1.12 G When a *firm* undertakes a range of business for an *market eligible counterparty* or *professional client intermediate customer* and has separate agreements for each type of business undertaken, the *firm* may treat *client money* held on behalf of the *client* differently for different types of business; for example, a *firm* may, under *CASS* 4.1.9R or *CASS* 4.1.11R, elect to segregate *client money* in connection with *securities* transactions and not segregate (by complying with *CASS* 4.1.9R or *CASS* 4.1.11R) *money* in connection with *contingent liability investments* for the same *client*.
- ...
- 4.1.24 G When a *firm* realises *client collateral* to meet liabilities of that *client*, it should do so in accordance with the relevant terms and conditions (see *CASS* 2.3.2R to *CASS* 2.3.6R), and for a *retail client private customer*, in accordance with *COB* 7.8 (Realisation of a private customer's assets).
- ...
- 4.3.26 R Unless a *firm* notifies a *retail client private customer* 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 *retail client private customer* all interest earned on that *client money*. Any interest due to a *client* will be *client money*.

4.3.27 G If no interest is payable to a *retail client* ~~private customer~~, that fact should be separately identified in an agreement or notification.

...

Transfer of client money to a third party

4.3.29 G CASS 4.3.30R sets out the requirements a *firm* must comply with when it transfers *client money* to another *person* without discharging its fiduciary duty owed to that *client*. Such circumstances arise when, for example, 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 equity balance* ~~equity balance~~, as defined in ~~CASS 4.3.79R~~, 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 CASS 4.3.99R.

4.3.30 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) ...

(2) in the case of a *retail client* ~~private customer~~, that *customer* has been notified that the *client money* may be transferred to the other *person*.

...

4.3.40 R A *firm* (other than a *trustee firm*) may hold *client money* with a bank that is not an *approved bank* if all of the following conditions are met:

(1) ...

...

(4) the *firm* notifies each relevant ~~market eligible~~ *counterparty* and *professional client* ~~intermediate customer~~ and obtains the prior written consent of each relevant *retail client* ~~private customer~~ that:

(a) ...

...

...

4.3.79 R ~~A *client's equity balance* is the amount which the *firm* would be liable (ignoring for the purposes of this rule any non-cash collateral held) to pay to a *client* (or the *client* to the *firm*) in respect of his *margined transactions* if each of his open positions was liquidated at the closing or settlement prices published by the relevant exchange or other appropriate pricing source and his account closed. [deleted]~~

...

- 4.3.81 R The total margined transaction requirement is:
- (1) the sum of each of the *client's equity balance* ~~equity balance~~, as ~~defined in CASS 4.3.79R~~, which are positive;
- Less
- (2) the proportion of any individual negative *client equity balance* ~~equity balance~~ *equity balance* which is secured by *approved collateral*; and
 - (3) the net aggregate of the *firm's equity balance* (negative balances being deducted from positive balances) on transaction accounts for *clients customers* with exchanges, *clearing houses*, *intermediate brokers* and *OTC counterparties*.

...

- 4.3.84 G The terms '*client equity balance* in ~~CASS 4.3.79R~~' *client equity balance* and '*firm's equity balance*' in CASS 4.3.80R refer to cash values and do not include non-cash *collateral* or other *designated investments* held in respect of a *margined transaction*.

- 4.3.85 R
- (1) When, in respect of a *client*, there is a positive individual *client balance* and a negative *client equity balance* ~~equity balance~~ *equity balance*, a *firm* may offset the credit against the debit and hence have a reduced individual *client balance* in CASS 4.3.72R for that *client*.
 - (2) When, in respect of a *client*, there is a negative individual *client balance* and a positive *client equity balance* ~~equity balance~~ *equity balance*, a *firm* may offset the credit against the debit and hence have a reduced *client equity balance* ~~equity balance~~ *equity balance* in CASS 4.3.81 R for that *client*.

...

- 4.3.108 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's equity balance* ~~equity balance~~, as ~~defined in CASS 4.3.79R~~, for transactions undertaken on the London Metal Exchange on behalf of those US-resident investors from the calculation required by CASS 4.3.81R.

...

4.5 Mandate Rules

4.5.1 R [deleted]

4.5.2 G [deleted]

4.5.3 G [deleted]

4.5.4 G [deleted]

4.5.5 R [deleted]

...

5 Client money ~~and mandates~~: insurance mediation activity

5.1.1 R ...

(1) ...

(2) CASS 5.1 to CASS 5.6 do not, subject to (3), apply:

(a) to a *firm* to the extent that it acts in accordance with ~~CASS 4~~ the non-directive client money chapter or the MiFID client money chapter; or

...

...

5.1.8 G *Firms* which carry on *designated investment business* which may, for example, involve them handling *client money* in respect of life assurance business should refer to ~~CASS 4~~ the non-directive client money chapter which includes provisions enabling *firms* to elect to comply solely with ~~CASS 4~~ that chapter or with ~~CASS 5~~ the insurance client money chapter in respect of that business. *Firms* that also carry on *MiFID business* may elect to comply solely with the MiFID client money chapter with respect of *client money* in respect of which the non-directive client money chapter or the insurance client money chapter apply.

...

5.7 Mandates

5.7.1 R [deleted]

5.7.2 G [deleted]

5.7.3 G [deleted]

5.7.4 G [deleted]

5.7.5 R [deleted]

5.7.6 R [deleted]

...

After CASS 5, insert the following provisions. This material is all new and it is not underlined.

6.1 Custody: MiFID business

Application

- 6.1.1 R This chapter (the *custody rules*) applies to a *MiFID investment firm*:
- (1) when it holds *financial instruments* belonging to a *client* in the course of its *MiFID business*; or
 - (2) that opts to comply with the *custody rules* under this chapter in accordance with CASS 6.1.17R (Opt-in to the MiFID custody rules).
- 6.1.2 G *Firms* are reminded that dividends (actual or payments in lieu), *stock lending* fees and other payments received for the benefit of a *client*, and which are due to the *clients* should be held in accordance with the *MiFID client money chapter* where appropriate.
- 6.1.3 G This chapter does not apply where a *firm* issues depositary receipts. The *custody rules* in the *non-directive custody chapter* provide a specialist regime for the issue of depositary receipts (see CASS 2.1.24R to CASS 2.1.26R).
- Business in the name of the firm
- 6.1.4 R The *custody rules* do not apply where a *firm* carries on business in its name but on behalf of the *client* where that is required by the very nature of the transaction and the *client* is in agreement.
- [Note: recital 26 to *MiFID*]
- 6.1.5 G For example, this chapter does not apply where a *firm* borrows *financial instruments* from a *client* as principal under a *stock lending* agreement.
- Title transfer collateral arrangements
- 6.1.6 R The *custody rules* do not apply where a *client* transfers full ownership of a *financial instrument* to a *firm* for the purpose of securing or otherwise covering present or future, actual, contingent or prospective obligations.
- [Note: recital 27 to *MiFID*]
- 6.1.7 G A title transfer financial collateral arrangement under the *Financial Collateral Directive* is a type of transfer of instruments to cover obligations where the *financial instrument* will not be regarded as belonging to the *client*.
- 6.1.8 G *Firms* are reminded of the *client's best interests rule*, which requires them to act honestly, fairly and professionally in accordance with the best interests of their *clients* when structuring their business particularly in

respect of the effect of that structure on *firms'* obligations under this chapter.

- 6.1.9 G *Firms* are reminded that, in certain cases, the *collateral rules* apply where a *firm* receives collateral from a *client* in order to secure the obligations of the *client*.

Affiliated companies

- 6.1.10 G The fact that a *client* is an *affiliated company* does not affect the operation of the *custody rules* in relation to that *client*.

- 6.1.11 G A *firm* that holds *financial instruments* on behalf of an *affiliated company* in respect of its *non-MiFID business* and opts under CASS 6.1.17R to comply with this chapter in respect of that *non-MiFID business*, should refer to CASS 2.1.9R(1) to determine whether the assets falls within the scope of the *custody rules* in the *non-directive custody chapter* and therefore within the scope of the opt-in.

Delivery versus payment transactions

- 6.1.12 R (1) A *firm* need not treat this chapter as applying in respect of a delivery versus payment transaction through a commercial settlement system if it is intended that the *financial instrument* is either to be:
- (a) in respect of a *client's* purchase, due to the *client* within one *business day* following the *client's* fulfilment of a payment obligation; or
 - (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 *financial instrument* by the *client*.

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

Arranging registration and recommendations

- 6.1.13 G This chapter does not apply where a *firm* arranges registration of a *financial instrument*. In such circumstances, a *firm* must comply with the relevant *custody rules* in the *non-directive custody chapter* (see CASS 2.1.22R).

- 6.1.14 G This chapter does not apply where a *firm* recommends to a *retail client* a third party to hold the assets of that *client*. In such circumstances, a *firm* must comply with the relevant *custody rules* in the *non-directive custody chapter* (see CASS 2.2.19R).

Temporary handling of financial instruments

6.1.15 G The *custody rules* do not apply if a *firm* temporarily handles a *financial instrument* belonging to a *client*. A *firm* should temporarily handle *financial instrument* for no longer than is reasonably necessary. In most transactions this would be no longer than one *business day*, but it may be longer or shorter depending upon the transaction in question. For example, when a *firm* executes an order to sell shares which have not been registered on a dematerialised exchange, handling documents for longer periods may be reasonably necessary. However, in the case of *financial instruments* in *bearer form*, the *firm* is expected to handle them for less than one *business day*. When a *firm* temporarily handles *financial instruments*, it is still obliged to comply with *Principle 10* (Clients' assets).

6.1.16 G When a *firm* temporarily handles a *financial instrument*, in order to comply with its obligation to act in accordance with *Principle 10* (Clients' assets), the following are guides to good practice:

- (1) a *firm* should keep the *financial instrument* secure, record it as belonging to that *client*, and forward it to the *client* or in accordance with the *client's* instructions as soon as practicable after receiving it; and
- (2) a *firm* should make and retain a record of the fact that the *firm* has handled that *financial instrument* and of the details of the *client* concerned and of any action the *firm* has taken.

Opt-in to the MiFID custody rules

6.1.17 R (1) A *firm* that holds *financial instruments* to which this chapter applies and assets in respect of which the *non-directive custody chapter* applies, may elect to comply with the provisions of this chapter in respect of all assets so held and if it does so, this chapter applies as if all such assets were *financial instruments* that the *firm* receives and holds in the course of, or in connection with, its *MiFID business*.

(2) An election under this *rule* must be in respect of all the activities of the *firm* when it is *safeguarding and administering investments* belonging to a *client* with the exception of *arranging safeguarding and administration of assets* within the scope of *CASS 2.1.21R* and *CASS 2.1.22R* and depositary receipt business within the scope of *CASS 2.1.24R* to *CASS 2.1.26R*.

(3) A *firm* must make and retain a written record of the 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.

6.1.18 G A *firm* cannot rely upon this opt-in in respect of *arranging safeguarding and administration of assets* and depositary receipt business as the *custody rules*

in the *non-directive custody chapter* provide specialised regimes in respect of these types of business which are outside the scope of this chapter.

- 6.1.19 G If a *firm* has opted to comply with this chapter, the *non-directive custody chapter* will have no application to the activities to which the election applies.
- 6.1.20 G A *firm* that is only subject to the *non-directive custody chapter* may not choose to comply with this chapter.
- Disposal of financial instruments
- 6.1.21 R The *custody rules* cease to have effect in relation to a *financial instrument* it has been disposed of in accordance with a valid *client* instruction.
- General purpose
- 6.1.22 G *Principle 10* (Clients' assets) requires a *firm* to arrange adequate protection for *clients'* assets when it is responsible for them. As part of these protections, the *custody rules* require a *firm* to take appropriate steps to protect *financial instruments* for which it is responsible.
- 6.1.23 G The *rules* in this chapter are designed primarily to restrict the commingling of *client* and the *firm's* assets and minimise the risk of the *client's financial instruments* being used by the *firm* without the *client's* agreement or contrary to the *client's* wishes, or being treated as the *firm's* assets in the event of its insolvency.
- 6.1.24 G The *custody rules* also implement the provisions of *MiFID* which regulate the obligations of a *firm* when it holds *financial instruments* belonging to a *client*.

6.2 Holding of client assets

Requirement to protect clients' financial instruments

- 6.2.1 R A *firm* must, when holding *financial instruments* belonging to *clients*, make adequate arrangements so as to safeguard *clients'* ownership rights, especially in the event of the *firm's* insolvency, and to prevent the use of *financial instruments* belonging to a *client* on the *firm's* own account except with the *client's* express consent.

[Note: article 13(7) of *MiFID*]

Requirement to have adequate organisational arrangements

- 6.2.2 R A *firm* must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of *clients' financial instruments*, or the rights in connection with those *financial instruments*, as a result of the misuse of the *financial instruments*, fraud, poor administration, inadequate record-keeping or negligence.

[Note: article 16(1)(f) of the *MiFID implementing Directive*]

- 6.2.3 R To the extent practicable, a *firm* must effect appropriate registration or recording of legal title to a *financial instrument* 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*;
 - (2) a *nominee company* which is controlled by:
 - (a) the *firm*;
 - (b) an *affiliated company*;
 - (c) a *recognised investment exchange* or a *designated investment exchange*; or
 - (d) a *third party* with whom *financial instruments* are deposited under CASS 6.3;
 - (3) any other third party if:
 - (a) the *financial instrument* is subject to the law or market practice of a jurisdiction outside the *United Kingdom* and the *firm* has taken reasonable steps to determine that it is in the *client's* best interests to register or record it in that way, or that it is not feasible to do otherwise, because of the nature of the applicable law or market practice; and
 - (b) the *firm* has notified the *client* in writing;
 - (4) the *firm* if:
 - (a) the *financial instrument* is subject to the law or market practice of a jurisdiction outside the *United Kingdom* and the *firm* has taken reasonable steps to determine that it is in the *client's* best interests to register or record it in that way, or that it is not feasible to do otherwise, because of the nature of the applicable law or market practice; and
 - (b) the *firm* has notified the *client* if a *professional client*, or obtained prior written consent if a *retail client*.
- 6.2.4 R A *firm* must accept the same level of responsibility to its *client* for any *nominee company* controlled by 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 *financial instrument* in the same name as that in which legal title to a *financial instrument* is registered or recorded, but only if:

- (1) the *firm's financial instruments* are separately identified in the *firm's* records from the *financial instruments*; or
 - (2) the *firm* registers or records a *financial instrument* in accordance with CASS 6.2.3R(4).
- 6.2.6 G A *firm* when complying with CASS 6.2.3R(3) or CASS 6.2.3R(4) will be expected to demonstrate that adequate investigations have been made of the market concerned by reference to local sources, which may include an appropriate legal opinion.
- 6.2.7 R A *firm* must ensure that any documents of title to *financial instruments* in *bearer form*, belonging to the *firm* and which it holds in its physical possession, are kept separately from any document of title to a *client's financial instrument* in *bearer form*.
- 6.3 Depositing assets with third parties
- 6.3.1 R
- (1) A *firm* may deposit *financial instruments* held by it on behalf of its *clients* into an account or accounts opened with a third party, but only if it exercises all due skill, care and diligence in the selection, appointment and periodic review of the third party and of the arrangements for the holding and safekeeping of those *financial instruments*.
 - (2) A *firm* must take the necessary steps to ensure that any *client's financial instruments* deposited with a third party, in accordance with this *rule* are identifiable separately from the *financial instruments* belonging to the *firm* and from the *financial instruments* 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.
 - (3) When a *firm* makes the selection, appointment and conducts the periodic review referred under this *rule*, it must take into account:
 - (a) the expertise and market reputation of the third party; and
 - (b) any legal requirements or market practices related to the holding of those *financial instruments* that could adversely affect *clients' rights*.
 - (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 *financial instruments* belonging to *clients*.

[Note: articles 16(1)(d) and 17(1) of the *MiFID implementing Directive*]

- 6.3.2 G In discharging its obligations under this section, a *firm* should also consider, together with any other relevant matters:
- (1) once a *financial instrument* has been lodged by the *firm* with the third party, the third party's performance of its services to the *firm*;
 - (2) the arrangements that the third party has in place for holding and safeguarding the *financial instrument*;
 - (3) current industry standard reports, for example Financial Reporting and Auditing Group (FRAG) 21 report or its equivalent;
 - (4) the capital or financial resources of the third party;
 - (5) the credit rating of the third party; and
 - (6) any other activities undertaken by the third party and, if relevant, any *affiliated company*.
- 6.3.3 G A *firm* should consider carefully the terms of its agreements with third parties with which it will deposit *financial instruments* 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 *financial instrument* credited to it does not belong to the *firm*;
 - (2) that the third party will hold or record a *financial instrument* belonging to the *firm's client* separately from any *financial instrument* belonging to the *firm* or to the third party;
 - (3) the arrangements for registration or recording of the *financial instrument* if this will not be registered in the *client's* name;
 - (4) the restrictions over the third party's right to claim a lien, right of retention or sale over any *financial instrument* standing to the credit of the account;
 - (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 *financial instrument* caused by the fraud, wilful default or negligence of the third party or an agent appointed by him.

- 6.3.4 R (1) A *firm* must only deposit *financial instruments* with a third party in a jurisdiction which specifically regulates and supervises the safekeeping of *financial instruments* for the account of another person with a third party who is subject to such regulation.
- (2) A *firm* must not deposit *financial instruments* held on behalf of a *client* with a third party in a country that is not an *EEA State* (third country) and which does not regulate the holding and safekeeping of *financial instruments* for the account of another person unless:
- (a) the nature of the *financial instruments* or of the *investment services* connected with those *financial instruments* requires them to be deposited with a third party in that third country; or
 - (b) the *financial instruments* are held on behalf of a *professional client* and the *client* requests the *firm* in writing to deposit them with a third party in that third country.
- (3) In the case of activities a *firm* has opted into this chapter under CASS 6.1.17R, (1) and (2) do not apply. However, the *firm* must deposit *financial instruments* belonging to *clients* pursuant to such activities with a *custodian* and must hold any document of title to a *financial instrument* either in the physical possession of the *firm* or:
- (a) for a *retail client*, with a *custodian*;
 - (b) for a *professional client*, with one or more of the following:
 - (i) a *custodian*;
 - (ii) any *person* whom the *firm* has taken reasonable steps to determine is a *person* whose business includes the provision of appropriate *safe custody* services; or
 - (iii) in accordance with the *professional client's* specific written instructions.

[Note: article 17(2) and (3) of the *MiFID implementing Directive*]

6.4 Use of financial instruments

- 6.4.1 R (1) A *firm* must not enter into arrangements for *securities financing transactions* in respect of *financial instruments* held by it on behalf of a *client* or otherwise use such *financial instruments* for its own account or the account of another *client* of the *firm*, unless:
- (a) the *client* has given express prior consent to the use of the *financial instruments* on specified terms; and
 - (b) the use of that *client's financial instruments* is restricted to the specified terms to which the *client* consents.

- (2) A *firm* must not enter into arrangements for *securities financing transactions* in respect of *financial instruments* held by it on behalf of a *client* in an omnibus account held by a third party, or otherwise use *financial instruments* held in such an account for its own account or for the account of another *client* unless, in addition to the conditions set out in (1):
- (a) each *client* whose *financial instruments* are held together in an omnibus account has given express prior consent in accordance with (1)(a); or
 - (b) the *firm* has in place systems and controls which ensure that only *financial instruments* belonging to *clients* who have given express prior consent in accordance with the requirements of (1)(a) are used.
- (3) For the purposes of obtaining the express prior consent of a *retail client* under this *rule* the signature of the *retail client* or an equivalent alternative mechanism is required.

[Note: article 19 of the *MiFID implementing Directive*]

- 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:
- (1) the *firm* ensures that *relevant collateral* is provided by the borrower in favour of the *client*;
 - (2) the current realisable value of the *financial instrument* and of the *relevant collateral* is monitored daily; and
 - (3) the *firm* provides *relevant collateral* to make up the difference where the current realisable value of the collateral falls below that of the *financial instrument*, unless otherwise agreed in writing by the *client*.
- 6.4.3 R Where a *firm* uses *financial instruments* as permitted in this section, the records of the *firm* must include details of the *client* on whose instructions the use of the *financial instruments* has been effected, as well as the number of *financial instruments* used belonging to each *client* who has given consent, so as to enable the correct allocation of any loss.

[Note: article 19(2) of the *MiFID implementing Directive*]

6.5 Records, accounts and reconciliations

Records and accounts

- 6.5.1 R A *firm* must keep such records and accounts as necessary to enable it at any

time and without delay to distinguish *financial instruments* held for one *client* from *financial instruments* held for any other *client*, and from the *firm's* own *financial instruments*.

[Note: article 16(1)(a) of the *MiFID implementing Directive*]

- 6.5.2 R A *firm* must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the *financial instruments* held for *clients*.

[Note: article 16(1)(b) of the *MiFID implementing Directive*]

Record keeping

- 6.5.3 R A *firm* must ensure that the records made under this section are retained for a period of five years after they are made.

Internal reconciliation of financial instruments held for clients

- 6.5.4 G (1) SYSC 4.1.1R requires *firms* to have robust governance arrangements, such as internal control mechanisms, including sound administrative and accounting procedures and effective control and safeguard arrangements for information processing systems. In addition, SYSC 6.1.1R requires *firms* to establish, implement and maintain adequate policies and procedures sufficient to ensure the *firm's* compliance with its obligations under the *regulatory system*. Carrying out internal reconciliations of the *financial instruments* held for each *client* with the *financial instruments* held by the *firm* and third parties is an important step in the discharge of the *firm's* obligations under CASS 6.5.2R, SYSC 4.1.1R and SYSC 6.1.1R.

(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.

(3) Reconciliation methods which can be adopted for these purposes include the 'total count method', which requires that all *financial instruments* be counted and reconciled as at the same date.

(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 *financial instrument* are counted and reconciled as at the same date; and
- (b) all *financial instruments* are counted and reconciled during a period of six months.

6.5.5 R A *firm* that uses an alternative reconciliation method must first send a written confirmation to the *FSA* 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.

Reconciliations with external records

6.5.6 R A *firm* must conduct on a regular basis, reconciliations between its internal accounts and records and those of any third parties by whom those *financial instruments* are held.

[Note: article 16(1)(c) of the *MiFID implementing Directive*]

6.5.7 G Where a *firm* deposits *financial instruments* 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 *financial instruments* credited to the account, 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*.

Frequency of external reconciliations

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 *financial instruments* are held.

Independence of person conducting reconciliations

6.5.9 G Whenever possible, a *firm* should ensure that 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 reconciled (see *SYSC 5.1.6R*).

Reconciliation 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.

6.5.11 G Items recorded or held within a suspense or error account fall within the scope of discrepancies.

6.5.12 G A *firm* may, where justified, conclude that another *person* is responsible for an irreconcilable *shortfall* despite the existence of a dispute with that other *person* about the unreconciled item. In those circumstances, the *firm* is not required to

make good the *shortfall* but is expected to take reasonable steps to resolve the position with the other *person*.

Notification requirements

- 6.5.13 R A *firm* must inform the *FSA* in writing without delay:
- (1) if it has not complied with, or is unable, in any material respect, to comply with the requirements in *CASS* 6.5.1R, *CASS* 6.5.2R or *CASS* 6.5.6R; or
 - (2) if, having carried out a reconciliation, it has not complied with, or is unable, in any material respect, to comply with *CASS* 6.5.10R.

Audit of compliance with the MiFID custody rules

- 6.5.14 G *Firms* are reminded that the auditor of the *firm* has to confirm in the report submitted to the *FSA* under *SUP* 3.10 (Duties of auditors: notification and report on client assets) that the *firm* has maintained systems adequate to enable it to comply with the *rules* in this chapter.
- 6.5.15 G *Firms* that use an alternative reconciliation method are reminded that the *firm's* auditor must confirm to the *FSA* in writing that the *firm* has in place systems and controls which are adequate to enable it to use another method effectively (see *CASS* 6.5.5R).

After *CASS* 6, insert the following provisions. This material is all new and it is not underlined.

Client money: MiFID business

7.1 Application and Purpose

Application

- 7.1.1 R This chapter (the *client money rules*) applies to a *MiFID investment firm*:
- (1) that holds *client money*; or
 - (2) that opts to comply with this chapter in accordance with *CASS* 7.1.3R(1) (Opt-in to the MiFID client money rules);

unless otherwise specified in this section.

- 7.1.2 G *CASS* 7.2 (Definition of client money) sets out the circumstances in which *money* is considered *client money* for the purposes of this chapter.

Opt-in to the MiFID client money rules

- 7.1.3 R (1) A *firm* that receives or holds *money* in respect of which this chapter applies and *money* in respect of which the *non-directive client money chapter* or the *insurance client money chapter* applies, may elect to comply with the provisions of this chapter in respect of all such *money* and if it does so, this chapter applies as if all such *money* were *money* that the *firm* receives and holds in the course of, or in connection with, its *MiFID business*.
- (2) A *firm* must make and retain a written record of any election it makes under this *rule*, including the date from which the election is to be effective. The *firm* must make the record on the date it makes the election and must keep it for a period of five years after ceasing to use it.
- 7.1.4 G The opt-in to this chapter in accordance with this section does not apply in respect of *money* that a *firm* holds outside of the scope of the *non-directive client money chapter* or the *insurance client money chapter*, such as *money* falling within the scope of the opt-out for non-IMD designated investment business (see CASS 4.1.11R).
- 7.1.5 G If a *firm* has opted to comply with this chapter, the *non-directive client money chapter* or the *insurance client money chapter* will have no application to the activities to which the election applies.
- 7.1.6 G A *firm* that is only subject to the *non-directive client money chapter* or the *insurance client money chapter* may not opt to comply with this chapter.
- 7.1.7 G If a *firm* that has agreed with an *insurance undertaking* under the *client money rules* in the *insurance client money chapter* to treat the undertaking's *money* as *client money*, opts in to this chapter in accordance with this section, the *insurance undertaking's* interest under the trust (or in Scotland agency) will be subordinated to the interests of the *firm's* other *clients*.
- Credit institutions
- 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*]
- 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.

7.1.10 G Pursuant to *Principle 10 (Clients' assets)*, a *credit institution* that holds *money* as a deposit with itself should be able to account to all of its *clients* for amounts held on their behalf 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.

7.1.11 G A *credit institution* is reminded that the exemption for deposits is not an absolute exemption from the *client money rules*.

Affiliated companies

7.1.12 G A *firm* that holds *money* on behalf of, or receives *money* from, an *affiliated company* in respect of *MiFID business* must treat the *affiliated company* as any other *client* of the *firm* for the purposes of this chapter.

7.1.13 G A *firm* that holds *client money* on behalf of, or receives *money* from, an *affiliated company* in respect of its *non-MiFID business* and opts under CASS 7.1.3R(1) to comply with this chapter in with respect of that *non-MiFID business*, should refer to the *non-directive client money chapter* (see CASS 4.1.18R (Affiliated companies)) to determine whether that *money* falls within the scope of the *non-directive client money chapter* and therefore within the scope of the opt-in.

Coins

7.1.14 R The *client money rules* do not apply with respect to coins held on behalf of a *client* if the *firm* and the *client* have agreed that the *money* (or *money* of that type) is to be held by the *firm* for the intrinsic value of the metal which constitutes the coin.

Solicitors

7.1.15 R (1) An *authorised professional firm* regulated by the Law Society (of England and Wales), the Law Society of Scotland or the Law Society of Northern Ireland must comply with the *MiFID client money (minimum implementing) rules* and also with the following rules of its *designated professional body* and if it does so, it will be deemed to comply with the *client money rules* in this chapter.

(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; 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; and
- (c) if the *firm* is regulated by the Law Society of Northern Ireland, the Solicitors' Accounts Regulations 1998.

General purpose

- 7.1.16 G (1) *Principle 10* (Clients' assets) requires a *firm* to arrange adequate protection for *clients'* assets when the *firm* is responsible for them. An essential part of that protection is the proper accounting and treatment of *client money*. The *client money rules* provide requirements for *firms* that receive or hold *client money*, in whatever form.
- (2) The *client money rules* also implement the provisions of *MiFID* which regulate the obligations of a *firm* when it holds *client money*.

7.2 Definition of client money

- 7.2.1 R For the purposes of this chapter and the *MiFID custody chapter*, *client money* means any *money* that a *firm* receives from or holds for, or on behalf of, a *client* in the course of, or in connection with, its *MiFID business* unless otherwise specified in this section.

Business in the name of the firm

- 7.2.2 R *Money* is not *client money* where the *firm* carries on business in its own name on behalf of the *client* where that is required by the very nature of the transaction and the *client* is in agreement.

[Note: recital 26 to *MiFID*]

Title transfer collateral arrangements

- 7.2.3 R Where a *client* transfers full ownership of *money* to a *firm* for the purpose of securing or otherwise covering present or future, actual or contingent or prospective obligations, such *money* should no longer be regarded as *client money*.

[Note: recital 27 to *MiFID*]

- 7.2.4 G A title transfer financial collateral arrangement under *the Financial Collateral Directive* is an example of a type of transfer of *money* to cover

obligations where that *money* will not be regarded as *client money*.

- 7.2.5 G Where a *firm* has received full title or full ownership to *money* under a collateral arrangement, the fact that it has also taken a security interest over its obligation to repay that *money* to the *client* would not result in the *money* being *client money*. This can be compared to a situation in which a *firm* takes a charge or other security interest over *money* held in a *client bank account*, where that *money* would still be *client money* as there would be no absolute transfer of title to the *firm*. However, if that security interest includes a "right to use arrangement", under which the *client* agrees to transfer all of its rights to *money* in that account to the *firm* upon the exercise of the right to use, the *money* may cease to be *client money*, but only once the right to use is exercised and the *money* is transferred out of the account to the *firm*.
- 7.2.6 G *Firms* are reminded of the *client's best interest rule*, which requires a *firm* to act honestly, fairly and professionally in accordance with the best interests of its *clients* when structuring its business particularly in respect of the effect of that structure on *firms'* obligations under the *client money rules*.
- 7.2.7 G Pursuant to the *client's best interests rule*, a *firm* should ensure that where a *retail client* transfers full ownership of *money* to a *firm*:
- (1) the *client* is notified that full ownership of the *money* has been transferred to the *firm* and, as such, the *client* no longer has a proprietary claim over this *money* and the *firm* can deal with it on its own right;
 - (2) the transfer is for the purposes of securing or covering the *client's* obligations;
 - (3) an equivalent transfer is made back to the *client* if the provision of collateral by the *client* is no longer necessary; and
 - (4) there is a reasonable link between the timing and the amount of the collateral transfer and the obligation that the *client* owes, or is likely to owe, to the *firm*.

Money in connection with a "delivery versus payment" transaction

- 7.2.8 R *Money* need not be treated as *client money* in respect of a delivery versus payment transaction through a commercial settlement system if it is intended that either:
- (1) in respect of a *client's* purchase, *money* from a *client* will be due to the *firm* within one *business day* upon the fulfilment of a delivery obligation; or
 - (2) in respect of a *client's* sale, *money* is due to the *client* within one *business day* following the *client's* fulfilment of a delivery obligation;

unless the delivery or payment by the *firm* does not occur by the close of business on the third *business day* following the date of payment or delivery of the *investments* by the *client*.

Money due and payable to the firm

- 7.2.9 R (1) *Money* is not *client money* when it becomes properly due and payable to the *firm* for its own account.
- (2) For these purposes, if a *firm* makes a payment to, or on the instructions of, a *client*, from an account other than a *client bank account*, until that payment has cleared, no equivalent sum from a *client bank account* for reimbursement will become due and payable to the *firm*.
- 7.2.10 G *Money* held as *client money* becomes due and payable to the *firm* or for the *firm's* own account, for example, because the *firm* acted as *principal* in the contract or the *firm*, acting as agent, has itself paid for *securities* in advance of receiving the purchase *money* from its *client*. The circumstances in which it is due and payable will depend on the contractual arrangement between the *firm* and the *client*.
- 7.2.11 G When a *client's* obligation or liability, that is secured by that *client's* asset, crystallises, and the *firm* realises the asset in accordance with an agreement entered into between the *client* and the *firm*, the part of the proceeds of the asset to cover such liability that is due and payable to the *firm* is not *client money*. However, any proceeds of sale in excess of the amount owed by the *client* to the *firm* should be paid over to the *client* immediately or be held in accordance with the *client money rules*.

Commission rebate

- 7.2.12 G When a *firm* has entered into an arrangement under which *commission* is rebated to a *client*, those rebates need not be treated as *client money* until they become due and payable to the *client* in accordance with the terms of the contractual arrangements between the parties.
- 7.2.13 G When *commission* rebate becomes due and payable to the *client*, the *firm* should:
- (1) treat it as *client money*; or
- (2) pay it out in accordance with the *rule* regarding the discharge of a *firm's* fiduciary duty to the *client* (see CASS 7.2.15R);

unless the *firm* and the *client* have entered into an arrangement under which the *client* has agreed to transfer full ownership of this *money* to the *firm* as collateral against payment of future professional fees (see CASS 7.2.3R (Title transfer collateral arrangements)).

Interest

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

Discharge of fiduciary duty

7.2.15 R *Money* ceases to be *client money* if it is paid:

- (1) to the *client*, or a duly authorised representative of the *client*; or
- (2) to a third party on the instruction of the *client*, unless it is transferred to a third party in the course of effecting a transaction, in accordance with CASS 7.5.2R (Transfer of client money to a third party); or
- (3) into a bank account of the *client* (not being an account which is also in the name of the *firm*); or
- (4) to the *firm* itself, when it is due and payable to the *firm* (see CASS 7.2.9R (Money due and payable to the firm)); or
- (5) to the *firm* itself, when it is an excess in the *client bank account* (see CASS 7.6.13R(2) (Reconciliation discrepancies)).

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.

7.2.17 R When a *firm* draws a cheque or other payable order to discharge its fiduciary duty to the *client*, it must continue to treat the sum concerned as *client money* until the cheque or order is presented and paid by the bank.

Allocated but unclaimed client money

7.2.18 G The purpose of the *rule* on allocated but unclaimed *client money* is to allow 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 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.

7.2.20 E (1) Reasonable steps should include:

- (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*;
- (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);

- (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;
- (d) making and retaining records of all balances released from *client bank accounts*; and
- (e) undertaking to make good any valid claim against any released balances.

(2) Compliance with (1) may be relied on as tending to establish compliance with CASS 7.2.19R.

(3) Contravention of (1) may be relied on as tending to establish contravention of CASS 7.2.19R.

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*.

7.3 Organisational requirements: client money

Requirement to protect client money

7.3.1 R A *firm* must, when holding *client money*, make adequate arrangements to safeguard the *client's* rights and prevent the use of *client money* for its own account.

[Note: article 13(8) of *MiFID*]

Requirement to have adequate organisational arrangements

7.3.2 R A *firm* must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of *client money*, or of rights in connection with *client money*, as a result of misuse of *client money*, fraud, poor administration, inadequate record-keeping or negligence.

[Note: article 16(1)(f) of the *MiFID implementing Directive*]

7.4 Segregation of client money

Depositing client money

7.4.1 R A *firm*, on receiving any *client money*, must promptly place this *money* into one or more accounts opened with any of the following:

- (1) a central bank;
- (2) a *BCD credit institution*;

(3) a bank authorised in a third country;

(4) a *qualifying money market fund*.

[Note: article 18(1) of the *MiFID implementing Directive*]

7.4.2 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*.

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 the *MiFID custody chapter*.

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

7.4.4 G A *firm* that places *client money* in a *qualifying money market fund* should ensure that it has the *permissions* required to invest in and hold units in that fund and must comply with the *rules* that are relevant for those activities.

7.4.5 R A *firm* must give a *client* the right to oppose the placement of his *money* in a *qualifying money market fund*.

[Note: article 18(3) of the *MiFID implementing Directive*]

7.4.6 G If a *firm* that intends to place *client money* in a *qualifying money market fund* is subject to the *requirement to disclose information before providing services*, it should, in compliance with that obligation, notify the *client* that:

(1) *money* held for that *client* will be held in a *qualifying money market fund*; and

(2) as a result, the *money* will not be held in accordance with the *client money rules* but in accordance with the *custody rules*.

A *firm's* selection of a credit institution, bank or money market fund

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 *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*]

7.4.8 R When a *firm* makes the selection, appointment and conducts the periodic review of a *credit institution*, a bank or a *qualifying money market fund*, it must take into account:

(1) the expertise and market reputation of the third party; and

- (2) any legal requirements or market practices related to the holding of *client money* that could adversely affect *clients'* rights.

[Note: article 18(3) of the *MiFID implementing Directive*]

- 7.4.9 G In discharging its obligations when selecting, appointing and reviewing the appointment of a *credit institution*, a bank or a *qualifying money market fund*, a *firm* should also consider, together with any other relevant matters:
- (1) the need for diversification of risks;
 - (2) the capital of the *credit institution* or bank;
 - (3) the amount of *client money* placed, as a proportion of the *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;
 - (4) the credit rating of the *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 *credit institution* or bank and *affiliated companies*.
- 7.4.10 R A *firm* must make a record of the grounds upon which it satisfies itself as to the appropriateness of its selection of a *credit institution*, a bank or a *qualifying money market fund*. 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 *client money*.
- Client bank accounts
- 7.4.11 R A *firm* must take the necessary steps to ensure that *client money* deposited, in accordance with CASS 7.4.1R, in a central bank, a *credit institution*, a bank authorised in a third country or a *qualifying money market fund* is held in an account or accounts identified separately from any accounts used to hold *money* belonging to the *firm*.
- [Note: article 16(1)(e) of the *MiFID implementing Directive*]
- 7.4.12 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 7.9.3G).
- 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.

Payment of client money into a client bank account

- 7.4.14 G Two approaches that a *firm* can adopt in discharging its obligations under the *MiFID client money segregation requirements* 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 *FSA* 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.
- 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* comply with its obligations to perform reconciliations of records and accounts (see *CASS 7.6.2R*). A *firm* that adopts the alternative approach will segregate *client money* into a *client bank account* on a daily basis, after having performed a reconciliation of records and accounts of the entitlement of each *client* for whom the *firm* holds *client money* with the records and accounts of the *client money* the *firm* holds in *client bank account* and *client transaction accounts* to determine what the *client money* requirement was at the close of the previous *business day*.
- 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, into a *client bank account*; 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*).
- 7.4.18 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), *SYSC 4.1.1R* and *SYSC 6.1.1R*, 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*).

- 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 1).

7.4.20 G Pursuant to the *MiFID client money segregation requirements*, 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 pay into a *client bank account* *money* of its own, and that *money* will then become *client money* for the purposes of this chapter.

Automated transfers

- 7.4.22 G Pursuant to the *MiFID 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.

Mixed remittance

- 7.4.23 G Pursuant to the *MiFID 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.

Appointed representatives, field representatives and other agents

- 7.4.24 G (1) Pursuant to the *MiFID 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, 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*.

- (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).

- 7.4.25 G The *firm* should ensure that its *appointed representatives, field representatives* or other agents keeps *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*.
- 7.4.26 G A *firm* that operates a number of small branches, but holds or accounts for all *client money* centrally, may treat those small branches in the same way as *appointed representatives*.

Client entitlements

- 7.4.27 G Pursuant to the *MiFID 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.

- 7.4.28 G Pursuant to the *MiFID 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.

Money due to a client from a firm

- 7.4.29 G Pursuant to the *MiFID 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*.

Segregation in different currency

7.4.30 R A *firm* may segregate *client money* in a different currency from that of receipt. 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 7.4.30R) does not apply where the *client* has instructed the *firm* to convert the *money* into and hold it in a different currency.

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 *client money* to another *person* without discharging its fiduciary duty owed to that *client*. Such circumstances arise when, for example, a *firm* passes *client money* to a *clearing house* in the form of margin for the *firm's* obligations to the *clearing house* that are referable to transactions undertaken by the *firm* for the relevant clients. They may also arise when a *firm* passes *client money* to an *intermediate broker* for *contingent liability investments* in the form of initial or variation margin on behalf of a *client*. In these circumstances, the *firm* remains responsible for that *client's 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 the *client money*:
 - (a) for the purpose of a transaction for a *client* through or with that *person*; or
 - (b) to meet a *client's* obligation to provide collateral for a transaction (for example, an *initial margin* requirement for a *contingent liability investment*); and
- (2) in the case of a *retail client*, that *client* has been notified that the *client money* may be transferred to the other *person*.

7.5.3 G 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*.

7.6 Records, accounts and reconciliations

Records and accounts

7.6.1 R A *firm* must keep such records and accounts as are necessary to enable it, at any time and without delay, to distinguish *client money* held for one *client* from *client money* held for any other *client*, and from its own *money*.

[Note: article 16(1)(a) of the *MiFID implementing Directive*]

7.6.2 R A *firm* must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the *client money* held for *clients*.

[Note: article 16(1)(b) of the *MiFID implementing Directive*]

Client entitlements

7.6.3 G Pursuant to *CASS 7.6.2R, SYSC 4.1.1R* and *SYSC 6.1.1R*, a *firm* should take reasonable steps to ensure that is notified promptly of any receipt of *client money* in the form of a *client* entitlement.

Record keeping

7.6.4 R A *firm* must ensure that records made under *CASS 7.6.1R* and *CASS 7.6.2R* 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*.

Internal reconciliations of client money balances

7.6.6 G (1) *SYSC 4.1.1R* requires *firms* to have robust governance arrangements, such as internal control mechanisms, including sound administrative and accounting procedures and effective control and safeguard arrangements for information processing systems. In addition, *SYSC 6.1.1R* requires *firms* to establish, implement and maintain adequate policies and procedures sufficient to ensure the *firm's* compliance with its obligations under the *regulatory system*. 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, SYSC 4.1.1R* and *SYSC 6.1.1R*.

- (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.
- (3) The *standard method of internal client money reconciliation* sets out a method of reconciliation of *client money* balances that the *FSA* believes should be one of the steps that a *firm* takes when carrying out internal reconciliations of *client money*.

Records

- 7.6.7 R (1) A *firm* must make records, sufficient to show and explain the method of internal reconciliation of *client money* balances under *CASS 7.6.2R* used, and if different from the *standard method of internal client money reconciliation*, to show and explain that:
- (a) the method of internal reconciliation of *client money* balances used affords an equivalent degree of protection to the *firm's clients* to that afforded by the *standard method of internal client money reconciliation*; and
 - (b) in the event of a *primary pooling event* or a *secondary pooling event*, the method used is adequate to enable the *firm* to comply with the *client money (MiFID business) distribution rules*.
- (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 made for a period of five years after ceasing to use it.
- 7.6.8 R A *firm* that does not use the *standard method of internal client money reconciliation* must first send a written confirmation to the *FSA* 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.

Reconciliations with external records

- 7.6.9 R A *firm* must conduct, on a regular basis, reconciliations between its internal accounts and records and those of any third parties by whom *client money* is held.

[Note: article 16(1)(c) of the *MiFID implementing Directive*]

Frequency of external 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.

- (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.

Method of external reconciliations

- 7.6.11 G A method of reconciliation of *client money* balances with external records that the *FSA* 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.

- 7.6.12 R Any *approved collateral* held in accordance with the *client money rules* must be included within this reconciliation.

Reconciliation discrepancies

- 7.6.13 R When any discrepancy arises as a result of a *firm's* internal reconciliations, the *firm* must identify the reason for the discrepancy and ensure that:
- (1) any *shortfall* is paid into a *client bank account* by the close of business on the day that the reconciliation is performed; or
 - (2) any excess is withdrawn 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*, 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 arising from a reconciliation between a *firm's* internal records and those of third parties that hold *client money*, and one record or a set of records examined by the *firm* during its reconciliation indicates that there is a need to have a greater amount of *client money* or *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 *FSA* in writing without delay:
- (1) if it has not complied with, or is unable, in any material respect, to comply with the requirements in *CASS 7.6.1R*, *CASS 7.6.2R* or *CASS 7.6.9R*;
 - (2) if having carried out a reconciliation it has not complied with, or is unable, in any material respect, to comply with *CASS 7.6.13R* to *CASS 7.6.15R*.

Audit of compliance with the MiFID client money rules

- 7.6.17 G *Firms* are reminded that the auditor of the *firm* has to confirm in the report submitted to the *FSA* under *SUP 3.10* (Duties of auditors: notification and report on client assets) that the *firm* has maintained systems adequate to enable it to comply with the *client money rules*.
- 7.6.18 G *Firms* that do not adopt the normal approach are reminded that the *firm's* auditor must confirm to the *FSA* in writing that the *firm* has in place systems and controls which are adequate to enable it to operate the alternative approach effectively (see *CASS 7.4.15R*).
- 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 *FSA* in writing that the *firm* has in place systems and controls which are adequate to enable it to use another method effectively (see *CASS 7.6.8R*).

7.7 Statutory trust

- 7.7.1 G Section 139(1) of the *Act* (Miscellaneous ancillary matters) provides that *rules* may make provision which result in *client money* being held by a *firm* on trust (England and Wales and Northern Ireland) or as agent (Scotland only). This section creates a fiduciary relationship between the *firm* and its *client* under which *client money* is in the legal ownership of the *firm* but remains in the beneficial ownership of the *client*. In the event of *failure* of the *firm*, costs relating to the distribution of *client money* may have to be borne by the trust.

Requirement

- 7.7.2 R A *firm* receives and holds *client money* as trustee (or in Scotland as agent)

on the following terms:

- (1) for the purposes of and on the terms of the *client money rules* and the *client money (MiFID business) distribution rules*;
- (2) subject to (3), for the *clients* (other than *clients* which are *insurance undertakings* when acting as such with respect of *client money* received in the course of *insurance mediation activity* and that was opted in to this chapter) for whom that *money* is held, according to their respective interests in it;
- (3) after all valid claims in (2) have been met, for *clients* which are *insurance undertakings* with respect of *client money* received in the course of *insurance mediation activity* according to their respective interests in it;
- (4) on *failure* of the *firm*, for the payment of the costs properly attributable to the distribution of the *client money* in accordance with (2); and
- (5) after all valid claims and costs under (2) to (4) have been met, for the *firm* itself.

7.8 Notification and acknowledgement of trust

Banks

- 7.8.1 R (1) When a *firm* opens a *client bank account*, the *firm* must give or have given written notice to the bank requesting the bank to acknowledge to it in writing that:
- (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.

Exchange, clearing house, intermediate broker or OTC counterparty

- 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:

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

7.9 Client money distribution

Application

- 7.9.1 R This section (the *client money (MiFID business) 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* occurs.

Purpose

- 7.9.2 G The *client money (MiFID business) distribution rules* seek to facilitate the timely return 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*.

Failure of the authorised firm: primary pooling event

- 7.9.3 G A *firm* can hold *client money* in either a *general client bank account*, a *designated client bank account* or a *designated client fund account*. 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. 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. 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 (MiFID business) distribution rules*.

- 7.9.4 R A *primary pooling event* occurs:
- (1) on the *failure* of the *firm*;
 - (2) on the vesting of assets in a *trustee* in accordance with an 'assets requirement' imposed under section 48(1)(b) of the *Act*;
 - (3) on the coming into force of a *requirement* for all *client money* held by the *firm*; or
 - (4) when the *firm* notifies, or is in breach of its duty to notify, the *FSA*, in accordance with CASS 7.6.16R (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*.

- 7.9.5 R CASS 7.9.4R(4) does not apply so long as:
- (1) the *firm* is taking steps, in consultation with the *FSA*, to establish those records; and
 - (2) there are reasonable grounds to conclude that the records will be capable of rectification within a reasonable period.

Pooling and distribution

- 7.9.6 R If a *primary pooling event* occurs:
- (1) *client money* held in each *client money* account of the *firm* is treated as pooled; and
 - (2) the *firm* must distribute that *client money* 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 7.9.7R.
- 7.9.7 R
- (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*.
 - (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 *client equity balance* for that *client*.
- 7.9.8 G A *client's* main claim is for the return of *client money* held in a *client bank account*. A *client* may be able to claim for any *shortfall* against money held

in a *firm's* own account. For that claim, the *client* will be an unsecured creditor of the *firm*.

Client money received after the failure of the firm

- 7.9.9 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 7.9.7R, shows that *money* is due from the *client* to the *firm* at the time of the *primary pooling event*.
- 7.9.10 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*.
- 7.9.11 R If a *firm* receives a *mixed remittance* after a *primary pooling event*, it must:
- (1) pay the full sum into the separate *client bank account* opened in accordance with CASS 7.9.9R; and
 - (2) pay the *money* that is not *client money* out of that *client bank account* into a *firm's* own bank account within one *business day* of the *day* on which the *firm* would normally expect the remittance to be cleared.
- 7.9.12 G Whenever possible the *firm* should seek to split a *mixed remittance* before the relevant accounts are credited.
- Failure of a bank, intermediate broker, settlement agent or OTC counterparty: secondary pooling events
- 7.9.13 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.
- 7.9.14 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

(3) (Depositing client money) or CASS 7.5.2R (Transfer of client money to a third party).

- 7.9.15 R CASS 7.9.19R to CASS 7.9.31R do not apply if, on the *failure* of the third party, the *firm* repays to its *clients* or pays into a *client bank account*, at an unaffected bank, an amount equal to the amount of *client money* which would have been held if a *shortfall* had not occurred at that third party.
- 7.9.16 G When *client money* is transferred to a third party, a *firm* continues to owe fiduciary duties to the *client*. Whether a *firm* is liable for a *shortfall* in *client money* caused by a third party failure will depend on whether it has complied with its duty of care as agent or trustee.

Failure of a bank

- 7.9.17 G When a bank *fails* and the *firm* decides not to make good the *shortfall* in the amount of *client money* held at that bank, a *secondary pooling event* will occur in accordance with CASS 7.9.19R. The *firm* would be expected to reflect the *shortfall* that arises at the *failed* bank in its records of the entitlement of *clients* and of *money* held with third parties.
- 7.9.18 G The *client money (MiFID business) distribution rules* seek to ensure that *clients* who have previously specified that they are not willing to accept the risk of the bank that has *failed*, and who therefore requested that their *client money* be placed in a *designated client bank account* at a different bank, should not suffer the loss of the bank that has *failed*.

Failure of a bank: pooling

- 7.9.19 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, then:
- (1) in relation to every *general client bank account* of the *firm*, the provisions of CASS 7.9.21R, CASS 7.9.26R and CASS 7.9.27R will apply;
 - (2) in relation to every *designated client bank account* held by the *firm* with the *failed* bank, the provisions of CASS 7.9.23R, CASS 7.9.26R and CASS 7.9.27R will apply;
 - (3) in relation to each *designated client fund account* held by the *firm* with the *failed* bank, the provisions of CASS 7.9.24R, CASS 7.9.26R and CASS 7.9.27R will apply;
 - (4) any *money* held at a bank, other than the bank that has *failed*, in *designated client bank accounts*, is not pooled with any other *client money*; and
 - (5) any *money* held in a *designated client fund account*, no part of which is held by the bank that has *failed*, is not pooled with any other *client money*.

- 7.9.20 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 7.9.23R, CASS 7.9.26R and CASS 7.9.27R will apply; and
 - (2) in relation to each *designated client fund account* held by the *firm* with the *failed* bank, the provisions of CASS 7.9.24R, CASS 7.9.26R and CASS 7.9.27R will apply.
- 7.9.21 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* of the bank, 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;
 - (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;
 - (3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed* bank until the *client* is repaid; and
 - (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), for the purposes of reconciliations pursuant to CASS 7.6.2R (Records and accounts), SYSC 4.1.1R (General organisational requirements) and SYSC 6.1.1R (Compliance) (as described in CASS 7.6.6G).
- 7.9.22 G The term 'which should have been held' is a reference to the *failed* bank's *failure* to hold the *client money* at the time of the pooling event.
- 7.9.23 R For each *client* with a *designated client bank account* 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* whose *client money* is held in a *designated client bank account* of the *firm* at the *failed* bank, rateably in accordance with their entitlements;
 - (2) a new *client money* entitlement must be calculated for each of the relevant *clients* by the *firm*, and the *firm's* records must be amended to reflect the reduced *client money* entitlement;
 - (3) the *firm* must make and retain a record of each *client's* share of the

client money shortfall at the *failed* bank until the *client* is repaid; and

- (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), for the purposes of reconciliations pursuant to CASS 7.6.2R (Records and accounts), SYSC 4.1.1R (General organisational requirements) and SYSC 6.1.1R (Compliance) (as described in CASS 7.6.6G).

7.9.24 R *Money held in each designated client fund account with the failed bank must be treated as pooled with any other designated client fund accounts of the firm which contain part of the same designated fund and:*

- (1) any *shortfall* in *client money* held, or which should have been held, in *designated client fund accounts* that has arisen as a result of the *failure*, must be borne by each of the *clients* whose *client money* is held in that designated fund, rateably in accordance with their entitlements;
- (2) a new *client money* entitlement must be calculated for each *client* by the *firm*, in accordance with (1), and the *firm's* records must be amended to reflect the reduced *client money* entitlement;
- (3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed* bank until the *client* is repaid; and
- (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), for the purposes of reconciliations pursuant to CASS 7.6.2R (Records and accounts), SYSC 4.1.1R (General organisational requirements) and SYSC 6.1.1R (Compliance) (as described in CASS 7.6.6G).

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

Client money received after the failure of a bank

7.9.26 R *Client money received by the firm after the failure of a bank, that would otherwise have been paid into a client bank account at that bank:*

- (1) must not be transferred to the *failed* bank unless specifically instructed by the *client* in order to settle an obligation of that *client* to the *failed* bank; 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 bank other than the one that has *failed*; or

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

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

- (1) pay the full sum into a *client bank account* other than one operated at the bank that has *failed*; and
- (2) pay the *money* that is not *client money* out of that *client bank account* within one *business day* of the day on which the *firm* would normally expect the remittance to be cleared.

7.9.28 G Whenever possible the *firm* should seek to split a *mixed remittance* before the relevant accounts are credited.

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

7.9.29 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 7.9.30R and CASS 7.9.31R will apply.

7.9.30 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 account*, 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 accounts* 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), SYSC 4.1.1R (General organisational requirements) and SYSC 6.1.1R (Compliance) (as described in CASS 7.6.6G).

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

- 7.9.31 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.

Notification to the FSA: failure of a bank, intermediate broker, settlement agent or OTC counterparty

- 7.9.32 R On the *failure* of a third party with which *money* is held, a *firm* must notify the *FSA*:
- (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.

CASS 7 Annex 1G

As explained in CASS 7.6.6G, in complying with its obligations under CASS 7.6.2R (Records and accounts), SYSC 4.1.1R (General organisational requirements) and SYSC 6.1.1R (Compliance), a *firm* should carry out internal reconciliations of records and accounts of *client money* the *firm* holds in *client bank accounts* and *client transaction accounts*. This Annex sets out a method of reconciliation that the *FSA* believes is appropriate for these purposes (the *standard method of internal client money reconciliation*).

1. Each *business day*, a *firm* that adopts the normal approach (see CASS 7.4.17G) should check whether its *client money* resource, being the aggregate balance on the *firm's client bank accounts*, as at the close of business on the previous *business day*, was at least equal to the *client money* requirement, as defined in paragraph 6 below, as at the close of business on that day.
2. Each *business day*, a *firm* that adopts the alternative approach (see CASS 7.4.18R) should ensure that its *client money* resource, being the aggregate balance on the *firm's client bank accounts*, as at the close of business on that *business day* is at least equal to the *client money* requirement, as defined in paragraph 6 below, as at the close of business on the previous *business day*.

3. No excess or *shortfall* should arise when adopting the alternative approach.
4. If a *firm* is operating the alternative approach and draws a cheque on its own bank account, it will be expected to account for those cheques that have not yet cleared when performing its reconciliations of records and accounts under paragraph 2. An historic average estimate of uncleared cheques may be used to satisfy this obligation (see CASS 7.4.19G(3)).
5. For the purposes of performing its reconciliations of records and accounts under paragraphs 1 or 2, a *firm* should use the values contained in its accounting records, for example its cash book, rather than values contained in statements received from its banks and other third parties.

Client money requirement

6. The *client money* requirement is either:
 - (1) (subject to paragraph 18) the sum of, for all *clients*:
 - (a) the individual *client* balances calculated in accordance with paragraph 7, excluding:
 - (i) individual *client* balances which are negative (that is, debtors); and
 - (ii) *clients' equity balances*; and
 - (b) the total *marginied transaction* requirement calculated in accordance with paragraph 14; or
 - (2) the sum of:
 - (a) for each *client bank account*:
 - (i) the amount which the *firm's* records show as held on that account; and
 - (ii) an amount that offsets each negative net amount which the *firm's* records show attributed to that account for an individual *client*; and
 - (b) the total *marginied transaction* requirement calculated in accordance with paragraph 14.

General transactions

7. The individual *client* balance for each *client* should be calculated in accordance with this table:

Individual client balance calculation

	Free <i>money</i> (no trades) and	A
	sale proceeds due to the <i>client</i> :	
(a)	in respect of <i>principal deals</i> when the <i>client</i> has delivered the <i>designated investments</i> ; and	B
(b)	in respect of <i>agency deals</i> , when either:	
(i)	the sale proceeds have been received by the <i>firm</i> and the <i>client</i> has delivered the <i>designated investments</i> ; or	C1
(ii)	the <i>firm</i> holds the <i>designated investments</i> for the <i>client</i> ; and	C2
	the cost of purchases:	
(c)	in respect of <i>principal deals</i> , paid for by the <i>client</i> but the <i>firm</i> has not delivered the <i>designated investments</i> to the <i>client</i> ; and	D
(d)	in respect of <i>agency deal</i> , paid for by the <i>client</i> when either:	
(i)	the <i>firm</i> has not remitted the <i>money</i> to, or to the order of, the counterparty; or	E1
(ii)	the <i>designated investments</i> have been received by the <i>firm</i> but have not been delivered to the <i>client</i> ;	E2
Less		
	<i>money</i> owed by the <i>client</i> in respect of unpaid purchases by or for the <i>client</i> if delivery of those <i>designated investments</i> has been made to the <i>client</i> ; and	F
	Proceeds remitted to the <i>client</i> in respect of sales transactions by or for the <i>client</i> if the <i>client</i> has not delivered the <i>designated investments</i> .	G
Individual <i>Client</i> Balance 'X' = (A+B+C1+C2+D+E1+E2)-F-G		X

8. A *firm* should calculate the individual *client* balance using the contract value of any *client* purchases or sales.
9. A *firm* may choose to segregate *designated investments* instead of the value identified in paragraph 7 (except E1) if it ensures that the *designated investments* are held in such a manner that the *firm* cannot use them for its own purposes.

10. Segregation in the context of paragraph 9 can take many forms, including the holding of a *safe custody investment* in a nominee name and the safekeeping of certificates evidencing title in a fire resistant safe. It is not the intention that all the *custody rules* in the *MiFID custody chapter* should be applied to *designated investments* held in the course of settlement.
11. In determining the *client money* requirement under paragraph 6, a *firm* need not include *money* held in accordance with CASS 7.2.8R (Delivery versus payment transaction).
12. In determining the *client money* requirement under paragraph 6, a *firm*:
 - (1) should include dividends received and interest earned and allocated;
 - (2) may deduct outstanding *fees*, calls, rights and interest charges and other amounts owed by the *client* which are due and payable to the *firm* (see CASS 7.2.9R);
 - (3) need not include *client money* in the form of *client* entitlements which are not required to be segregated (see CASS 7.4.27G) nor include *client money* forwarded to the *firm* by its appointed representatives, field representatives and other agents, but not received (see CASS 7.4.24G);
 - (4) should take into account any *client money* arising from CASS 7.6.13R (Reconciliation discrepancies); and
 - (5) should include any unallocated *client money*.

Equity balance

13. A *firm's* equity balance, whether with an exchange, *intermediate broker* or *OTC* counterparty, is the amount which the *firm* would be liable to pay to the exchange, *intermediate broker* or *OTC* counterparty (or vice-versa) in respect of the *firm's* *marginied transactions* if each of the open positions of the *firm's* *clients* was liquidated at the closing or settlement prices published by the relevant exchange or other appropriate pricing source and the *firm's* account with the exchange, *intermediate broker* or *OTC* counterparty is closed.

Margined transaction requirement

14. The total *marginied 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 *approved collateral*; and

- (3) the net aggregate of the *firm's* equity balance (negative balances being deducted from positive balances) on transaction accounts for *customers* with exchanges, *clearing houses*, *intermediate brokers* and *OTC* counterparties.
15. To meet a shortfall that has arisen in respect of the requirement in paragraph 6(1)(b) or 6(2)(b), a *firm* may utilise its own *approved collateral* provided it is held on terms specifying when it is to be realised for the benefit of *clients*, it is clearly identifiable from the *firm's* own property and the relevant terms are evidenced in writing by the *firm*. In addition, the proceeds of the sale of that *collateral* should be paid into a *client bank account*.
16. If a *firm's* total *marginied transaction* requirement is negative, the *firm* should treat it as zero for the purposes of calculating its *client money* requirement.
17. The terms '*client equity balance*' and '*firm's* equity balance' in paragraph 13 refer to cash values and do not include non-cash *collateral* or other *designated investments* held in respect of a *marginied transaction*.

Reduced client money requirement option

18. (1) When, in respect of a *client*, there is a positive individual *client* balance and a negative *client equity balance*, a *firm* may offset the credit against the debit and hence have a reduced individual *client* balance in paragraph 7 for that *client*.
- (2) When, in respect of a *client*, there is a negative individual *client* balance and a positive *client equity balance*, a *firm* may offset the credit against the debit and hence have a reduced *client equity balance* in paragraph 14 for that *client*.
19. The effect of paragraph 18 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 paragraphs 7 and 14, and, by so doing, reduce the amount the *firm* is required to segregate.

After CASS 7, insert the following provisions. This material is all new and it is not underlined.

Mandates

Application

- 8.1.1 R This chapter applies to a *firm* (including in its capacity as trustee under CASS 5.4) in respect of any written authority from a *client* under which the *firm* may control a *client's* assets or liabilities in the course of, or in connection with, the *firm's*:

- (1) *designated investment business* (including *MiFID business*); and
- (2) *insurance mediation activity*, except where it relates to a *reinsurance contract*.

8.1.2 G Mandates or similar authorities for the purpose of this chapter include a *firm's* authority over a *client's* safe custody account, for example for stock lending purposes, a *firm's* authority over a *client's* bank or building society account including direct debits in favour of the *firm*, and a *firm* holding a *client's* credit card details.

8.1.3 G *Firms* are reminded that the *mandate rules* do not apply to an *incoming EEA firm*, other than an *insurer*, with respect to its *passported activities*. The application of the *mandate rules* is also dependent on the location from which the activity is undertaken (see CASS 1.4.3G).

Purpose

8.1.4 G The *mandate rules* apply to those *firms* that control, rather than hold, *clients'* assets or are able to create liabilities in the name of a *client*. These *rules* seek to ensure that *firms* establish and maintain records and *internal controls* to prevent the misuse of the authority granted by the *client*.

General

8.1.5 R A *firm* that holds authorities of the sort referred to in this chapter, must establish and maintain adequate records and *internal controls* in respect of its use of the mandates, which must include:

- (1) an up-to-date list of the authorities and any conditions placed by the *client* or the *firm's* management on the use of them;
- (2) a record of all transactions entered into using the authority and *internal controls* to ensure that they are within the scope of authority of the *person* and the *firm* entering into the transaction;
- (3) the details of the procedures and authorities for the giving and receiving of instructions under the authority; and
- (4) where the *firm* holds a passbook or similar documents belonging to the *client*, *internal controls*, for the safeguarding (including against loss, unauthorised destruction, theft, fraud or misuse) of any passbook or similar document belonging to the *client* held by the *firm*.

Schedule 1

Record keeping requirements

The aim of the guidance in the following table is to give the reader a quick overall view of the relevant record keeping requirements.

It is not a complete statement of those requirements and should not be relied on as if it were.

CASS Sch 1.3

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
...				
<i>CASS 4.5.5R</i>	<i>Adequate records and internal controls in respect of the firm's use of mandates (see CASS 4.5.5R (1) to (4))</i>	<i>Up-to-date list of firm's authorities, all transactions entered into, important client documents held by the firm</i>	<i>Maintain current full details</i>	
...				
<i>CASS 5.8.3R</i>	<i>Mandates</i>	<i>Records of adequate internal controls for mandates</i>	<i>Not specified</i>	<i>not specified</i>
...				
<i>CASS 6.1.17R</i>	<i><u>Record of election to comply with the MiFID custody chapter</u></i>	<i><u>Record of election to comply with the MiFID custody chapter, including the date from which the election is to be effective</u></i>	<i><u>Date of the election</u></i>	<i><u>5 years (from the date the firm ceases to use the election)</u></i>
<i>CASS 6.3.1R(4)</i>	<i><u>Appropriateness of a MiFID investment firm's selection</u></i>	<i><u>Grounds upon which a MiFID investment firm satisfies itself as to the</u></i>	<i><u>Date of the selection</u></i>	<i><u>5 years (from the date the firm ceases to use the third party to hold</u></i>

	<u>of a third party</u>	<u>appropriateness of the firm's selection of a third party to hold financial instruments belonging to clients</u>		<u>financial instruments belonging to clients)</u>
<u>CASS 6.4.3R</u>	<u>Details of clients and financial instruments used for the firm's own account or the account of another client of the firm</u>	<u>Details of the client on whose instructions the use of the financial instruments has been effected and the number of financial instruments used belonging to each client</u>	<u>Maintain up-to-date records</u>	<u>5 years (from the date the record was made)</u>
<u>CASS 6.5.1R</u>	<u>Financial instruments held for each client and the firm's own financial instruments</u>	<u>All that is necessary to enable the firm to distinguish financial instruments held for one client from financial instruments held for any other client, and from the firm's own financial instruments</u>	<u>Maintain up-to-date records</u>	<u>5 years (from the date the record was made)</u>
<u>CASS 6.5.2R</u>	<u>Financial instruments held for clients</u>	<u>Accurate records to ensure the correspondence between the financial instruments held for each client and the financial instruments held by the firm</u>	<u>Maintain up-to-date records</u>	<u>5 years (from the date the record was made)</u>

		<u>and third parties</u>		
<u>CASS 7.1.3R(2)</u>	<u>Record of election to comply with the <i>MiFID client money chapter</i></u>	<u>Record of election to comply with the <i>MiFID client money chapter</i>, including the date from which the election is to be effective</u>	<u>Date of the election</u>	<u>5 years (from the date the <i>firm</i> ceases to use the election)</u>
<u>CASS 7.4.10R</u>	<u>Appropriateness of a <i>MiFID investment firm's</i> selection of a third party</u>	<u>Grounds upon which a <i>MiFID investment firm</i> satisfies itself as to the appropriateness of the <i>firm's</i> selection of a third party to hold <i>client money</i></u>	<u>Date of the selection</u>	<u>5 years (from the <i>firm</i> ceases to use the third party to hold <i>client money</i>)</u>
<u>CASS 7.6.1R</u>	<u><i>Client money</i> held for each <i>client</i> and the <i>firm's</i> own <i>money</i></u>	<u>All that is necessary to enable the <i>firm</i> to distinguish <i>client money</i> held for one <i>client</i> from <i>client money</i> held for any other <i>client</i>, and from the <i>firm's</i> own <i>money</i></u>	<u>Maintain up-to-date records</u>	<u>5 years (from the date the record was made)</u>
<u>CASS 7.6.2R</u>	<u><i>Client money</i> held for each <i>client</i></u>	<u>Accurate records to ensure the correspondence between the records and accounts of the entitlement of each <i>client</i> for whom the <i>firm</i> holds <i>client money</i> with the records and</u>	<u>Maintain up-to-date records</u>	<u>5 years (from the date the record was made)</u>

		<u>accounts of the client money the firm holds in client bank accounts and client transaction accounts</u>		
<u>CASS 7.6.7R</u>	<u>Internal reconciliation of client money balances</u>	<u>Explanation of method of internal reconciliation of client money balances used by the firm, and if different from the standard method of internal client money reconciliation, an explanation as to how the method used affords equivalent degree of protection to clients, and how it enables the firm to comply with the client money (MiFID business) distribution rules</u>	<u>Date the firm starts using the method</u>	<u>5 years (from the date the firm ceases to use the method)</u>
<u>CASS 7.9.21R(3)</u>	<u>Client money shortfall</u>	<u>Each client's entitlement to client money shortfall at the failed bank</u>	<u>Maintain up to date records</u>	<u>Until client is repaid</u>
<u>CASS 7.9.23R(3)</u>	<u>Client money shortfall</u>	<u>Each client's entitlement to client money shortfall at the failed bank</u>	<u>Maintain up to date records</u>	<u>Until client is repaid</u>

<u>CASS 7.9.24R(3)</u>	<u>Client money shortfall</u>	<u>Each client's entitlement to client money shortfall at the failed bank</u>	<u>Maintain up to date records</u>	<u>Until client is repaid</u>
<u>CASS 7.9.30R(3)</u>	<u>Client money shortfall</u>	<u>Each client's entitlement to client money shortfall at the failed intermediate broker, settlement agent or OTC counterparty</u>	<u>Maintain up to date records</u>	<u>Until client is repaid</u>
<u>CASS 8.1.5R</u>	<u>Adequate records and internal controls in respect of the firm's use of mandates (see CASS 8.1.5R (1) to (4))</u>	<u>Up to date list of firm's authorities and any conditions regarding the use of authorities, all transactions entered into, details of procedures and authorities for giving and receiving of instructions under authorities, and important client documents held by the firm</u>	<u>Maintain current full details</u>	<u>Not specified</u>

Schedule 2

Notification requirements

CASS Sch 2.1 G

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
...				

<u>CASS 6.5.13R(1)</u>	<u>Non-compliance or inability, in any material respect, to comply with the requirements in CASS 6.5.1R (Records and accounts), CASS 6.5.2R (Records and accounts, including internal reconciliations) or CASS 6.5.6R (Reconciliations with external records)</u>	<u>The fact that the firm has not complied or is unable, in any material respect, to comply with the requirements and the reasons for that</u>	<u>Non-compliance or inability, in any material respect, to comply with the requirements</u>	<u>Without delay</u>
<u>CASS 6.5.13R(2)</u>	<u>Non-compliance or inability, in any material respect, to comply with the requirements in CASS 6.5.10R (Reconciliation discrepancies)</u>	<u>The fact that the firm has not complied or is unable, in any material respect, to comply with the requirements and the reasons for that</u>	<u>Non-compliance or inability, in any material respect, to comply with the requirements</u>	<u>Without delay</u>
<u>CASS 7.6.16R(1)</u>	<u>Non-compliance or inability, in any material respect, to comply with the requirements in CASS 7.6.1R (Records and accounts), CASS 7.6.2R (Records and accounts, including internal reconciliations) or CASS 7.6.9R (Reconciliations with external records)</u>	<u>The fact that the firm has not complied or is unable, in any material respect, to comply with the requirements and the reasons for that</u>	<u>Non-compliance or inability, in any material respect, to comply with the requirements</u>	<u>Without delay</u>
<u>CASS 7.6.16R(2)</u>	<u>Non-compliance or inability, in any material respect, to comply with the requirements in</u>	<u>The fact that the firm has not complied or is unable, in any material</u>	<u>Non-compliance or inability, in any material respect, to</u>	<u>Without delay</u>

	<u>CASS 7.6.13R to CASS 7.6.15R (Reconciliation discrepancies)</u>	<u>respect, to comply with the requirements and the reasons for that</u>	<u>comply with the requirements</u>	
<u>CASS 7.9.32R(1)</u>	<u>Failure of a third party with which money is held – i.e.: bank, intermediate broker, settlement agent or OTC counterparty or other entity with which it has placed or to which it has passed client money</u>	<u>Full details</u>	<u>Firm becomes aware of the failure of the entity</u>	<u>As soon as the firm becomes aware</u>
<u>CASS 7.9.32R(2)</u>	<u>Failure of a third party with which money is held – i.e.: bank, intermediate broker, settlement agent or OTC counterparty or other entity with which it has placed or to which it has passed client money</u>	<u>Intentions regarding making good any shortfall that has arisen or may arise, and of the amounts involved</u>	<u>Failure of third party with which client money is held</u>	<u>As soon as reasonably practical</u>

...

Annex B

Amendments to the Senior Management Arrangements, Systems and Controls (SYSC)

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

...

- 1.1.8 G An example of the type of *rule* referred to in SYSC 1.1.7R with a different territorial scope is the custody rules in the non-directive custody chapter ~~in CASS 2 (Custody)~~. ~~CASS 2~~ These rules apply, for certain *UK firms*, to activities carried on from *branches* in other *EEA States* as well as *UK establishments* (CASS 1.3.3R (General application where?)). Therefore SYSC 2 and SYSC 3 apply to the *custody* activities described in ~~CASS 2~~ the non-directive custody chapter carried on from such a *branch* by such a *UK firm*. The *UK firm* must, for example, take reasonable care to establish systems and controls under SYSC 3.1.1R as are appropriate to those activities carried on from its *EEA branches* as well as from its *UK establishments*.

...

Annex C

Amendments to the Supervision manual (SUP)

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

...

Applicable sections (see SUP 3.1.1 R)

3.1.2	R	(1) Category of firm	(2) Section applicable to firm	(3) Section applicable to its auditor
		(1) ...		
		(2) <i>Authorised professional firm not within (1) to which either or both of CASS 2 (Client assets) and CASS 4 (Client money and mandates: designated investment business) the non-directive custody chapter, non-directive client money chapter, MiFID custody chapter or MiFID client money chapter applies; unless the firm is regulated by The Law Society (England and Wales), The Law Society of Scotland or The Law Society of Northern Ireland (Note 2)</i>	<i>SUP 3.1 – SUP 3.7</i>	<i>SUP 3.1, SUP 3.2, SUP 3.8, SUP 3.10</i>
		...		
		(7) <i>Investment management firm, personal investment firm (other than a small personal investment firm) or securities and futures firm (Note 3) which, in each case, has an auditor appointed as a result of a statutory provision other than the Act (<u>Notes 3 and</u></i>	<i>SUP 3.1 – SUP 3.7</i>	<i>SUP 3.1, SUP 3.2, SUP 3.8 - SUP 3.10</i>

	<u>3A)</u>		
(7A)	<i>Investment management firm, personal investment firm (other than a small personal investment firm), or securities and futures firm not within (7) to which either or both of CASS 2 (Client assets) and CASS 4 (Client money and mandates: designated investment business) the <u>non-directive custody chapter, non-directive client money chapter, MiFID custody chapter or MiFID client money chapter</u> applies</i>	<i>SUP 3.1 – SUP 3.7</i>	<i>SUP 3.1, SUP 3.2, SUP 3.8, SUP 3.10</i>
...			
(7D)	<i><u>Sole trader or partnership that is a MiFID investment firm (Note 3B)</u></i>	<i><u>SUP 3.1 – SUP 3.7</u></i>	<i><u>SUP 3.1, SUP 3.2, SUP 3.8, SUP 3.10</u></i>
...			
(10)	<i>Insurance intermediary (other than an exempt insurance intermediary) to which the <u>insurance client money chapter CASS 5 (Client money and mandates)</u> (except for CASS 5.2 (Holding money as agent)) applies (see Note 4)</i>	<i>SUP 3.1 – SUP 3.7</i>	<i>SUP 3.1, SUP 3.2, SUP 3.8, SUP 3.10</i>
...			
Note 1 = ...			
Note 2 = In row (2):			
(a)	CASS 2 (Client assets) <i>The <u>non-directive custody chapter</u> is treated as applying only if (i) the <u>firm safeguarding and administering investments</u> in connection with <u>managing investments</u> (other than when acting as trustee), or (ii) it <u>safeguarding and administering investments</u> in relation to <u>bonded investments</u> (and, in either case, it</i>		

	<u>has not opted to conduct all business that would fall within the <i>non-directive custody chapter</i> under the <i>MiFID custody chapter</i>).</u>
(b)	€ASS 4 (Client money and mandates: designated investment business) <u>The <i>non-directive client money chapter</i> is treated as applying only if the <i>firm</i> receives or holds <i>client money</i> other than under an arrangement where commission is rebated to the <i>client</i> (and assuming that it has not opted to conduct all business that would fall within the <i>non-directive client money chapter</i> under the <i>MiFID client money chapter</i>);</u>
	but, if <u>the <i>custody rules</i> or the <i>client money rules</i> above €ASS 2 or €ASS 4 is are treated as applying then <i>SUP 3.10</i> (Duties of auditors: notification and report on client assets) applies to the whole of the business within the scope of <u>the <i>custody rules</i> or the <i>client money rules</i> above €ASS 2 or €ASS 4.</u></u>
	...
	Note 3 = ...
	<u>Note 3A = If the <i>firm</i> has elected to comply with the <i>MiFID custody chapter</i> or the <i>MiFID client money chapter</i> also in respect of its <i>non-MiFID business</i> then <i>SUP 3.10</i> will apply to the whole of the business within the scope of the <i>MiFID custody chapter</i> or the <i>MiFID client money chapter</i>.</u>
	...
	<u>Note 3B = A <i>sole trader</i> or a <i>partnership</i> that is a <i>MiFID investment firm</i> must have its annual accounts audited.</u>
	...

...

Incoming firms

3.1.3 R This chapter ~~does not apply~~ applies to an *incoming EEA firm* (and the auditor of such a *firm*) only if it has a without a top-up permission or an auditor of such a *firm*.

...

3.1.8 G This chapter applies to an *authorised professional firm* as set out in rows (1) to (3) of *SUP 3.1.2R*:

(1) a *firm* in row (1) is treated in the same way as its equivalent in row (7);

(2) large parts of this chapter apply to a *firm* in row (2) and its auditor; the report on client assets under *SUP 3.10* (Duties of auditors: notification and report on client assets) must cover compliance for the whole of the business within the scope of whichever of ~~€ASS 2~~

~~and CASS 4~~ the custody rules and the client money rules ~~is are~~ treated as applying; but there is no requirement for the auditor to prepare a report to the FSA on the ~~firm's~~ firm's financial statements;

- (3) this chapter has limited application to a *firm* in row (3) and its auditor.

...

3.10.2 R An auditor of an *authorised professional firm* need not report under this section in relation to that *firm's* compliance with the client money rules in the non-directive client money chapter (~~CASS 4~~), if that ~~firm~~ firm is regulated by:

- (1) the Law Society (England and Wales);
- (2) the Law Society of Scotland;
- (3) the Law Society of Northern Ireland.

...

Client assets report

3.10.5	R	Whether in the auditor's opinion	
	(1)	the <i>firm</i> has maintained systems adequate to enable it to comply with the rules in <u>custody rules, the collateral rules and the client money rules (except CASS 5.2)</u> CASS 2 to CASS 4 and CASS 5.1 to CASS 5.8 (except CASS 5.2) throughout the period since the last date as at which a report was made;	
	(2)	the <i>firm</i> was in compliance with the rules in <u>custody rules, the collateral rules and the client money rules (except CASS 5.2)</u> CASS 2 to CASS 4 and CASS 5.1 to CASS 5.8 (except CASS 5.2) at the date as at which the report has been made;	
	(3)	...	
	(4)	if there has been a <i>secondary pooling event</i> during the period, the <i>firm</i> has complied with the <u>rules in CASS 4.4, and CASS 5.6 and CASS 7.9</u> (Client money distribution) in relation to that pooling event.	

...

Client assets report: timing of submission

3.10.7 R An auditor must deliver a report under SUP 3.10.4R to the FSA ~~so as to be received~~ within a reasonable time from the four months of the end of each period covered, unless it is the auditor of a *firm* falling within category (10) of SUP 3.1.2R.

[Note: article 20 of the *MiFID implementing Directive*]

3.10.7A G A period of four months, in ordinary circumstances, would be considered by the FSA as a reasonable time for the auditor to deliver the client assets report to the FSA.

3.10.8 R If an auditor is unable to report to the FSA within ~~the timetable set out in SUP 3.10.7R~~ a reasonable time, the auditor must notify the FSA and advise the FSA of the reasons why it has been unable to meet the requirements of SUP 3.10.7R.

...

6.4.22 G In deciding whether to cancel a *firm's part IV permission*, the FSA will take into account all relevant factors in relation to business carried on under that *permission*, including whether:

- (1) there are unresolved, unsatisfied or undischarged complaints against the *firm* from any of its *customers*;
- (2) the *firm* has complied with CASS 4.3.99R, ~~and~~ CASS 5.5.80R and CASS 7.2.15R (Client money: discharge of fiduciary duty) and CASS 4.3.104R and CASS 7.2.19R (Client money: allocated but unclaimed client money) if it has ceased to hold *client money*; these *rules* apply to both repayment and transfer to a third party;
- (3) the *firm* has ceased to hold or control *custody assets* in accordance with instructions received from *clients* (including instructions set out in an agreement entered into in accordance with CASS 2.3.2R and COBS 7.1.7R (Information concerning safeguarding of designated investments belonging to clients and client money));
- (4) ...

...

SUP 6 Annex 4G

SUP 6 Annex 4.2 Additional guidance for a firm winding down (running off) its business

1. ...
2. A *firm* must comply with CASS 4.3.99R, ~~and~~ CASS 5.5.80R and CASS 7.2.15R (Client money: discharge of fiduciary duty) and CASS 4.3.104R and CASS 7.2.19R (Client money: ~~a~~ Allocated but unclaimed client money) if it is ceasing to hold *client money*. A *firm* must also cease to hold or control *custody assets* in accordance with instructions received from *clients* (including instructions set out in an agreement entered into in accordance with CASS 2.3.2R and COBS 7.1.7R (Information concerning safeguarding

of designated investments belonging to clients and client money). These *rules* apply to both repayment and transfer to a third party.

...

Schedule 2 Notification requirements

SUP Sch
2.2

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
...				
SUP 3.10	Auditor: <i>client assets</i>	Either: (1)	Report period must end no more than 53 weeks after previous report.	Four months <u>A reasonable time</u>
...				

...

Annex D

Amendments to the Interim Prudential sourcebook for Investment Businesses (IPRU(INV))

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

Chapter 5: Interim Prudential Requirements for Former IMRO Firms

...

- 5.3.1(5) G The requirement to maintain adequate records of movements and holdings of *client money* and any interest paid on *client money* balances, are set out in CASS 4.1 to 4.3 (with respect of *designated investment business* that is not *MiFID business*) and in CASS 7.1 to 7.8 (with respect of *MiFID business*).

...