(a) in relation to a service charge, complies with the requirement to segregate such money in accordance with section 42 of the Landlord and Tenant Act 1987 ("the 1987 Act"); or

(b) in relation to money which is clients' money for the purpose of the Royal Institution of Chartered Surveyors' Rules of Conduct ("RICS rules") in force as at 14 January 2005, it complies with the requirement to segregate and account for such money in accordance with the RICS Members' Accounts rules.

(2) Paragraph (1)(a) also applies to a *firm* in Scotland or in Northern Ireland if in acting as a property manager the *firm* receives or holds a service charge and complies (so far as practicable) with section 42 of the 1987 Act as if the requirements of that provision applied to it.

(3) In addition to complying with (1), a *firm* must ensure that an account in which *money* held pursuant to the trust fund mentioned in section 42(3) of the 1987 Act or an account maintained in accordance with the RICS rules satisfies the requirements in ■ CASS 5.5.49 R to the extent that the *firm* will hold money as trustee or otherwise on behalf of its clients.

5.1.5 R Subject to ■ CASS 5.1.5A R *money* is not *client money* when:

(1) it becomes properly due and payable to the *firm*:

(a) for its own account; or

(b) in its capacity as agent of an *insurance undertaking* where the *firm* acts in accordance with ■ CASS 5.2; or

(2) it is otherwise received by the *firm* pursuant to an arrangement made between an *insurance undertaking* and another *person* (other than a *firm*) by which that other *person* has authority to underwrite risks, settle claims or handle refunds of *premiums* on behalf of that *insurance undertaking* outside the *United Kingdom* and where the *money* relates to that business.

5.1.5A R ■ CASS 5.1.5 R (1)(b) and ■ CASS 5.1.5 R (2) do not apply, and hence *money* is *client money*, in any case where:

(1) in relation to an activity specified in ■ CASS 5.2.3 R (1) (a) to ■ CASS 5.2.3 R (1) (c), the *insurance undertaking* has agreed that the *firm* may treat *money* which it receives and holds as agent of the *undertaking*, as *client money* and in accordance with the provisions of ■ CASS 5.3 to ■ CASS 5.6; and

(2) the agreement in (1) is in writing and adequate to show that the *insurance undertaking* consents to its interests under the trusts (or in Scotland agency) in ■ CASS 5.3.2 R or ■ CASS 5.4.7 R being subordinated to the interests of the *firm*'s other *clients*.

5.1.6 R Except where a *firm* and an *insurance undertaking* have (in accordance with ■ CASS 5.1.5A R) agreed otherwise, for the purposes of ■ CASS 5.1 to ■ CASS 5.6 an *insurance undertaking* (when acting as such) with whom a *firm* conducts *insurance mediation activity* is not to be treated as a *client* of the *firm*.

Purpose

5.1.7 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 handling of *client money*. The *rules* in ■ CASS 5.1 to ■ CASS 5.6 also give effect to the requirement in article 4.4 of the *Insurance Mediation Directive* that all necessary measures should be taken to protect *clients* against the inability of an *insurance intermediary* to transfer *premiums* to an *insurance undertaking* or to transfer the proceeds of a claim or *premium* refund to the insured.

(2) There are two particular approaches which *firms* can adopt which reflect options given in article 4.4. The first is to provide by law or contract for a transfer of risk from the *insurance intermediary* to the *insurance undertaking* (■ CASS 5.2). The second is that *client money* is strictly segregated by being transferred to *client accounts* that cannot be used to reimburse other creditors in the event of the *firm*'s insolvency (■ CASS 5.3 and ■ CASS 5.4 provide different means of achieving such segregation). ■ CASS 5.1.5A R permits a *firm* subject to certain conditions to treat *money* which it collects as agent of an *insurance undertaking* as *client money*; the principle of strict segregation is, however, satisfied because such *undertakings* must agree to their interests being subordinated to the interests of the *firm*'s other *clients*.

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 the *non-directive client money chapter* which includes provisions enabling *firms* to elect to comply solely with that chapter or with the *insurance client money chapter* in respect of that business. Firms that also carry on *MiFID or equivalent third country 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.

5.1.9 G *Firms* are reminded that ■ SUP 3 contains provisions which are relevant to the preparation and delivery of reports by auditors.

5.2 Holding money as agent of insurance undertaking

Introduction

5.2.1 G If a *firm* holds *money* as agent of an *insurance undertaking* then the *firm's clients* (who are not *insurance undertakings*) will be adequately protected to the extent that the *premiums* which it receives are treated as being received by the *insurance undertaking* when they are received by the agent and claims *money* and *premium* refunds will only be treated as received by the *client* when they are actually paid over. The *rules* in ■ CASS 5.2 make provision for agency agreements between *firms* and *insurance undertakings* to contain terms which make clear when *money* should be held by a *firm* as agent of an undertaking. *Firms* should refer to ■ CASS 5.1.5 R to determine the circumstances in which they may treat *money* held on behalf of *insurance undertakings* as *client money*.

5.2.2 G (1) Agency agreements between *insurance intermediaries* and *insurance undertakings* may be of a general kind and facilitate the introduction of business to the *insurance undertaking*. Alternatively, an agency agreement may confer on the *intermediary* contractual authority to commit the *insurance undertaking* to risk or authority to settle claims or handle *premium* refunds (often referred to as "binding authorities"). ■ CASS 5.2.3 R requires that binding authorities of this kind must provide that the *intermediary* is to act as the agent of the *insurance undertaking* for the purpose of receiving and holding *premiums* (if the *intermediary* has authority to commit the *insurance undertaking* to risk), claims *monies* (if the *intermediary* has authority to settle claims on behalf of the *insurance undertaking*) and *premium* refunds (if the *intermediary* has authority to make refunds of *premium* on behalf of the *insurance undertaking*). Accordingly such *money* is not, except where a *firm* and an *insurance undertaking* have in compliance with ■ CASS 5.1.5A R agreed otherwise, *client money* for the purposes of ■ CASS 5.

(2) Other introductory agency agreements may also, depending on their precise terms, satisfy some or all of the requirements of the type of written agreement described in ■ CASS 5.2.3 R. It is desirable that an *intermediary* should, before informing its *clients* (in accordance with ■ CASS 5.2.3 R (3)) that it will receive *money* as agent of an *insurance undertaking*, agree the terms of that notification with the relevant *insurance undertakings*.

Requirement for written agreement before acting as agent of insurance undertaking

5.2.3 R **(1) A *firm* must not agree to:**

(a) *deal in investments as agent* for an *insurance undertaking* in connection with *insurance mediation*; or

(b) act as agent for an *insurance undertaking* for the purpose of settling claims or handling *premium* refunds; or

(c) otherwise receive *money* as agent of an *insurance undertaking*;

unless:

(d) it has entered into a written agreement with the *insurance undertaking* to that effect; and

(e) it is satisfied on reasonable grounds that the terms of the policies issued by the *insurance undertaking* to the *firm's clients* are likely to be compatible with such an agreement; and

(f) (i) (in the case of (a)) the agreement required by (d) expressly provides for the *firm* to act as agent of the *insurance undertaking* for the purpose of receiving *premiums* from the *firm's clients*; and

(ii) (in the case of (b)) the agreement required by (d) expressly provides for the *firm* to act as agent of the *insurance undertaking* for the purpose of receiving and holding claims *money* (or, as the case may be, *premium* refunds) prior to transmission to the *client* making the *claim* (or, as the case may be, entitled to the *premium refund*) in question.

(2) A *firm* must retain a copy of any agreement it enters pursuant to (1) for a period of at least six years from the date on which it is terminated.

(3) Where a *firm* holds, or is to hold, *money* as agent for an *insurance undertaking* it must ensure that it informs those of its *clients* which are not *insurance undertakings* and whose transactions may be affected by the arrangement (whether in its *terms of business*, *client agreements* or otherwise in writing) that it will hold their *money* as agent of the *insurance undertaking* and if necessary the extent of such agency and whether it includes all items of *client money* or is restricted, for example, to the receipt of *premiums*.

(4) A *firm* may (subject to the consent of the *insurance undertaking* concerned) include in an agreement in (1) provision for *client money* received by its *appointed representative*, field representatives and other agents to be held as agent for the *insurance undertaking* (in which event it must ensure that the *representative* or agent provides the information to *clients* required by (3)).

5.2.4 G *Firms* are reminded that ■ CASS 5.1.5A R provides that, if the *insurance undertaking* has agreed in writing, *money* held in accordance with an agreement made under ■ CASS 5.2.3 R

may be treated as *client money* and may (but not otherwise) be kept in a *client bank account*.

5.2.5 G A *firm* which provides for the protection of a *client*(which is not an *insurance undertaking*) under ■ CASS 5.2 is relieved of the obligation to provide protection for that *client* under ■ CASS 5.3 or ■ CASS 5.4 to the extent of the items of client *money* protected by the agency agreement.

5.2.6 G A *firm* may, in accordance with ■ CASS 5.2.3 R (4), arrange for an *insurance undertaking* to accept responsibility for the *money* held by its *appointed representatives*, *field representatives*, and other agents, in which event ■ CASS 5.5.18 R to ■ CASS 5.5.25 G will not apply.

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5.2.7 G A *firm* may operate on the basis of an agency agreement as provided for by ■ CASS 5.2.3 R for some of its *clients* and with protection provided by a *client money* trust in accordance with ■ CASS 5.3 or ■ CASS 5.4 for other *clients*. A *firm* may also operate on either basis for the same *client* but in relation to different transactions. A *firm* which does so should be satisfied that its administrative systems and controls are adequate and, in accordance with ■ CASS 5.2.4 G, should ensure that *money* held for both types of *client* and business is kept separate.

5.3 Statutory trust

5.3.1 G Section 139(1) of the Act (Miscellaneous ancillary matters) provides that *rules* may make provision which results in *client money* being held by a *firm* on trust (England and Wales and Northern Ireland) or as agent (Scotland only). ■ CASS 5.3.2 R 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.

5.3.2 R **A *firm* (other than a *firm* acting in accordance with ■ CASS 5.4) 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 ■ CASS 5.3, ■ CASS 5.5 and the *client money (insurance) distribution rules*;

(2) subject to (4), for the *clients* (other than *clients* which are *insurance undertakings* when acting as such) 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* according to their respective interests in it;

(4) on the failure of the *firm*, for the payment of the costs properly attributable to the distribution of the *client money* in accordance with (2) and (3); and

(5) after all valid claims and costs under (2) to (4) have been met, for the *firm* itself.

5.3.3 G (1) A *firm* which holds *client money* can discharge its obligation to ensure adequate protection for its *clients* in respect of such *money* by complying with ■ CASS 5.3 which provides for such *money* to be held by the *firm* on the terms of a trust imposed by the *rules*.

(2) The trust imposed by ■ CASS 5.3 is limited to a trust in respect of *client money* which a *firm* receives and holds. The consequential and supplementary requirements in ■ CASS 5.5 are designed to secure the proper segregation and

maintenance of adequate *client money* balances. In particular, ■ CASS 5.5 does not permit a *firm* to use *client money* balances to provide credit for *clients* (or potential *clients*) such that, for example, their *premium* obligations may be met in advance of the *premium* being remitted to the *firm*. A *firm* wishing to provide credit for *clients* may however do so out of its own funds.

5.4 Non-statutory client money trust

Introduction

5.4.1 G

(1) ■ CASS 5.4 permits a *firm*, which has adequate resources, systems and controls, to declare a trust on terms which expressly authorise it, in its capacity as trustee, to make advances of credit to the *firm*'s *clients*. The *client money* trust required by ■ CASS 5.4 extends to such debt obligations which will arise if the *firm*, as trustee, makes credit advances, to enable a *client*'s *premium* obligations to be met before the *premium* is remitted to the *firm* and similarly if it allows claims and *premium* refunds to be paid to the *client* before receiving remittance of those *monies* from the *insurance undertaking*.

(2) ■ CASS 5.4 does not permit a *firm* to make advances of credit to itself out of the *client money* trust. Accordingly, ■ CASS 5.4 does not permit a *firm* to withdraw *commission* from the *client money* trust before it has received the *premium* from the *client* in relation to the *non-investment insurance contract* which generated the *commission*.

Voluntary nature of this section

5.4.2 R **A *firm* may elect to comply with the requirements in this section, and may do so for some of its business whilst complying with ■ CASS 5.3 for other parts.**

5.4.3 R **A *firm* is not subject to ■ CASS 5.3 when and to the extent that it acts in accordance with this section.**

Conditions for using the non-statutory client money trust

5.4.4 R **A *firm* may not handle *client money* in accordance with the *rules* in this section unless each of the following conditions is satisfied:**

(1) the *firm* must have and maintain systems and controls which are adequate to ensure that the *firm* is able to monitor and manage its *client money* transactions and any credit risk arising from the operation of the trust arrangement and, if in accordance with ■ CASS 5.4.2 R a *firm* complies with both the rules in ■ CASS 5.3 and ■ CASS 5.4, such systems and controls must extend to both arrangements;

(2) the *firm* must obtain, and keep current, written confirmation from its auditor that it has in place systems and controls which are adequate to meet the requirements in (1);

(3) the *firm* must designate a *manager* with responsibility for overseeing the *firm's* day to day compliance with the systems and controls in (1) and the *rules* in this section;

(4) the *firm* (if, under the terms of the non-statutory trust, it is to handle *client money* for *retail customers*) must have and at all times maintain capital resources of not less than £50,000 calculated in accordance with ■ MIPRU 4.4.1 R; and

(5) in relation to each of the *clients* for whom the *firm* holds *money* in accordance with ■ CASS 5.4, the *firm* must take reasonable steps to ensure that its *terms of business* or other *client agreements* adequately explain, and obtain the *client's* informed consent to, the *firm* holding the *client's money* in accordance with ■ CASS 5.4 (and in the case of a *client* which is an *insurance undertaking* (when acting as such) there must be an agreement which satisfies ■ CASS 5.1.5A R).

5.4.5 G The amount of a *firm's* capital resources maintained for the purposes of ■ MIPRU 4.2.11 R will also satisfy (in whole or in part) the requirement in ■ CASS 5.4.4 R (4).

Client money to be received under the non-statutory client money trust

5.4.6 R Except to the extent that a *firm* acts in accordance with ■ CASS 5.3, a *firm* must not receive or hold any *client money* unless it does so as trustee (or, in Scotland, as agent) and has properly executed a deed (or equivalent formal document) to that effect.

Contents of trust deed

5.4.7 R The deed referred to in ■ CASS 5.4.6 R must provide that the *money* (and, if appropriate, *designated investments*) are held:

(1) for the purposes of and on the terms of:

(a) ■ CASS 5.4;

(b) the applicable provisions of ■ CASS 5.5; and

(c) the *client money (insurance) distribution rules*

(2) subject to (4), for the *clients* (other than *clients* which are *insurance undertakings* when acting as such) 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* 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 (3); and

(5) after all valid claims and costs under (2) to (4) have been met, for the *firm* itself.

5.4.8 R The deed (or equivalent formal document) referred to in ■ CASS 5.4.6 R may provide that:

(1) the *firm*, acting as trustee (or, in Scotland, as agent), has power to make advances or give credit to *clients* or *insurance undertakings* from *client money*, provided that it also provides that any debt or other obligation of a *client* or resulting obligation of an *insurance undertaking*, in relation to an advance or credit, is held on the same terms as ■ CASS 5.4.7 R;

(2) the benefit of a letter of credit or unconditional guarantee provided by an *approved bank* on behalf of a *firm* to satisfy any shortfall in the *firm's client money* resource (as calculated under ■ CASS 5.5.65 R) when compared with the firm's client money requirement (as calculated under ■ CASS 5.5.66 R or as appropriate ■ CASS 5.5.68 R), is held on the same terms as ■ CASS 5.4.7 R.

5.5 Segregation and the operation of client money accounts

Application

5.5.1 R Unless otherwise stated each of the provisions in ■ CASS 5.5 applies to *firms* which are acting in accordance with ■ CASS 5.3 (Statutory trust) or ■ CASS 5.4 (Non-statutory trust).

5.5.2 G One purpose of ■ CASS 5.5 is to ensure that, unless otherwise permitted, *client money* is kept separate from the *firm's* own *money*. Segregation, in the event of a *firm's* failure, is important for the effective operation of the trust that is created to protect *client money*. The aim is to clarify the difference between *client money* and general creditors' entitlements in the event of the *failure* of the *firm*.

Requirement to segregate

5.5.3 R A *firm* must, except to the extent permitted by ■ CASS 5.5, hold *client money* separate from the *firm's money*.

Money due to a client from a firm

5.5.4 R If a *firm* is liable to pay *money* to a *client*, it must as soon as possible, and no later than one *business day* after the *money* is due and payable:

(1) pay it into a *client bank account*, in accordance with ■ CASS 5.5.5 R; or

(2) pay it to, or to the order of, the *client*.

Segregation

5.5.5 R A *firm* must segregate *client money* by either:

(1) paying it as soon as is practicable into a *client bank account*; or

(2) paying it out in accordance with ■ CASS 5.5.80 R.

5.5.6 G The *FSA* expects that in most circumstances it will be practicable for a *firm* to pay *client money* into a *client bank account* by not later than the next *business day* after receipt.

5.5.7 G Where an insurance transaction involves more than one *firm* acting in a chain such that for example *money* is transferred from a "producing" broker who has received *client money* from a *consumer* to an intermediate broker and thereafter to an *insurance undertaking*, each broker *firm* will owe obligations to its immediate *client* to segregate *client money* which it receives (in this example the producing broker in relation to the *consumer* and the intermediate broker in relation to the producing broker). A *firm* which allows a third party broker to hold or control *client money* will not thereby be relieved of its fiduciary obligations (see ■ CASS 5.5.34 R).

5.5.8 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 at intervals of not more than twenty five *business days* 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.**

5.5.9 R **A *firm* must not hold *money* other than *client money* in a *client bank account* unless it is:**

(1) **a minimum sum required to open the account, or to keep it open; or**

(2) ***money* temporarily in the account in accordance with ■ CASS 5.5.16 R (Withdrawal of commission and mixed remittance); or**

(3) **interest credited to the account which exceeds the amount due to *clients* as interest and has not yet been withdrawn by the *firm*.**

5.5.10 R **If it is prudent to do so to ensure that *client money* is protected (and provided that doing so would otherwise be in accordance with ■ CASS 5.5.63 R (1)(b)(ii)), a *firm* may pay into, or maintain in, a *client bank account money* of its own, and that *money* will then become *client money* for the purposes of ■ CASS 5 and the *client money (insurance) distribution rules*.**

5.5.11 R **A *firm*, when acting in accordance with ■ CASS 5.3 (statutory trust), must ensure that the total amount of *client money* held for each *client* in any of the *firm's client money bank accounts* is positive and that no payment is made from any such account for the benefit of a *client* unless the *client* has provided the *firm* with cleared funds to enable the payment to be made.**

5.5.11A G When a *firm* acts in accordance with ■ CASS 5.3 (Statutory trust) it should not make a payment from the *client bank account* unless it is satisfied on reasonable grounds that the *client* has provided it with cleared funds. Accordingly, a *firm* should normally allow a reasonable period of time for cheques to clear. If a withdrawal is made and the *client's* cheque is subsequently dishonoured it will be the *firm's* responsibility to make good the *shortfall* in the account as quickly as possible (and without delay whilst a cheque is re-presented).

5.5.12 R **If *client money* is received by the *firm* in the form of an automated transfer, the *firm* must 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* no later than the next *business day* after receipt.

5.5.13 G A *firm* can hold *client money* in either a *general client bank account* (■ CASS 5.5.38 R) or a *designated client bank account* (■ CASS 5.5.39 R). 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* for those *clients* who requested that 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. 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 (insurance) distribution rules*.

5

Non-statutory trust - segregation of designated investments

5.5.14 R **(1) A *firm* which handles *client money* in accordance with the *rules* for a non-statutory trust in ■ CASS 5.4 may, to the extent it considers appropriate, but subject to (2), satisfy the requirement to segregate *client money* by segregating or arranging for the segregation of *designated investments* with a value at least equivalent to such *money* as would otherwise have been segregated into a *client bank account*.**

(2) A *firm* may not segregate *designated investments* unless it:

(a) takes reasonable steps to ensure that any *consumers* whose *client money* interests may be protected by such segregation are aware that the *firm* may operate such an arrangement and have (whether through its *terms of business*, client agreements, or otherwise in writing) an adequate opportunity to give their informed consent;

(b) ensures that the terms on which it will segregate *designated investments* include provision for it to take responsibility for meeting any *shortfall* in its *client money* resource which is attributable to falls in the market value of a segregated *investment*;

(c) provides in the deed referred to in ■ CASS 5.4.6 R for *designated investments* which it segregates to be held by it on the terms of the non-statutory trust; and

(d) takes reasonable steps to ensure that the segregation is at all times in conformity with the range of permitted

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***investments*, general principles and conditions in ■ CASS 5 Annex 1 R.**

5.5.15 G A *firm* which takes advantage of ■ CASS 5.5.14 R will need to consider whether its *permission* should include the *permitted activity of managing investments*. If the *firm* is granted a power to manage with discretion the funds over which it is appointed as trustee under the trust deed required by ■ CASS 5.4 then it will be likely to need a *permission* to *manage investments*. It is unlikely to need such a permission, however, if it is merely granted a power to invest but the deed stipulates that the funds may only be managed with discretion by another *firm* (which has the necessary *permission*). Such an arrangement would not preclude the *firm* holding *client money* as trustee from appointing another *firm* (or *firms*) as manager and setting an appropriate strategy and overall asset allocation, subject to the limits set out in ■ CASS 5 Ann 1 R. A *firm* may also need to consider whether it needs a *permission* to operate a *collective investment scheme* if any of its *clients* are to participate in the income or gains arising from the acquisition or disposal of *designated investments*.

5

Withdrawal of commission and mixed remittance

5.5.16 R **(1) A *firm* may draw down *commission* from the *client bank account* if:**

(a) it has received the *premium* from the *client* (or from a third party *premium* finance provider on the *client's* behalf); and

(b) this is consistent with the *firm's terms of business* which it maintains with the relevant *client* and the *insurance undertaking* to whom the *premium* will become payable;

and the *firm* may draw down *commission* before payment of the *premium* to the *insurance undertaking*, provided that the conditions in (a) and (b) are satisfied.

(2) If a *firm* receives a *mixed remittance* (that is part *client money* and part other *money*), it must:

(a) pay the full sum into a *client bank account* in accordance with ■ CASS 5.5.5 R; and

(b) pay the *money* that is not *client money* out of the *client bank account* as soon as reasonably practicable and in any event by not later than twenty-five *business days* after the day on which the remittance is cleared (or, if earlier, when the *firm* performs the *client money* calculation in accordance with ■ CASS 5.5.63 R (1)).

5.5.17 G (1) As soon as *commission* becomes due to the *firm* (in accordance with ■ CASS 5.5.16 R (1)) it must be treated as a remittance which must be withdrawn in accordance with ■ CASS 5.5.16 R (2). The procedure required by ■ CASS 5.5.16 R will also apply where *money*is due and payable to the *firm* in respect of *fees* due from *clients* (whether to the *firm* or other professionals).

(2) *Firms* are reminded that *money* received in accordance with ■ CASS 5.2 must not, except where a *firm* and an *insurance undertaking* have (in accordance

with ■ CASS 5.1.5A R) agreed otherwise, be kept in a *client bank account*. *Client money* received from a third-party *premium* finance provider should, however, be segregated into a *client bank account*.

(3) Where a *client* makes payments of *premium* to a *firm* in instalments, ■ CASS 5.5.16 R (1) applies in relation to each instalment.

(4) If a *firm* is unable to match a remittance with a transaction it may be unable to immediately determine whether the payment comprises a *mixed remittance* or is *client money*. In such cases the remittance should be treated as *client money* while the *firm* takes steps to match the remittance to a transaction as soon as possible.

Appointed representatives, field representatives and other agents

5.5.18 R

(1) Subject to (4), a *firm* must in relation to each of its *appointed representatives*, *field representatives* and other agents comply with ■ CASS 5.5.19 R to ■ CASS 5.5.21 R (Immediate segregation) or with ■ CASS 5.5.23 R (Periodic segregation and reconciliation).

(2) A *firm* must in relation to each *representative* or other agent keep a record of whether it is complying with ■ CASS 5.5.19 R to ■ CASS 5.5.21 R or with ■ CASS 5.5.23 R.

(3) A *firm* is, but without affecting the application of ■ CASS 5.5.19 R to ■ CASS 5.5.23 R, to be treated as the recipient of *client money* which is received by any of its *appointed representatives*, *field representatives* or other agents.

(4) Paragraphs (1) to (3) do not apply in relation to an *appointed representative*, *field representative* or other agent to which (if it were a *firm*) ■ CASS 5.1.4AR (1) or ■ CASS 5.1.4AR (2) would apply, but subject to the *representative* or agent maintaining an account which satisfies the requirements of ■ CASS 5.5.49 R to the extent that the *representative* or agent will hold *client money* on trust or otherwise on behalf of its *clients*.

Immediate segregation

5.5.19 R

A *firm* must establish and maintain procedures to ensure that *client money* received by its *appointed representatives*, *field representatives*, or other agents of the *firm* is:

(1) paid into a *client bank account* of the *firm* in accordance with ■ CASS 5.5.5 R; or

(2) 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 by the close of the third *business day*.

5.5.20 G For the purposes of ■ CASS 5.5.19 R, the *client money* received on *business day* one should be forwarded to the *firm* or specified business address of the *firm* 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* to be sent to the *firm* or the specified business address of the *firm* by first class post no later than the next *business day* after receipt would meet the requirements of ■ CASS 5.5.19 R.

5.5.21 R **If *client money* is received in accordance with ■ CASS 5.5.19 R, the *firm* must ensure that its *appointed representatives*, *field representatives* or other agents keep *client money* (whether in the form of *premiums*, claims *money* or *premium* refunds) 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*.**

5.5.22 G A *firm* which acts in accordance with ■ CASS 5.5.19 R to ■ CASS 5.5.21 R need not comply with ■ CASS 5.5.23 R.

Periodic segregation and reconciliation

5.5.23 R **(1) A *firm* must, on a regular basis, and at reasonable intervals, ensure that it holds in its *client bank account* an amount which (in addition to any other amount which it is required by these *rules* to hold) is not less than the amount which it reasonably estimates to be the aggregate of the amounts held at any time by its *appointed representatives*, *field representatives*, and other agents.**

(2) A *firm* must, not later than ten *business days* following the expiry of each period in (1):

(a) carry out, in relation to each such *representative* or agent, a reconciliation of the amount paid by the *firm* into its *client bank account* with the amount of *client money* actually received and held by the *representative* or other agent; and

(b) make a corresponding payment into, or withdrawal from, the account.

5.5.24 G (1) ■ CASS 5.5.23 R allows a *firm* with *appointed representatives*, *field representatives* and other agents to avoid the need for the *representative* to forward *client money* on a daily basis but instead requires a *firm* to segregate into its *client money bank account* amounts which it reasonably estimates to be sufficient to cover the amount of *client money* which the *firm* expects its *representatives* or agents to receive and hold over a given period. At the expiry of each such period, the *firm* must obtain information about the actual amount of *client money* received and held by its *representatives* so that it can reconcile the amount of *client money* it has segregated with the amounts actually received and held by its *representatives* and agents. The frequency at which this reconciliation is to be performed is not prescribed but it must be at regular and reasonable intervals having regard to the nature and frequency of the *insurance business* carried on by its *representatives* and agents. For example, a period of six *months* might be appropriate for a *representative* which conducts business involving the receipt

of *premiums* only infrequently whilst for other *representatives* a periodic reconciliation at *monthly* intervals (or less) may be appropriate.

(2) Where a *firm* operates on the basis of ■ CASS 5.5.23 R, the *money* which is segregated into its *client bank account* is *client money* and will be available to meet any obligations owed to the *clients* of its *representatives* who for this purpose are treated as the *firm*'s*clients*.

5.5.25 G A *firm* which acts in accordance with ■ CASS 5.5.23 R need not comply with ■ CASS 5.5.19 R to ■ CASS 5.5.21 R.

Client entitlements

5.5.26 R **A *firm* must take reasonable steps to ensure that it is notified promptly of any receipt of *client money* in the form of *client* entitlements.**

5.5.27 G The 'entitlements' mentioned in ■ CASS 5.5.26 R refer to any kind of miscellaneous payment which the *firm* receives on behalf of a *client* and which are due to be paid to the *client*.

5.5.28 R **When a *firm* receives a *client* entitlement on behalf of a *client*, it must pay any part of it which is *client money*:**

(1) for *client* entitlements received in the *United Kingdom*, into a *client bank account* in accordance with ■ CASS 5.5.5 R; or

(2) for *client* entitlements received outside the *United Kingdom*, into any bank account operated by the *firm*, provided that such *client money* is:

(a) paid to, or in accordance with, the instructions of the *client* concerned; or

(b) paid into a *client bank account* in accordance with ■ CASS 5.5.5 R (1), as soon as possible but no later than five *business days* after the *firm* is notified of its receipt.

5.5.29 R **A *firm* must take reasonable steps to ensure that a *client* entitlement which is *client money* is allocated within a reasonable period of time after notification of receipt.**

Interest and investment returns

5.5.30 R **(1) In relation to *consumers*, a *firm* must, subject to (2), take reasonable steps to ensure that its *terms of business* or other client agreements adequately explain, and where necessary obtain a *client*'s informed consent to, the treatment of interest and, if applicable, investment returns, derived from its holding of *client money* and any segregated *designated investments*.**

(2) **In respect of interest earned on *client bank* accounts, (1) does not apply if a *firm* has reasonable ground to be satisfied that in relation to *insurance mediation activities* carried on with or for a *consumer* the amount of interest earned will be not more than £20 per transaction.**

5.5.31 G If no interest is payable to a *consumer*, that fact should be separately identified in the *firm's* client agreement or *terms of business*.

5.5.32 G If a *firm* outlines its *policy* on its payment of interest, it need not necessarily disclose the actual rates prevailing at any particular time; the *firm* should disclose the terms, for example, LIBOR plus or minus 'x' percentage points.

Transfer of client money to a third party

5.5.33 G ■ CASS 5.5.34 R 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 another broker for the purposes of the *client's* transaction being effected. A *firm* can only discharge itself from its fiduciary duty by acting in accordance with, and in the circumstances permitted by, ■ CASS 5.5.80 R.

5.5.34 R **A *firm* may allow another *person*, such as another broker to hold or control *client money*, but only if:**

(1) **the *firm* transfers the *client money* for the purpose of a transaction for a *client* through or with that *person*; and**

(2) **in the case of a *consumer*, that *customer* has been notified (whether through a client agreement, *terms of business*, or otherwise in writing) that the *client money* may be transferred to another *person*.**

5.5.35 G In relation to the notification required by ■ CASS 5.5.34 R (2), there is no need for a *firm* to make a separate disclosure in relation to each transfer made.

5.5.36 G A *firm* should not hold excess *client money* with another broker. It should be held in a *client bank account*.

Client bank accounts

5.5.37 G The *FSA* generally requires a *firm* to place *client money* in a *client bank account* with an *approved bank*. However, a *firm* which is an *approved bank* must not (subject to ■ CASS 5.1.1 R (2)(e)) hold *client money* in an account with itself.

5.5.38 R (1) **A *firm* must ensure that *client money* is held in a *client bank account* at one or more *approved banks*.**

(2) If the *firm* is a bank, it must not hold *client money* in an account with itself.

5.5.39 R A *firm* may open one or more *client bank accounts* in the form of a *designated client bank account*. Characteristics of these accounts are that:

(1) the account holds *money* of one or more *clients*;

(2) the account includes in its title the word 'designated';

(3) the *clients* whose *money* is in the account have each consented in writing to the use of the bank with which the *client money* is to be held; and

(4) in the event of the *failure* of that bank, the account is not pooled with any other type of account unless a *primary pooling event* occurs.

5.5.40 G (1) A *firm* may operate as many *client* accounts as it wishes.

(2) A *firm* is not obliged to offer its *clients* the facility of a *designated client bank account*.

(3) Where a *firm* holds *money* in a *designated client bank account*, the effect upon either:

(a) the *failure* of a bank where any other *client bank account* is held; or

(b) the *failure* of a third party to whom *money* has been transferred out of any other *client bank account* in accordance with ■ CASS 5.5.34 R;

(each of which is a *secondary pooling event*) is that *money* held in the *designated client bank account* is not pooled with *money* held in any other account. Accordingly *clients* whose *money* is held in a *designated client bank account* will not share in any *shortfall* resulting from a *failure* of the type described in (a) or (b).

(4) Where a *firm* holds *client money* in a *designated client bank account*, the effect upon the failure of the *firm* (which is a *primary pooling event*) is that *money* held in the *designated client bank account* is pooled with *money* in every other *client bank account* of the *firm*. Accordingly, *clients* whose *money* is held in a *designated client bank account* will share in any *shortfall* resulting from a *failure*of the *firm*.

5.5.41 R A *firm* may hold *client money* with a bank that is not an *approved bank* if all the following conditions are met:

(1) the *client money* relates to one or more insurance transactions which are subject to the law or market practice of a jurisdiction outside the *United Kingdom*;

(2) because of the applicable law or market practice of that overseas jurisdiction, it is not possible to hold the *client money* in a *client bank account* with an *approved bank*;

(3) the *firm* holds the *money* with such a bank for no longer than is necessary to effect the transactions;

(4) the *firm* notifies each relevant *client* and has, in relation to a *consumer*, a client agreement, or *terms of business* which adequately explain that:

(a) *client money* will not be held with an *approved bank*;

(b) in such circumstances, the legal and regulatory regime applying to the bank with which the *client money* is held will be different from that of the *United Kingdom* and, in the event of a *failure* of the bank, the *client money* may be treated differently from the treatment which would apply if the *client money* were held by an *approved bank* in the *United Kingdom*; and

(c) if it is the case, the particular bank has not accepted that it has no right of set-off or counterclaim against *money* held in a *client bank account*, in respect of any sum owed on any other account of the *firm*, notwithstanding the *firm's* request to the bank as required by ■ CASS 5.5.49 R; and

(5) the *client money* is held in a designated bank account.

A firm's selection of a bank

5.5.42 G A *firm* owes a duty of care to a *client* when it decides where to place *client money*. The review required by ■ CASS 5.5.43 R is intended to ensure that the risks inherent in placing *client money* with a bank are minimised or appropriately diversified by requiring a *firm* to consider carefully the bank or banks with which it chooses to place *client money*. For example, a *firm* which is likely only to hold relatively modest amounts of *client money* will be likely to be able to satisfy this requirement if it selects an *authorised* UK clearing bank.

5.5.43 R **Before a *firm* opens a *client bank account* and as often as is appropriate on a continuing basis (and no less than once in each financial year), it must take reasonable steps to establish that the bank is appropriate for that purpose.**

5.5.44 G A *firm* should consider diversifying placements of *client money* with more than one bank where the amounts are, for example, of sufficient size to warrant such diversification.

5.5.45 G When considering where to place *client money* and to determine the frequency of the appropriateness test under ■ CASS 5.5.43 R, a *firm* should consider taking into account, together with any other relevant matters:

(1) the capital of the bank;

(2) the amount of *client money* placed, as a proportion of the bank's capital and *deposits*;

(3) the credit rating of the bank (if available); and

(4) to the extent that the information is available, the level of risk in the investment and loan activities undertaken by the bank and its *affiliated companies*.

5.5.46 G A *firm* will be expected to perform due diligence when opening a *client bank account* with a bank that is authorised by an *EEA regulator*. Any continuing assessment of that bank may be restricted to verification that it remains authorised by an *EEA regulator*.

5

Group banks

5.5.47 R **Subject to ■ CASS 5.5.41 R, a *firm* that holds or intends to hold *client money* with a bank which is in the same *group* as the *firm* must:**

(1) undertake a continuous review in relation to that bank which is at least as rigorous as the review of any bank which is not in the same *group*, in order to ensure that the decision to use a *group* bank is appropriate for the *client*;

(2) disclose in writing to its *client* at the outset of the *client* relationship (whether by way of a client agreement, *terms of business* or otherwise in writing) or, if later, not less than 20 *business days* before it begins to hold *client money* of that *client* with that bank:

(a) that it is holding or intends to hold *client money* with a bank in the same *group*;

(b) the identity of the bank concerned; and

(c) that the *client* may choose not to have his *money* placed with such a bank.

5.5.48 R **If a *client* has notified a *firm* in writing that he does not wish his *money* to be held with a bank in the same *group* as the *firm*, the *firm* must either:**

(1) place that *client money* in a *client bank account* with another bank in accordance with ■ CASS 5.5.38 R; or

(2) return that *client money* to, or pay it to the order of, the *client*.

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Notification and acknowledgement of trust (banks)

5.5.49 R 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:

(1) that all *money* standing to the credit of the account is held by the *firm* as trustee (or if relevant in Scotland, 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

(2) that 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*.

5.5.50 R In the case of a *client bank account* in the *United Kingdom*, if the bank does not provide the acknowledgement referred to in ■ CASS 5.5.49 R 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.

5.5.51 R In the case of a *client bank account* outside the *United Kingdom*, if the bank does not provide the acknowledgement referred to in ■ CASS 5.5.49 R within 20 *business days* after the *firm* dispatched the notice, the *firm* must notify the *client* of this fact as set out in ■ CASS 5.5.53 R.

5.5.52 G *Firms* are reminded of the provisions of ■ CASS 5.5.41 R (4), which sets out the notification and consents required when using a bank that is not an *approved bank*.

Notification to clients: use of an approved bank outside the United Kingdom

5.5.53 R A *firm* must not hold, for a *consumer*, *client money* in a *client bank account* outside the *United Kingdom*, unless the *firm* has previously disclosed to the *consumer* (whether in its *terms of business*, client agreement or otherwise in writing):

(1) that his *money* may be deposited in a *client bank account* outside the *United Kingdom* but that the *client* may notify the *firm* that he does not wish his *money* to be held in a particular jurisdiction;

(2) that in such circumstances, the legal and regulatory regime applying to the *approved bank* will be different from that of the *United Kingdom* and, in the event of a *failure* of the bank, his *money* may be treated in a different manner from that which would apply if the *client money* were held by a bank in the *United Kingdom*; and

(3) if it is the case, that a particular bank has not accepted that it has no right of set-off or counterclaim against *money* held in a *client*

bank account in respect of any sum owed on any other account of the *firm*, notwithstanding the *firm*'s request to the bank as required by ■ CASS 5.5.49 R.

5.5.54 G There is no need for a *firm* to make a separate disclosure under ■ CASS 5.5.53 R (1) and ■ CASS 5.5.53 R (2) in relation to each jurisdiction.

5.5.55 G *Firms* are reminded of the provisions of ■ CASS 5.5.41 R (4), which sets out the notification and consents required when using a bank that is not an *approved bank*.

5.5.56 R If a *client* has notified a *firm* in writing before entering into a transaction that *client money* is not to be held in a particular jurisdiction, the *firm* must either:

(1) hold the *client money* in a *client bank account* in a jurisdiction to which the *client* has not objected; or

(2) return the *client money* to, or to the order of, the *client*.

5.5.57 G *Firms* are reminded of the provisions of ■ CASS 5.5.41 R (4), which sets out the notification and consents required when using a bank that is not an *approved bank*.

Notification to consumers: use of broker or settlement agent outside the United Kingdom

5.5.58 R A *firm* must not undertake any transaction for a *consumer* that involves *client money* being passed to another broker or *settlement agent* located in a jurisdiction outside the *United Kingdom*, unless the *firm* has previously disclosed to the *consumer* (whether in its *terms of business*, client agreement or otherwise in writing):

(1) that his *client money* may be passed to a *person* outside the *United Kingdom* but the *client* may notify the *firm* that he does not wish his *money* to be passed to a *money* in a particular jurisdiction; and

(2) that, in such circumstances, the legal and regulatory regime applying to the broker or *settlement agent* will be different from that of the *United Kingdom* and, in the event of a *failure* of the broker or *settlement agent*, this *money* may be treated in a different manner from that which would apply if the *money* were held by a broker or *settlement agent* in the *United Kingdom*.

5.5.59 G There is no need for a *firm* to make a separate disclosure under ■ CASS 5.5.58 R in relation to each jurisdiction.

5.5.60 R If a *client* has notified a *firm* before entering into a transaction that he does not wish his *money* to be passed to another broker or *settlement agent* located in a particular jurisdiction, the *firm* must either:

(1) hold the *client money* in a *client bank account* in the *United Kingdom* or a jurisdiction to which the *money* has not objected and pay its own *money* to the *firm's* own account with the broker, agent or counterparty; or

(2) return the *money* to, or to the order of, the *client*.

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

5.5.61 R On the *failure* of a third party with which *client money* is held, a *firm* must notify the *FSA*:

(1) as soon as it becomes aware, of the *failure* of any bank, other broker or *settlement agent* 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.

Client money calculation and reconciliation

5.5.62 G (1) In order that a *firm* may check that it has sufficient *money* segregated in its *client bank account* (and held by third parties) to meet its obligations to *clients* it is required periodically to calculate the amount which should be segregated (the *client money* requirement) and to compare this with the amount shown as its *client money* resource. This calculation is, in the first instance, based upon the *firm's* accounting records and is followed by a reconciliation with its banking records. A *firm* is required to make a payment into the *client bank account* if there is a shortfall or to remove any *money* which is not required to meet the *firm's* obligations.

(2) For the purpose of calculating its *client money* requirement two alternative calculation methods are permitted, but a *firm* must use the same method in relation to ■ CASS 5.3 and ■ CASS 5.4. The first refers to individual *client* cash balances; the second to aggregate amounts of *client money* recorded on a *firm* business ledgers.

5.5.63 R (1) A *firm* must, as often as is necessary to ensure the accuracy of its records and at least at intervals of not more than 25 *business days*:

(a) check whether its *client money* resource, as determined by ■ CASS 5.5.65 R on the previous *business day*, was at least equal to the *client money* requirement, as determined by ■ CASS 5.5.66 R or ■ CASS 5.5.68 R, as at the close of business on that day; and

(b) ensure that:

(i) any *shortfall* is paid into a *client bank account* by the close of business on the day the calculation is performed; or

(ii) any excess is withdrawn within the same time period unless ■ CASS 5.5.9 R or ■ CASS 5.5.10 R applies to the extent that the *firm* is satisfied on reasonable grounds that it is prudent to maintain a positive margin to ensure the calculation in (a) is satisfied having regard to any unreconciled items in its business ledgers as at the date on which the calculations are performed; and

(c) include in any calculation of its *client money* requirement (whether calculated in accordance with ■ CASS 5.5.66 R or ■ CASS 5.5.68 R) any amounts attributable to *client money* received by its *appointed representatives*, *field representatives* or other agents and which, as at the date of calculation, it is required to segregate in accordance with ■ CASS 5.5.19 R.

(2) A *firm* must within ten *business days* of the calculation in (a) reconcile the balance on each *client bank account* as recorded by the *firm* with the balance on that account as set out in the statement or other form of confirmation used by the bank with which that account is held.

(3) When any discrepancy arises as a result of the reconciliation carried out in (2), 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 those of the *firm*.

(4) While a *firm* is unable to resolve a difference arising from a reconciliation, 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* 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 either pay its own *money* into a relevant account or make a withdrawal of any excess.

5.5.64 R A *firm* must keep a record of whether it calculates its *client money* requirement in accordance with ■ CASS 5.5.66 R or ■ CASS 5.5.68 R and may only use one method during each annual accounting period (which method must be the same in relation to both ■ CASS 5.3 and ■ CASS 5.4).

Client money resource

5.5.65 R The *client money* resource, for the purposes of ■ CASS 5.5.63 R (1)(a), is:

(1) the aggregate of the balances on the *firm's client money bank accounts*, as at the close of business on the previous *business day* and, if held in accordance with ■ CASS 5.4, *designated investments* (valued on a prudent and consistent basis) together with *client money* held by a third party in accordance with ■ CASS 5.5.34 R; and

(2) (but only if the *firm* is comparing the *client money* resource with its *client's money* (accruals) requirement in accordance with ■ CASS 5.5.68 R) to the extent that *client money* is held in accordance with ■ CASS 5.3 (statutory trust), insurance debtors (which in this case cannot include pre-funded items); and

(3) (but only if the *firm* is comparing the *client money* resource with its *client's money* (accruals) requirement in accordance with ■ CASS 5.5.68 R) to the extent that *client money* is held in accordance with ■ CASS 5.4 (non-statutory trust):

(a) all insurance debtors (including pre-funded items whether in respect of advance *premiums*, claims, *premium* refunds or otherwise) shown in the *firm's* business ledgers as amounts due from *clients*, *insurance undertakings* and other *persons*, such debts valued on a prudent and consistent basis to the extent required to meet any shortfall of the *client money* resource compared with the *firm's client money* requirement; and

(b) the amount of any letter of credit or unconditional guarantee provided by an *approved bank* and held on the terms of the trust (or, in Scotland, agency), limited to:

(i) the maximum sum payable by the *approved bank* under the letter of credit or guarantee; or

(ii) if less, the amount which would, apart from the benefit of the letter of credit or guarantee, be the *shortfall* of the *client money* resource compared with the *client money* requirement under ■ CASS 5.5.66 R or ■ CASS 5.5.68 R.

But a *firm* may treat a transaction with an *insurance undertaking* which is not a *UK domestic firm* as complete, and accordingly may (but only for the purposes of the calculation in (1)) disregard any unreconciled items of *client money* transferred to an intermediate broker relating to such a transaction, if:

(4) it has taken reasonable steps to ascertain whether the transaction is complete; and

(5) it has no reason to consider the transaction has not been completed; and

(6) a period of at least 12 *months* has elapsed since the *money* was transferred to the intermediate broker for the purpose of the transaction.

Client money (client balance) requirement

5.5.66 R A *firm's client money* (*client* balance) requirement is the sum of, for all *clients*, the individual *client* balances calculated in accordance with ■ CASS 5.5.67 R but excluding any individual balances which are negative (that is, uncleared *client* funds).

5.5.67 R The individual *client* balance for each *client* must be calculated as follows:

(1) the amount paid by a *client* to the *client* (to include all *premiums*); plus

(2) the amount due to the *client* (to include all claims and *premium* refunds); plus

(3) the amount of any interest or investment returns due to the *client*;

(4) less the amount paid to *insurance undertakings* for the benefit of the *client* (to include all *premiums* and *commission* due to itself) (i.e. *commissions* that are due but have not yet been removed from the client account);

(5) less the amount paid by the *firm* to the *client* (to include all claims and *premium* refunds);

and where the individual *client* balance is found by the sum ((1) + (2) + (3)) - ((4) + (5)).

Client money (accruals) requirement

5.5.68 R A *firm's client money* (accruals) requirement is the sum of the following:

(1) all insurance creditors shown in the *firm's* business ledgers as amounts due to *insurance undertakings*, *clients* and other *persons*; plus

(2) unearned commission being the amount of commission shown as accrued (but not shown as due and payable) as at the date of the calculation (a prudent estimate must be used if the *firm* is unable to produce an exact figure at the date of the calculation).

5.5.69 R A *firm* which calculates its *client money* requirement on the preceding basis must in addition and within a reasonable period be able to match its *client money* resource to its requirement by reference to individual *clients* (with such matching being achieved for the majority of its *clients* and transactions).

[deleted]

5.5.70 R [deleted]

5.5.71 G [deleted]

5.5.72 R [deleted]

[deleted]

5.5.73 R [deleted]

[deleted]

5.5.74 R [deleted]

5.5.75 R [deleted]

Failure to perform calculations or reconciliation

5.5.76 R A *firm* must notify the *FSA* immediately if it is unable to, or does not, perform the calculation required by ■ CASS 5.5.63 R (1).

5.5.77 R A *firm* must notify the *FSA* immediately it becomes aware that it may not be able to make good any *shortfall* identified by ■ CASS 5.5.63 R (1) by the close of business on the day the calculation is performed and if applicable when the reconciliation is completed.

5.5.78 R [deleted]

Discharge of fiduciary duty

5.5.79 G The purpose of ■ CASS 5.5.80 R to ■ CASS 5.5.83 R is to set out those situations in which a *firm* will have fulfilled its contractual and fiduciary obligations in relation to any *client money* held for or on behalf of its *client*, or in relation to the *firm's* ability to require repayment of that *money* from a third party.

5.5.80 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 or with the specific consent of the *client*, but not if it is transferred to a third party in the course of effecting a transaction, in accordance with ■ CASS 5.5.34 R; 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* in accordance with ■ CASS 5.1.5 R (1); or

(5) to the *firm* itself, when it is an excess in the *client bank account* as set out in ■ CASS 5.5.63 R (1)(b)(ii).

5.5.81 G

(1) A *firm* which pays professional fees (for example to a loss adjuster or valuer) on behalf of a *client* may do so in accordance with ■ CASS 5.5.80 R (2) where this is done on the instruction of or with the consent of the *client*.

(2) 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 compliance with ■ CASS 5.5.80 R and a transferee *firm* will come under an obligation to treat any *client money* so transferred in accordance with these *rules*.

(3) *Firms* are reminded of their obligation, when transferring *money* to third parties in accordance with ■ CASS 5.5.34 R, to use appropriate skill, care and judgment in their selection of third parties in order to ensure adequate protection of *client money*.

(4) *Firms* are reminded that, in order to calculate their *client money* resource in accordance with ■ CASS 5.5.63 R to ■ CASS 5.5.65 R, they will need to have systems in place to produce an accurate accounting record showing how much *client money* is being held by third parties at any point in time. For the purposes of ■ CASS 5.5.63 R to ■ CASS 5.5.65 R, however, a *firm* must assume that *monies* remain at an intermediate broker awaiting completion of the transaction unless it has received confirmation that the transaction has been completed.

5.5.82 R **When a *firm* draws a cheque or other payable order to discharge its fiduciary duty under ■ CASS 5.5.80 R, it must continue to treat the sum concerned as *client money* until the cheque or order is presented and paid by the bank.**

5.5.83 R **For the purposes of ■ CASS 5.1.5 R, 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 will become due and payable to the *firm* or may be withdrawn from a *client bank account* by way of reimbursement.**

Records

5.5.84 R **A *firm* must ensure that proper records, sufficient to show and explain the *firm's* transactions and commitments in respect of its *client money*, are made and retained for a period of three years after they were made.**

5.6 Client money distribution

Application

5.6.1 R

(1) ■ CASS 5.6 (the *client money (insurance) distribution rules*) applies to a *firm* that in holding *client money* is subject to ■ CASS 5.3 (statutory trust) or ■ CASS 5.4 (Non-statutory trust) when a *primary pooling event* or a *secondary pooling event* occurs.

(2) In the event of there being any discrepancy between the terms of the trust as required by ■ CASS 5.4.7 R (1)(c) and the provisions of ■ CASS 5.6, the latter shall apply.

5.6.2 G

(1) The *client money (insurance) distribution rules* have force and effect on any *firm* that holds *client money* in accordance with ■ CASS 5.3 or ■ CASS 5.4. Therefore, they may apply to a *UK branch* of a non-*EEA firm*. In this case, the *UK branch* of the *firm* may be treated as if the *branch* itself is a free-standing entity subject to the *client money (insurance) distribution rules*.

(2) *Firms* that act in accordance with ■ CASS 5.4 (Non-statutory trust) are reminded that the *client money (insurance) distribution rules* should be given effect in the terms of trust required by ■ CASS 5.4.

Purpose

5.6.3 G

The *client money (insurance) 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

5.6.4 G

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.

5.6.5 R

A *primary pooling event* occurs:

(1) on the *failure* of the *firm*; or

(2) on the vesting of assets in a trustee in accordance with an 'assets *requirement*' imposed under section 48(1)(b) of the *Act*; or

(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 5.5.77 R, that it is unable correctly to identify and allocate in its records all valid claims arising as a result of a *secondary pooling event*.

5.6.6 R ■ CASS 5.6.5 R (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.

5

Pooling and distribution

5.6.7 R If a *primary pooling event* occurs:

(1) *client money* held in each *client money* account of the *firm* is treated as pooled;

(2) the *firm* must distribute that *client money* in accordance with ■ CASS 5.3.2 R or, as appropriate, ■ CASS 5.4.7 R, so that each *client* receives a sum which is rateable to the *client money* entitlement calculated in accordance with ■ CASS 5.5.66 R; and

(3) the *firm* must, as trustee, call in and make demand in respect of any debt due to the *firm* as trustee, and must liquidate any *designated investment*, and any letter of credit or guarantee upon which it relies for meeting any *shortfall* in its *client money* resource and the proceeds shall be pooled together with other *client money* as in (1) and distributed in accordance with (2).

5.6.8 G A *client's* main claim is for the return of *client money* held in a *client bank account*. A *client* may 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

5.6.9 R *Client money* received by the *firm* (including in its capacity as trustee under ■ CASS 5.4 (Non-statutory trust)) 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 completed at the time of the *primary pooling event*; or

(2) it is *money* relating to a *client*, for whom the *client money* requirement, calculated in accordance with ■ CASS 5.5.66 R or ■ CASS 5.5.68 R, shows that *money* is due from the *client* to the *firm* including in its capacity as trustee under ■ CASS 5.4 (Non-statutory trust) at the time of the *primary pooling event*.

5.6.10 G *Client money* received after the *primary pooling event* relating to an incomplete transaction should be used to complete that transaction.

5.6.11 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 5.6.9 R; and

(2) pay the *money* that is not *client money* out of that *client bank account* into the *firm's* own bank account within one *business day* of the *day* on which the remittance is cleared.

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

Failure of a bank, other broker or settlement agent: secondary pooling events

5.6.13 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.

5.6.14 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 5.5.34 R.

5.6.15 R ■ CASS 5.6.20 R to ■ CASS 5.6.31 R 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.

5.6.16 G When *client money* is transferred to a third party, a *firm* continues to owe a fiduciary duty to the *client*. However, consistent with a fiduciary's responsibility (whether as agent or trustee) for third parties under general law, a *firm* will not be held responsible for a *shortfall* in *client money* caused by a third party *failure* if it has complied with those duties.

5.6.17 G To comply with its duties, the *firm* should show proper care:

(1) in the selection of a third party; and

(2) when monitoring the performance of the third party.

In the case of *client money* transferred to a bank, by demonstrating compliance with ■ CASS 5.5.43 R, a *firm* should be able to demonstrate that it has taken reasonable steps to comply with its duties.

Failure of a bank

5.6.18 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 5.6.20 R. The *firm* would be expected to reflect the *shortfall* that arises at the *firm's* bank in the periodic *client money* calculation by reducing the *client money* resource and *client money* requirement accordingly.

5.6.19 G The *client money (insurance) 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 *fails*, and who therefore requested that their *client money* be placed in a *designated client bank account* as a different bank, should not suffer the loss of the bank that has *failed*.

5

Failure of a bank: pooling

5.6.20 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 5.6.22 R and ■ CASS 5.6.26 R to ■ CASS 5.6.28 G will apply;**

(2) **in relation to every *designated client bank account* held by the *firm* with the *failed* bank, the provisions of ■ CASS 5.6.24 R and ■ CASS 5.6.26 R to ■ CASS 5.6.28 G will apply; and**

(3) **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*.**

5.6.21 R **If a *secondary pooling event* occurs as a result of the *failure* of a bank where one or more *designated client bank accounts* are held then in relation to every *designated client bank account* held by the *firm* with the *failed* bank, the provisions of ■ CASS 5.6.24 R and ■ CASS 5.6.26 R to ■ CASS 5.6.28 G will apply.**

5.6.22 R ***Money* held in each *general client bank 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*, 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 a *general client bank 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* entitlements, calculated in accordance with (2), when performing the *client money* calculation in accordance with ■ CASS 5.5.63 R to ■ CASS 5.5.69 R.

5.6.23 G The term 'which should have been held' is a reference to the *failed* bank's failure (and elsewhere, as appropriate, is a reference to the other *failed* third party's failure) to hold the *client money* at the time of the pooling event.

5

5.6.24 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), when performing the periodic *client money* calculation, in accordance with ■ CASS 5.5.63 R to ■ CASS 5.5.69 R.

5.6.25 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

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5.6.26 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.

5.6.27 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 remittance is cleared.

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

Failure of an intermediate broker or settlement agent: pooling

5.6.29 R If a *secondary pooling event* occurs as a result of the *failure* of another broker or *settlement agent* to whom the firm has transferred *client's money* then, in relation to every *general client bank account* of the *firm*, the provisions of ■ CASS 5.6.26 R to ■ CASS 5.6.28 G and ■ CASS 5.6.30 R will apply.

5.6.30 R *Money* held in each *general client bank 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*, that has arisen as a result of the *failure*, must be borne by all the *clients* whose *client money* is held in a *general client bank account* of the *firm*, rateably in accordance with their entitlements;

(2) a new *client money* entitlement must be calculated for each *client* by the *firm*, to reflect the requirements of (1), and the *firm's* records must be amended to reflect the reduced *client money* entitlement;

(3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed* intermediate broker or *settlement agent* until the *client* is repaid; and

(4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), when performing the periodic *client money* calculation, in accordance with ■ CASS 5.5.63 R to ■ CASS 5.5.69 R.

Client money received after the failure of a broker or settlement agent

5.6.31 R *Client money* received by the *firm* after the *failure* of another broker or *settlement agent*, to whom the *firm* has transferred *client money* that would otherwise have been paid into a *client bank account* at that broker or *settlement agent*:

(1) must not be transferred to the *failed* thirty party unless specifically instructed by the *client* in order to settle an obligation of that *client* to the *failed* broker or *settlement agent*; 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 on the failure of a bank, other broker or settlement agent

5.6.32 R The provisions of ■ CASS 5.5.61 R apply.

5.7 Mandates

5.7.1	R	[deleted]
5.7.2	R	[deleted]
5.7.3	G	[deleted]
5.7.4	G	[deleted]
5.7.5	G	[deleted]
5.7.6	R	[deleted]

5.8 Safe keeping of client's documents and other assets

Application

5.8.1 R

(1) ■ CASS 5.8 applies to a *firm* (including in its capacity as trustee under ■ CASS 5.4) which in the course of *insurance mediation activity* takes into its possession for safekeeping any *client* title *documents* (other than *documents* of no value) or other tangible assets belonging to *clients*.

(2) ■ CASS 5.8 does not apply to a *firm* when:

(a) carrying on an *insurance mediation activity* which is in respect of a *reinsurance contract*; or

(b) acting in accordance with ■ CASS 6 (Custody rules).

Purpose

5.8.2 G

The *rules* in this section amplify the obligation in *Principle* 10 which requires a *firm* to arrange adequate protection for *client's* assets. *Firms* carrying on *insurance mediation activities* may hold, on a temporary or longer basis, *client* title *documents* such as *policy documents* (other than *policy documents* of no value) and also items of physical property if, for example, a *firm* arranges for a valuation. The *rules* are intended to ensure that *firms* make adequate arrangements for the safe keeping of such property.

Requirement

5.8.3 R

(1) A *firm* which has in its possession or control *documents* evidencing a *client's* title to a *contract of insurance* or other similar *documents* (other than documents of no value) or which takes into its possession or control tangible assets belonging to a *client*, must take reasonable steps to ensure that any such *documents* or items of property:

(a) are kept safe until they are delivered to the *client*;

(b) are not delivered or given to any other *person* except in accordance with instructions given by the *client*; and that

a record is kept as to the identity of any such *documents* or items of property and the dates on which they were received by the *firm* and delivered to the *client* or other *person*.

(2) A *firm* must retain the record required in (1) for a period of three years after the document or property concerned is delivered to the *client* or other *person*.

Segregation of designated investments: permitted investments, general principles and conditions (This Annex belongs to ■ CASS 5.5.14 R)

1 **The general principles which must be followed when client money segregation includes designated investments:**

(a) **there must be a suitable spread of investments;**

(b) **investments must be made in accordance with an appropriate liquidity strategy;**

(c) **the investments must be in accordance with an appropriate credit risk policy;**

(d) **any foreign exchange risks must be prudently managed.**

2 **Table of permitted designated investments for the purpose of CASS 5.5.14 R (1).**

Investment type	Qualification
1. Negotiable *debt security* (including a certificate of deposit)	(a) Remaining term to maturity of 5 years or less; and (b) The issuer or *investment* must have a short-term credit rating of A1 by Standard and Poor's, or P1 by Moody's Investor Services, or F1 by Fitch if the instrument has a remaining term to maturity of 366 days or less; or a minimum long term credit rating of AA- by Standards and Poor's, or Aa3 by Moody's Investor Services or AA- by Fitch if the instrument has a term to maturity of more than 366 days.
2. A *repo* in relation to negotiable *debt security*	As for 1 above and where the credit rating of the counterparty also meets the criteria in 1.
3. Bond funds	(a) An *authorised fund* or a *recognised scheme* or an investment company which is registered by the Securities and Exchange Commission of the United States of America under the Investment Company Act 1940; (b) A minimum credit rating and risk rating of Aaf and S2 respectively by Standard and Poor's or Aa and MR2 respectively by Moody's Investor Services or AA and V2 respectively by Fitch.
4. Money market fund	(a) An *authorised fund* or a *recognised scheme*; (b) A minimum credit and risk rating of Aaa and MR1+ respectively by Moody's Investor Services or AAAm by Standard and Poor's or AAA and V1+ respectively by Fitch.

	5. *Derivatives*	**Only for the purpose of prudently managing foreign currency risks.**

3 **The general conditions which must be satisfied in the segregation of *designated investments* are:**

(a) **any redemption of an *investment* must be by payment into the *firm's client money* bank account;**

(b) **where the credit or risk rating of a *designated investment* falls below the minimum set out in the Table, the *firm* must dispose of the *investment* as soon as possible and in any event not later than 20 *business days* following the downgrade;**

(c) **where any *investment* or issuer has more than one rating, the lowest shall apply.**

Chapter 6

Custody rules

LME-003018

6.1 Application

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

(1) [deleted]

(a) [deleted]

(b) [deleted]

(1A) when it holds *financial instruments* belonging to a *client* in the course of its *MiFID business*; and/or

(1B) when it is *safeguarding and administering investments*, in the course of business that is not *MiFID business*.

(2) [deleted]

6.1.1A G The *regulated activity* of *safeguarding and administering investments* covers both the *safeguarding and administration of assets (without arranging)* and*arranging safeguarding and administration of assets*, when those assets are either *safe custody investments* or *custody assets*. A *safe custody investment* is, in summary, a *designated investment* which a *firm* receives or holds on behalf of a *client*. *Custody assets* include *designated investments*, and any other assets that the *firm* holds or may hold in the same portfolio as a *designated investment* held for or on behalf of a *client*.

6.1.1B R ***Firms* to which the *custody rules* apply by virtue of ■ CASS 6.1.1R (1B) must also apply the *custody rules* to those *custody assets* which are not *safe custody investments* in a manner appropriate to the nature and value of those *custody assets*.**

6.1.1C G In accordance with article 42 of the *Regulated Activities Order*, a *firm* ("I") will not be *arranging safeguarding and administration of assets* if it introduces a *client* to another *firm* whose *permitted activities* include the *safeguarding and administration of investments*, or to an *exempt person* acting as such, with a view to that other *firm* or *exempt person*:

(1) providing a safe custody service in the *United Kingdom*; or

(2) arranging for the provision of a safe custody service in the *United Kingdom* by another *person*;

and the other *firm*, *exempt person* or other *person* who is to provide the safe custody service is not in the same *group* as I, and does not remunerate I.

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 *client money chapter* where appropriate.

6.1.3 G [deleted]

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 *safe custody assets* from a client as principal under a *stock lending* agreement.

Title transfer collateral arrangements

6.1.6 R **(1) The *custody rules* do not apply where a *client* transfers full ownership of a *safe custody asset* to a *firm* for the purpose of securing or otherwise covering present or future, actual, contingent or prospective obligations.**

[Note: recital 27 to *MiFID*]

(2) Excepted from (1) is a transfer of the full ownership of a *safe custody asset*:

(a) belonging to a *retail client*;

(b) whose purpose is to secure or otherwise cover that *client's* present or future, actual, contingent or prospective obligations under a *contract for differences* or a *rolling spot forex contract* that is a *future*, and in either case where that contract is entered into with a *firm* acting as *market maker*; and

(c) which is made to that *firm* or to any other *person arranging* on its behalf.

6.1.6A R **(1) Subject to (2), where a *firm* makes arrangements for the purpose of securing or otherwise covering present or future, actual, contingent or prospective obligations of a *retail client* those arrangements must not provide for the taking of a transfer of full ownership of any of that *client's safe custody assets*.**

(2) The application of (1) is confined to the taking of a transfer of full ownership:

(a) whose purpose is to secure or otherwise cover that *retail client's* obligations under a *contract for differences* ora *rolling spot forex contract* that is a *future*, and in either case where that contract is entered into with a *firm* acting as *market maker*; and

(b) which is made to that *firm* or to any other *person* arranging on its behalf.

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*.

Prime brokerage agreements

6.1.9A G A *prime brokerage firm* is reminded of the additional obligations in ■ CASS 9.3.1 R which apply to *prime brokerage agreements*.

Affiliated companies - MiFID business

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

Affiliated companies - non-MiFID business

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

(1) the *firm* has been notified that the *designated investment* belongs to a *client* of the *affiliated company*; or

(2) the *affiliated company* is a *client* dealt with at arm's length.

6.1.11 G [deleted]

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 *safe custody asset* is either to be:

(a) in respect of a *client's* purchase, due to the *client* within one *business day* following the *client's* fulfilment of a payment obligation; 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 *safe custody asset* by the *client*.

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

6.1.13 G [deleted]

6.1.14 G [deleted]

Temporary handling of safe custody assets

6.1.15 G The *custody rules* do not apply if a *firm* temporarily handles a *safe custody asset* belonging to a *client*. A *firm* should temporarily handle a *safe custody asset* 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 de-materialised exchange, handling documents for longer periods may be reasonably necessary. However, in the case of *safe custody assets* in *bearer form*, the *firm* is expected to handle them for less than one *business day*. When a *firm* temporarily handles *safe custody assets*, it is still obliged to comply with *Principle* 10 (Clients' assets).

6.1.16 G When a *firm* temporarily handles a *safe custody asset*, 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 *safe custody asset* 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 *safe custody asset* and of the details of the *client* concerned and of any action the *firm* has taken.

Exemptions which do not apply to MiFID business

6.1.16A R The exemptions in ■ CASS 6.1.16B R to ■ CASS 6.1.16D G do not apply to a *MiFID investment firm* which holds *financial instruments* belonging to a client in the course of *MiFID business*.

Operators of regulated collective investment schemes

6.1.16B R The *custody rules* do not apply to a *firm* when it acts as the *operator* of a *regulated collective investment scheme*, in relation to activities carried on for the purpose of, or in connection with, the operation of the *scheme*.

Personal investment firms

6.1.16C R The *custody rules* do not apply to a *personal investment firm* when it temporarily holds a *designated investment*, other than in *bearer form*, belonging to a *client*, if the *firm*:

(1) keeps it secure, records it as belonging to that *client*, and forwards it to the *client* or in accordance with the *client's* instructions, as soon as practicable after receiving it;

(2) retains the *designated investment* for no longer than the *firm* has taken reasonable steps to determine is necessary to check for errors and to receive the final *document* in connection with any series of transactions to which the *documents* relate; and

(3) makes a record, which must then be retained for a period of 5 years after the record is made, of all the *designated investments* handled in accordance with (1) and (2) together with the details of the *clients* concerned and of any action the *firm* has taken.

6.1.16D G Administrative convenience alone should not lead a *personal investment firm* to rely on ■ CASS 6.1.16C R. *Personal investment firms* should consider what is in the *client's* interest and not rely on ■ CASS 6.1.16C R as a matter of course.

Trustees and depositaries

6.1.16E R The specialist regime in ■ CASS 6.1.16F R to ■ CASS 6.1.16I G does not apply to a *MiFID investment firm* which holds *financial instruments* belonging to a client in the course of *MiFID business*.

6.1.16F R When a *trustee firm* or *depositary* acts as a *custodian* for a trust or *collective investment scheme* and:

(1) the trust or *scheme* is established by written instrument; and

(2) the *trustee firm* or *depositary* has taken reasonable steps to determine that the relevant law and provisions of the trust instrument or *scheme* constitution will provide protections at

least equivalent to the *custody rules* for the trust property or *scheme* property;

the *trustee firm* or *depositary* need comply only with the *custody rules* listed in the table below.

Reference	Rule
CASS 6.1.1 R to CASS 6.1.9 G and CASS 6.1.15 G to CASS 6.1.16C R	Application
CASS 6.1.16E R to CASS 6.1.16I G	Trustees and depositaries
CASS 6.1.22 G to CASS 6.1.24 G	General purpose
CASS 6.2.1 R and CASS 6.2.2 R	Protection of clients' safe custody assets
CASS 6.2.3 R and CASS 6.2.6 G	Registration and recording
CASS 6.2.7 R	Holding
CASS 6.4.1 R and CASS 6.4.2 G	Use of safe custody assets
CASS 6.5.	Records, accounts and reconciliations

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6.1.16G G The reasonable steps referred in ■ CASS 6.1.16FR (2) could include obtaining an appropriate legal opinion to that effect.

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

6.1.16I G A *trustee firm* or *depositary* that just *arranges safeguarding and administration of assets* may also take advantage of the exemption in ■ CASS 6.1.16J R (Arrangers).

Arrangers

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

Reference	Rule
CASS 6.1.1 R to CASS 6.1.9 G and CASS 6.1.15 G to CASS 6.1.16B R	Application
CASS 6.1.16J R	Arrangers
CASS 6.1.22 G to CASS 6.1.24 G	General purpose
CASS 6.3.1 R (1A) and CASS 6.3.2 G	Arranging for assets to be deposited with third parties
CASS 6.1.16K R	Records

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

6.1.17 R (1) [deleted]

(1A) [deleted]

(2) [deleted]

(3) [deleted]

6.1.18 G [deleted]

6.1.19 G [deleted]

6.1.20 G [deleted]

6.1.20A G [deleted]

6.1.21 R **[deleted]**

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 *safe custody assets* 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 safe custody assets* 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, where relevant, implement the provisions of *MiFID* which regulate the obligations of a *firm* when it holds *financial instruments* belonging to a *client* in the course of its *MiFID business*.

6.2 Holding of client assets

Requirement to protect clients' safe custody assets

6.2.1 R A *firm* must, when holding *safe custody assets* 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 *safe custody assets* 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*' *safe custody assets*, or the rights in connection with those *safe custody assets*, as a result of the misuse of the *safe custody assets*, fraud, poor administration, inadequate record-keeping or negligence.

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

Registration and recording of legal title

6.2.3 R To the extent practicable, a *firm* must effect appropriate registration or recording of legal title to a *safe custody asset* in the name of:

(1) the *client* (or, where appropriate, the *trustee firm*), unless the *client* is an *authorised person* acting on behalf of its *client*, in which case it may be registered in the name of the *client* of that *authorised person*;

(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 (Depositing assets and arranging for assets to be deposited with third parties);

(3) any other third party if:

(a) the *safe custody asset* is subject to the law or market practice of a jurisdiction outside the *United Kingdom* and the *firm* has taken reasonable steps to determine that it is in the *client*'s best interests to register or record it in that way, or that it is not feasible to do otherwise, because of the nature of the applicable law or market practice; and

(b) the *firm* has notified the *client* in writing;

(4) the *firm* if:

(a) the *safe custody asset* is subject to the law or market practice of a jurisdiction outside the *United Kingdom* and the *firm* has taken reasonable steps to determine that it is in the *client*'s best interests to register or record it in that way, or that it is not feasible to do otherwise, because of the nature of the applicable law or market practice; and

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

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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 *applicable assets* in the same name as that in which legal title to a *safe custody asset* is registered or recorded, but only if:

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

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

6.2.6 G A *firm* when complying with ■ CASS 6.2.3 R (3) or ■ CASS 6.2.3 R (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.

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6.2.7 R A *firm* must ensure that any documents of title to *applicable assets* 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 *safe custody assets* in *bearer form*.

6.3 Depositing assets and arranging for assets to be deposited with third parties

6.3.1 R (1) A *firm* may deposit *safe custody assets* 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 *safe custody assets*.

(1A) A *firm* which arranges the registration of a *safe custody investment* through a third party must exercise all due skill, care and diligence in the selection and appointment of the third party.

(2) A *firm* must take the necessary steps to ensure that any *client*'s *safe custody assets* deposited with a third party, in accordance with this *rule* are identifiable separately from the *applicable assets* belonging to the *firm* and from the *applicable assets* belonging to that third party, by means of differently titled accounts on the books of the third party or other equivalent measures that achieve the same level of protection.

(3) When a *firm* makes the selection, appointment and conducts the periodic review referred to 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 *safe custody assets* 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 *safe custody assets* 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 *safe custody asset* 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 *safe custody asset*;

(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 *safe custody assets* belonging to a *client*. The following terms are examples of the issues *firms* should address in this agreement:

(1) that the title of the account indicates that any *safe custody asset* credited to it does not belong to the *firm*;

(2) that the third party will hold or record a *safe custody asset* belonging to the *firm*'s *client* separately from any *applicable asset* belonging to the *firm* or to the third party;

(3) the arrangements for registration or recording of the *safe custody asset* if this will not be registered in the *client*'s name;

(4) [deleted]

(5) the restrictions over the circumstances in which the third party may withdraw assets from the account;

(6) the procedures and authorities for the passing of instructions to or by the *firm*;

(7) the procedures regarding the claiming and receiving of dividends, interest payments and other entitlements accruing to the *client*; and

(8) the provisions detailing the extent of the third party's liability in the event of the loss of a *safe custody asset* caused by the fraud, wilful default or negligence of the third party or an agent appointed by him.

6.3.4 R **(1) A *firm* must only deposit *safe custody assets* with a third party in a jurisdiction which specifically regulates and supervises the safekeeping of *safe custody assets* for the account of another person with a third party who is subject to such regulation.**

(2) A *firm* must not deposit *safe custody assets* 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 *safe custody assets* for the account of another person unless:

(a) the nature of the *safe custody assets* or of the *investment services* connected with those *safe custody assets* requires them to be deposited with a third party in that third country; or

(b) the *safe custody assets* 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) [deleted]

(a) [deleted]

(b) [deleted]

(i) [deleted]

(ii) [deleted]

(iii) [deleted]

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

6.3.5 R Subject to ■ CASS 6.3.6 R, in relation to a third party with which a *firm* deposits *safe custody assets* belonging to a *client*, a *firm* must ensure that any agreement with that third party relating to the custody of those assets does not include the grant to that party, or to any other *person*, of a lien or a right of retention or sale over the *safe custody assets*, or a right of set-off over any *client money* derived from those *safe custody assets*.

6.3.6 R A *firm* may conclude an agreement with a third party relating to the custody of *safe custody assets* which confers on that party, or on another *person* instructed by that party to provide custody services for those assets, a lien, right of retention or sale, or right of set-off in favour of that party or that other *person* only if that lien or right:

(1) is confined to those *safe custody assets* held in an account with that third party or that other person and extends only to properly incurred charges and liabilities arising from the provision of custody services in respect of *safe custody assets* held in that account; or

(2) arises under the operating terms of a securities depository, securities settlement system or central counterparty in whose account *safe custody assets* are recorded or held, and provided that it does so for the purpose only of facilitating the settlement of trades involving the assets held in that account; or

(3) arises in relation to those *safe custody assets* held in a jurisdiction outside the *United Kingdom*, provided that:

(a) it does so as a result of local applicable law in that jurisdiction or is necessary for that *firm* to gain access to the local market in that jurisdiction; and

(b) in respect of each *client* to which those assets belong, either:

(i) the *firm* has taken reasonable steps to determine that holding those assets subject to that lien or right is in the best interests of that *client*; or

(ii) where a *client* is a *professional client*, the *firm* is instructed by that *client* to hold those assets in that jurisdiction notwithstanding the existence of that lien or right.

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6.3.7 G A *firm* will be considered to be acting on the instructions of its *professional client* under ■ CASS 6.3.6R (3)(b)(ii) where:

(1) the *firm* has received an individual instruction or has a standing instruction in its terms of business which results in it holding *safe custody assets* in the relevant jurisdiction; and

(2) prior to acting on the instruction, the *firm* has expressly informed the *client* that holding that *client's safe custody assets* in the relevant jurisdiction will involve the granting of a lien or right over those assets. The *firm* may do this by discussing the lien or right individually with the *client* or by including reference to it in terms of business (which may themselves cross refer to a separate list of relevant jurisdictions to which ■ CASS 6.3.6R (3)(a) applies maintained on the *firm's* website in a form accessible to *clients*) or by a similar method.

6.3.8 R **For the purpose of ■ CASS 6.3.6 R, references to a *safe custody asset* include any *client money* derived from that *safe custody asset*. *Client money* derived from a *safe custody asset* may be regarded as held in the same account as that *safe custody asset* even though that money and those assets may be recorded separately.**

6.3.9 R **■ CASS 6.3.6 R does not permit a *firm* to agree to a right of set-off of the kind prohibited by either ■ CASS 7.8.1 R or ■ CASS 7.8.2 R in relation to *client money*.**

6.4 Use of safe custody assets

6.4.1 R

(1) A *firm* must not enter into arrangements for *securities financing transactions* in respect of *safe custody assets* held by it on behalf of a *client* or otherwise use such *safe custody assets* 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 *safe custody assets* on specified terms; and

(b) the use of that *client's safe custody assets* 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 *safe custody assets* held by it on behalf of a *client* in an omnibus account held by a third party, or otherwise use *safe custody assets* 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 *safe custody assets* 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 *safe custody assets* 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.

(4) [deleted]

[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 *safe custody asset* 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 *safe custody asset*, unless otherwise agreed in writing by the *client*.

6.4.3 R **Where a *firm* uses *safe custody assets* as permitted in this section, the records of the *firm* must include details of the *client* on whose instructions the use of the *safe custody assets* has been effected, as well as the number of *safe custody assets* 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 *safe custody assets* held for one *client* from *safe custody assets* held for any other *client*, and from the *firm's* own *applicable assets*.

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

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

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

6.5.2A R A *firm* must keep a copy of every executed *client* agreement that includes that *firm's* right to use *safe custody assets* for its own account, including in the case of a *prime brokerage agreement* the disclosure annex referred to in ■ CASS 9.3.1 R.

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 safe custody assets held for clients

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

(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 *safe custody assets* 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 *safe custody asset* are counted and reconciled as at the same date; and

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

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 *safe custody assets* are held.**

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

6.5.7 G Where a *firm* deposits *safe custody assets* belonging to a *client* with a third party, in complying with the requirements of ■ CASS 6.5.6 R, the *firm* should seek to ensure that the third party will deliver to the *firm* a statement as at a date or dates specified by the *firm* which details the description and amounts of all the *safe custody assets* credited to the account, and that this statement is delivered in adequate time to allow the *firm* to carry out the periodic reconciliations required in ■ CASS 6.5.6 R.

Frequency of external reconciliations

6.5.8 G A *firm* should perform the reconciliation required by ■ CASS 6.5.6 R:

(1) as regularly as is necessary; and

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

to ensure the accuracy of its internal accounts and records against those of third parties by whom *safe custody assets* are held.

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.

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 6.5.1 R, ■ CASS 6.5.2 R or ■ CASS 6.5.6 R; or

(2) if, having carried out a reconciliation, it has not complied with, or is unable, in any material respect, to comply with ■ CASS 6.5.10 R.

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 *custody rules*.

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 6.5.5 R).

Chapter 7

Client money rules

LME-003038

7.1 Application and Purpose

Application

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

(1) [deleted]

(a) [deleted]

(b) [deleted]

(2) [deleted]

(3) its *MiFID business*; and/or

(4) its *designated investment business*, that is not *MiFID business* in respect of any *investment agreement* entered into, or to be entered into, with or for a *client*;

unless otherwise specified in this section.

7.1.2 G [deleted]

Opt-in to the client money rules

7.1.3 R (1) A *firm* that receives or holds *money* to which this chapter applies in relation to:

(a) its *MiFID business*; or

(b) its *MiFID business* and its *designated investment business* which is not *MiFID business*;

and holds *money* in respect of which ■ CASS 5 applies, may elect to comply with the provisions of this chapter in respect of all such *money* and if it does so, this chapter applies as if all such *money* were *money* that the *firm* receives and holds in the course of, or in connection with, its *MiFID business*.

(1A) [deleted]

(1B) A *firm* that receives or holds *money* to which this chapter applies solely in relation to its *designated investment business* which is not *MiFID business* and receives or holds *money* in respect of which the *insurance client money chapter* applies, may elect to comply with the provisions of this chapter in respect of all such *money* and if it does so, this chapter applies as if all such *money* were *money* that the *firm* receives and holds in the course of or in connection with its *designated investment business*.

(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 the *client money rules* inthis chapter does not apply in respect of *money* that a *firm* holds outside of the scope of the *insurance client money chapter*.

7.1.5 G If a *firm* has opted to comply with this chapter, the *insurance client money chapter* will have no application to the activities to which the election applies.

7.1.6 G A *firm* that is only subject to the *insurance client money chapter* may not opt to comply with this chapter.

7.1.7 G [deleted]

7.1.7A G [deleted]

Money that is not client money: 'opt outs' for any business other than insurance mediation activity

7.1.7B R ■ CASS 7.1.7C G to ■ CASS 7.1.7I G do not apply to a *firm* in relation to *money* held in connection with its *MiFID business* to which this chapter applies or in relation to *money* for which the *firm* has made an election under ■ CASS 7.1.3 R (1).

Professional client opt-out

7.1.7C G The 'opt out' provisions provide a *firm* with the option of allowing a *professional client* to choose whether their *money* is subject to the *client money rules* (unless the *firm* is conducting *insurance mediation activity*).

7.1.7D R Subject to ■ CASS 7.1.7F R, *money* is not *client money* when a *firm* (other than a *sole trader*) holds that *money* on behalf of, or receives it from, a *professional client*, other than in the course of *insurance mediation activity*,

and the *firm* has obtained written acknowledgement from the *professional client* that:

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

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

(3) the *professional client* will rank only as a general creditor of the *firm*.

'Opt-outs' for non-IMD business

7.1.7E G For a *firm* whose business is not governed by the *Insurance Mediation Directive*, it is possible to 'opt out' on a one-way basis. However, in order to maintain a comparable regime to that applying to *MiFID business*, all '*MiFID* type' business undertaken outside the scope of *MiFID*, should comply with the *client money rules* or be 'opted out' on a two-way basis.

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7.1.7F R *Money* is not *client money* if a *firm*, in respect of *designated investment business* which is not an *investment service or activity*, an *ancillary service*, a *listed activity* or *insurance mediation activity*:

(1) holds it on behalf of or receives it from a *professional client* who is not an *authorised person*; and

(2) has sent a separate written notice to the *professional client* stating the matters set out in ■ CASS 7.1.7DR (1) to ■ CASS 7.1.7DR (3).

7.1.7G G When a *firm* undertakes a range of business for a *professional client* and has separate agreements for each type of business undertaken, the *firm* may treat *client money* held on behalf of the *client* differently for different types of business; for example, a *firm* may, under ■ CASS 7.1.7D R or ■ CASS 7.1.7F R, elect to segregate *client money* in connection with *securities* transactions and not segregate (by complying with ■ CASS 7.1.7D R or ■ CASS 7.1.7F R) *money* in connection with *contingent liability investments* for the same *client*.

7.1.7H R When a *firm* transfers *client money* to another *person*, the *firm* must not enter into an agreement under ■ CASS 7.1.7D R or ■ CASS 7.1.7F R with that other *person* in relation to that *client money* or represent to that other *person* that the *money* is not *client money*.

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7.1.7I G ■ CASS 7.1.7H R prevents a *firm*, when passing *client money* to another *person* under ■ CASS 7.5.2 R (transfer of client money to a third party), from making use of the 'opt out' provisions under ■ CASS 7.1.7D R or ■ CASS 7.1.7F R.

Credit institutions and approved banks

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*.

7.1.11A R **(1) This *rule* applies to a *firm* which is an *approved bank* but not a *BCD credit institution*.**

(2) The *client money rules* do not apply to money held by the *approved bank* if it is undertaking business which is not *MiFID business* but only when the money is held in an account with itself, in which case the *firm* must notify the *client* in writing that:

(a) *money* held for that *client* in an account with the *approved bank* will be held by the *firm* as banker and not as trustee (or in Scotland as agent); and

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

Affiliated companies - MiFID business

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.

Affiliated companies - non-MiFID business

7.1.12A R A *firm* that holds *money* on behalf of, or receives *money* from, an *affiliated company* in respect of *designated investment business* which is not *MiFID business* must not treat the *money* as *client money* unless:

(1) the *firm* has been notified by the *affiliated company* that the *money* belongs to a *client* of the *affiliated company*; or

(2) the *affiliated company* is a *client* dealt with at arm's length; or

(3) the *affiliated company* is a manager of an *occupational pension scheme* or is an overseas company; and

(a) the *money* is given to the *firm* in order to carry on *designated investment business* for or on behalf of the *clients* of the *affiliated company*; and

(b) the *firm* has been notified by the *affiliated company* that the *money* is to be treated as *client money*.

7.1.13 G [deleted]

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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 that, with respect to its *regulated activities*, is subject to the following rules of its *designated professional body*, must comply with those rules and, where relevant paragraph (3), and if it does so, it will be deemed to comply with the *client money rules*.

(2) The relevant rules are:

(a) if the *firm* is regulated by the Law Society (of England and Wales):

(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

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

(3) If the *firm* in (1) is a *MiFID investment firm* that receives or holds *money* for, or on behalf of a client in the course of, or in connection with its *MiFID business*, it must also comply with the *MiFID client money (minimum implementing) rules* in relation to that business.

Long term insurers and friendly societies

7.1.15A R This chapter does not apply to the *permitted activities* of a *long-term insurer* or a *friendly society*, unless it is a *MiFID investment firm* that receives *money* from or holds *money* for or on behalf of a *client* in the course of, or in connection with, its *MiFID business*.

Contracts of insurance

7.1.15B R This chapter does not apply to *client money* held by a *firm* which:

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

(2) in relation to such *client money* elects to act in accordance with the *insurance client money chapter*.

7.1.15C R A *firm* should make and retain a written record of any election which it makes under ■ CASS 7.1.15B R.

Life assurance business

7.1.15D G (1) A *firm* which receives and holds *client money* in respect of life assurance business in the course of its *designated investment business* that is not *MiFID business* may:

(a) under ■ CASS 7.1.3 R (1B) elect to comply with the *client money chapter* in respect of such *client money* and in doing so avoid the need to comply with the *insurance client money chapter* which would otherwise apply to the *firm* in respect of *client money* received in the course of its *insurance mediation activity*; or

(b) under ■ CASS 7.1.15B R, elect to comply with the *insurance client money chapter* in respect of such *client money*.

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

Trustee firms (other than trustees of unit trust schemes)

7.1.15E R A *trustee firm* which holds *money* in relation to its *designated investment business* which is not *MiFID business* to which this chapter applies, must hold any such *client money* separate from its own *money* at all times.

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

Reference	Rule
CASS 7.1.1 R to CASS 7.1.6 G, and CASS 7.1.8 R to CASS 7.1.14 R	Application
CASS 7.1.15E R and CASS 7.1.15F R	Trustee firms (other than trustees of unit trust schemes)
CASS 7.1.16 G	General principle
CASS 7.7.2 R to CASS 7.7.4 G	Requirement
CASS 7.4.1 R to CASS 7.4.6 G	Depositing client money
CASS 7.4.7 R to CASS 7.4.13 G	A firm's selection of credit institution, bank or money market fund
CASS 7.6.6 G to CASS 7.6.16 R	Reconciliation of client money balances

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, where relevant, implement the provisions of *MiFID* which regulate the obligations of a *firm* when it holds *client money* in the course of its *MiFID business*.

7.2 Definition of client money

7.2.1 R [deleted]

7.2.2 R [deleted]

Title transfer collateral arrangements

7.2.3 R (1) Where a *client* transfers full ownership of *money* to a *firm* for the purpose of securing or otherwise covering present or future, actual or contingent or prospective obligations, such *money* should no longer be regarded as *client money*.

[Note: recital 27 to *MiFID*]

(2) Excepted from (1) is a transfer of the full ownership of *money*:

(a) belonging to a *retail client*;

(b) whose purpose is to secure or otherwise cover that *client's* present or future, actual, contingent or prospective obligations under a *contract for differences* or a *rolling spot forex contract* that is a *future*, and in either case where that contract is entered into with a *firm* acting as *market maker*; and

(c) which is made to that *firm* or to any other *person arranging* on its behalf.

7.2.3A R (1) Subject to (2), where a *firm* makes arrangements for the purpose of securing or otherwise covering present or future, actual, contingent or prospective obligations of a *retail client* those arrangements must not provide for the taking of a transfer of full ownership of any of that *client's money*.

(2) The application of (1) is confined to the taking of a transfer of full ownership:

(a) whose purpose is to secure or otherwise cover that *retail client's* obligations under a *contract for differences* or a *rolling spot forex contract* that is a *future*, and in either case where that

contract is entered into with a *firm* acting as *market maker*; and

(b) which is made to that *firm* or to any other *person* arranging on its behalf.

7.2.4 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*.

7.2.8A G The exclusion from the *client money rules* for delivery versus payment transactions under ■ CASS 7.2.8 R is an example of an exclusion from the *client money rules* which is permissible by virtue of recital 26 of *MiFID*.

7.2.8B R *Money* need not be treated as *client money* in respect of a delivery versus payment transaction, for the purpose of settling a transaction in relation to *units* in a *regulated collective investment scheme*, if:

(1) the *authorised fund manager* receives it from a *client* in relation to the *authorised fund manager's* obligation to issue *units*, in an *AUT* or to arrange for the issue of *units* in an *ICVC*, in accordance with *COLL*, unless the *price* of those *units* has not been determined by the close of business on the next *business day*:

(a) following the date of the receipt of the *money* from the *client*; or

(b) if the *money* was received by an *appointed representative* of the *authorised fund manager*, in accordance with ■ CASS 7.4.24 G, following the date of receipt at the specified business address of the *authorised fund manager*; or

(2) the *money* is held in the course of redeeming *units* where the proceeds of that redemption are paid to a *client* within the time specified in *COLL*; when an *authorised fund manager* draws a cheque or other payable order within these time frames the provisions of ■ CASS 7.2.17 R and ■ CASS 7.2.9 R (2) will not apply.

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*.

7.2.10A G *Firms* are reminded that, notwithstanding that *money* may be due and payable to them, they have a continuing obligation to segregate *client money* in accordance with the *client money rules*. In particular, in accordance with ■ CASS 7.6.2 R, *firms* must ensure the accuracy of their records and accounts and are reminded of the requirement to carry out internal reconciliations of *client money* balances, either in accordance with the *standard method of internal client money reconciliation* or a different method which meets the requirements of ■ CASS 7.6.7 R and ■ CASS 7.6.8 R.

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 7.2.15 R);

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 7.2.3 R (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 7.5.2 R (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 7.2.9 R (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 7.6.13 R (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 7.2.19 R.

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

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 ■ CASS 6.

[**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*.

7.4.9A R **A *firm* must limit the funds that it deposits or holds with a relevant group entity or combination of such entities so that those funds do not at any point in time exceed 20 per cent of the balance on:**

(1) all of its *general client bank accounts* considered in aggregate;

(2) each of its *designated client bank accounts*; and

(3) each of its *designated client fund accounts*.

7.4.9B R **For the purpose of ■ CASS 7.4.9A R an entity is a relevant group entity if it is:**

(1) a *BCD credit institution*, a bank authorised in a third country, a *qualifying money market fund*, or the entity operating or managing a *qualifying money market fund*; and

(2) a member of the same *group* as that *firm*.

7.4.9C G The *rules* in ■ SUP 16.14 provide that a *firm* must report to the *FSA* in relation to the identity of the entities with which it deposits *client money* and the amounts of *client money* deposited with them. The *FSA* will use that information to monitor compliance with the diversification *rule* in ■ CASS 7.4.9A R.

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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 7.4.1 R, 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 7A.2.1 G (Failure of the authorised firm: primary pooling event).

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 *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* can comply with its obligations to perform reconciliations of records and accounts (see ■ CASS 7.6.2 R). A *firm* that adopts the alternative approach will segregate *client money* into a *client bank account* on a daily basis, after having performed a reconciliation of records and accounts of the entitlement of each *client* for whom the *firm* holds *client money* with the records and accounts of the *client money* the *firm* holds in *client bank accounts* and *client transaction accounts* to determine what the *client money* requirement was at the close of the previous *business day*.

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 7.2.15 R).

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 7.6.2 R (Records and accounts), and where relevant ■ SYSC 4.1.1 R (General requirements) and ■ SYSC 6.1.1 R (Compliance), adjust the balance held in its *client bank accounts* and then segregate the *money* in the *client bank account* until the calculation is re-performed on the next *business day*; or

(2) pay it out in accordance with the *rule* regarding the discharge of a *firm's* fiduciary duty to the *client* (see ■ CASS 7.2.15 R).

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 7.4.15 R); and

(3) use an historic average to account for uncleared cheques (see paragraph 4 of ■ CASS 7 Annex 1 G).

7.4.20 G Pursuant to the *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.**

7

Automated transfers

7.4.22 G Pursuant to the *client money segregation requirements*, a *firm* operating the normal approach that receives *client money* in the form of an automated transfer should take reasonable steps to ensure that:

(1) the *money* is received directly into a *client bank account*; and

(2) if *money* is received directly into the *firm's* own account, the *money* is transferred into a *client bank account* promptly, and in any event, no later than the next *business day* after receipt.

Mixed remittance

7.4.23 G Pursuant to the *client money segregation requirements*, a *firm* operating the normal approach that receives a *mixed remittance* (that is part *client money* and part other *money*) should:

(1) pay the full sum into a *client bank account* promptly, and in any event, no later than the next *business day* after receipt; and

(2) pay the *money* that is not *client money* out of the *client bank account* promptly, and in any event, no later than one *business day* of the day on which the *firm* would normally expect the remittance to be cleared.

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Appointed representatives, tied agents, field representatives and other agents

7.4.24 G (1) Pursuant to the *client money segregation requirements*, a *firm* operating the normal approach should establish and maintain procedures to ensure that

client money received by its *appointed representatives*, *tied agents*, *field representatives* or other agents is:

(a) paid into a *client bank account* of the *firm* promptly, and in any event, no later than the next *business day* after receipt; or

(b) forwarded to the *firm*, or in the case of a *field representative* forwarded to a specified business address of the *firm*, so as to ensure that the *money* arrives at the specified business address promptly, and in any event, no later than the close of the third *business day*.

(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*, *tied agents*, *field representatives* or other agents keep *client money* separately identifiable from any other *money* (including that of the *firm*) until the *client money* is paid into a *client bank account* or sent to the *firm*.

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* and *tied agents*.

Client entitlements

7.4.27 G Pursuant to the *client money segregation requirements*, a *firm* operating the normal approach that receives outside the *United Kingdom* a *client* entitlement on behalf of a *client* should pay any part of it which is *client money*:

(1) to, or in accordance with, the instructions of the *client* concerned; or

(2) into a *client bank account* promptly, and in any event, no later than five *business days* after the *firm* is notified of its receipt.

7.4.28 G Pursuant to the *client money segregation requirements*, a *firm* operating the normal approach should allocate a *client* entitlement that is *client money* to the individual *client* promptly and, in any case, no later than ten *business days* after notification of receipt.

Money due to a client from a firm

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

(1) to, or to the order of, the *client*; or

(2) into a *client bank account*.

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 7.4.30 R) does not apply where the *client* has instructed the *firm* to convert the *money* into and hold it in a different currency.

Commodity Futures Trading Commission Part 30 exemption order

7.4.32 G United States (US) legislation restricts the ability of non-US firms to trade on behalf of US customers on non-US futures and options exchanges. The relevant US regulator (the *CFTC*) operates an exemption system for *firms* authorised by the *FSA*. The *FSA* sponsors the application from a *firm* for exemption from Part 30 of the General Regulations under the US Commodity Exchange Act in line with this system.

7.4.33 G A *firm* with a *Part 30 exemption order* undertakes to the *CFTC* that it will refuse to allow any US customer to opt not to have his *money* treated as *client money* if it is held or received in respect of transactions on non-US exchanges, unless that US customer is an "eligible contract participant" as defined in section 1a(12) of the Commodity Exchange Act, 7 U.S.C. In doing so, the *firm* is representing that if available to it, it will not make use of the opt-out arrangements in ■ CASS 7.1.7B R to ■ CASS 7.1.7F R in relation to that business.

7.4.34 R **A *firm* must not reduce the amount of, or cancel a letter of credit issued under, an LME bond arrangement where this will cause the *firm* to be in breach of its *Part 30 exemption order*.**

7.4.35 R **A *firm* must notify the *FSA* immediately it arranges the *issue* of an individual letter of *credit* under an LME bond arrangement.**

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 7.2.15 R).

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 7.6.2 R (Records and accounts), and where relevant ■ SYSC 4.1.1 R (General requirements)and ■ SYSC 6.1.1 R (Compliance), a *firm* should take reasonable steps to ensure that it is notified promptly of any receipt of *client money* in the form of a *client* entitlement.

Record keeping

7.6.4 R **A *firm* must ensure that records made under ■ CASS 7.6.1 R and ■ CASS 7.6.2 R 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) 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 7.6.2 R, and where relevant ■ SYSC 4.1.1 R and ■ SYSC 6.1.1 R.

(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 7.6.2 R used, and if different from the *standard method of internal client money reconciliation*, to show and explain that:

(a) the method of internal reconciliation of *client money* balances used affords an equivalent degree of protection to the *firm*'s *clients* to that afforded by the *standard method of internal client money reconciliation*; and

(b) in the event of a *primary pooling event* or a *secondary pooling event*, the method used is adequate to enable the *firm* to comply with the *client money distribution rules*.

(2) A *firm* must make these records on the date it starts using a method of internal reconciliation of *client money* balances and must keep it for a period of five years after ceasing to use it.

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.

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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 7.4.20 G and ■ CASS 7.4.21 R).

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**

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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 7.6.1 R, ■ CASS 7.6.2 R or ■ CASS 7.6.9 R;

(2) if having carried out a reconciliation it has not complied with, or is unable, in any material respect, to comply with ■ CASS 7.6.13 R to ■ CASS 7.6.15 R.

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 7.4.15 R).

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 7.6.8 R).

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 distribution rules*;**

(2) **subject to (4), 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.**

7.7.3 R

A *trustee firm* which is subject to the *client money rules* by virtue of ■ CASS 7.1.1 R (4):

(1) must receive and hold *client money* in accordance with the relevant instrument of trust;

(2) subject to that, receives and holds *client money* on trust on the terms (or in Scotland on the agency terms) specified in ■ CASS 7.7.2 R.

7.7.4 G

If a *trustee firm* holds *client money* in accordance with ■ CASS 7.7.3 R (2), the *firm* should follow the provisions in ■ CASS 7.1.15E R and ■ CASS 7.1.15F R.

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.

Exchanges, clearing houses, intermediary brokers or OTC counterparties

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

7.9 [Deleted]

Annex 1

As explained in ■ CASS 7.6.6 G, in complying with its obligations under ■ CASS 7.6.2 R (Records and accounts), and where relevant ■ SYSC 4.1.1 R (General organisational requirements) and ■ SYSC 6.1.1 R (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 7.4.17 G) 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 7.4.18 G) 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 7.4.19 G (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 *margined 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 *margined 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 *money* (no trades) and	A
sale proceeds due to the *client*:	
(a) in respect of *principal deals* when the *client* has delivered the *designated investments*; and	B
(b) in respect of agency *deals*, when either:	
(i) the sale proceeds have been received by the *firm* and the *client* has delivered the *designated investments*; or	C1
(ii) the *firm* holds the *designated investments* for the *client*; and	C2
the cost of purchases:	
(c) in respect of *principal deals*, paid for by the *client* but the *firm* has not delivered the *designated investments* to the client; and	D
(d) in respect of agency *deals*, paid for by the *client* when either:	
(i) the *firm* has not remitted the *money* to, or to the order of, the counterparty; or	E1
(ii) the *designated investments* have been received by the *firm* but have not been delivered to the *client*;	E2
Less	
money owed by the *client* in respect of unpaid purchases by or for the *client* if delivery of those *designated investments* has been made to the *client*; and	F
Proceeds remitted to the *client* in respect of sales transactions by or for the *client* if the *client* has not delivered the *designated investments*.	G
Individual *Client* Balance 'X' = (A+B+C1+C2+D+E1+E2)-F-G	X

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 *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 7.2.8 R (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 7.2.9 R);

(3) need not include *client money* in the form of *client* entitlements which are not required to be segregated (see ■ CASS 7.4.27 G) nor include *client money* forwarded to the *firm* by its appointed representatives, *tied agents*, field representatives and other agents, but not received (see ■ CASS 7.4.24 G);

(4) should take into account any *client money* arising from ■ CASS 7.6.13 R (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 margined 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 *margined transaction* requirement is:

(1) the sum of each of the *client's equity balances* which are positive;

Less

(2) the proportion of any individual negative *client equity balance* which is secured by *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 *margined 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 *margined transaction*.

17A. A *firm* with a *Part 30 exemption order* which also operates an LME bond arrangement for the benefit of US-resident investors, should exclude the *client equity balances* for transactions undertaken on the London Metal Exchange on behalf of those US-resident investors from the calculation of the *margined transaction* requirement.

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.

Chapter 7A

Client money distribution

LME-003074

7A.1 Application and purpose

Application

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

Purpose

7A.1.2 G The *client money 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*.

7A.2 Primary pooling events

Failure of the authorised firm: primary pooling event

7A.2.1 G

(1) A *firm* can hold *client money* in a *general client bank account*, a *designated client bank account* or a *designated client fund account*.

(2) A *firm* holds all *client money* in *general client bank accounts* for its *clients* as part of a common pool of *money* so those particular *clients* do not have a claim against a specific sum in a specific account; they only have a claim to the *client money* in general.

(3) A *firm* holds *client money* in *designated client bank accounts* or *designated client fund accounts* for those *clients* that requested their *client money* be part of a specific pool of *money*, so those particular *clients* do have a claim against a specific sum in a specific account; they do not have a claim to the *client money* in general unless a *primary pooling event* occurs. A *primary pooling event* triggers a notional pooling of all the *client money*, in every type of *client money* account, and the obligation to distribute it.

(4) If the *firm* becomes insolvent, and there is (for whatever reason) a *shortfall* in *money* held for a *client* compared with that *client's* entitlements, the available funds will be distributed in accordance with the *client money distribution rules*.

7A.2.2 R

A *primary pooling event* occurs:

(1) on the *failure* of the *firm*;

(2) on the vesting of assets in a *trustee* in accordance with an 'assets *requirement*' imposed under section 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 7.6.16 R (Notification requirements), that it is unable correctly to identify and allocate in its records all valid claims arising as a result of a *secondary pooling event*.