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Financial Services Authority

# Enhancing the Client Assets Sourcebook

March 2010



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# List of acronyms

Alternative Investment Fund Managers Directive (AIFMD)

Consultation Paper (CP)

Client Assets Sourcebook (CASS)

Client Money and Assets Return (CMAR)

Controlled Function (CF)

Cost Benefit Analysis (CBA)

European Economic Area (EEA)

Financial Services Authority (FSA)

Financial Services and Markets Act 2000 (FSMA)

General Insurance Intermediaries (GIIs)

HM Treasury (the Treasury)

Information Technology (IT)

Information Systems (IS)

Insolvency Practitioner (IP)

Lehman Brothers International (Europe) (LBIE)

Markets in Financial Instruments Directive (MiFID)

Over The Counter (OTC)

Prime Brokerage Agreements (PBAs)

Securities and Futures Authority (SFA)

Segregated Accounts Reporting Statement (SARS)

Self-Regulatory Organisations (SROs)

Significant Influence Function (SIF)

Special Purpose Vehicles (SPVs)

The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by 30 June 2010.

Comments may be sent by electronic submission using the form on the FSA's website at ([www.fsa.gov.uk/Pages/Library/Policy/CP/2010/cp10\\_09\\_response.shtml](http://www.fsa.gov.uk/Pages/Library/Policy/CP/2010/cp10_09_response.shtml)).

Alternatively, please send comments in writing to:

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**It is the FSA's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure.**

**A confidential response may be requested from us under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Tribunal.**

Copies of this Consultation Paper are available to download from our website – [www.fsa.gov.uk](http://www.fsa.gov.uk). Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

# 1 Overview

## Background

- 1.1 The purpose of this Consultation Paper (CP) is to seek views on our proposals for enhancing the Client Assets Sourcebook (CASS).
- 1.2 The financial crisis has been well documented and we will not analyse it further in this paper. We have taken into account the issues highlighted by a number of insolvency appointments, including Lehman Brothers International (Europe) (LBIE). The focus of this paper is to consider proposals which will protect clients and consider market stability, in the event of a firm's insolvency.
- 1.3 During the past eighteen months we have observed a number of areas in which the CASS regime can be strengthened. We have engaged in pre-consultation with firms, trade associations, accounting firms and legal experts, through a combination of meetings, surveys and round-table discussions. We have also had the benefit of participating in HM Treasury's (the Treasury) working groups, the views of which provided the basis for the publication of two CPs considering effective resolution arrangements for investment banks.<sup>1</sup>
- 1.4 The Treasury has outlined a comprehensive package of proposals which considered legislative, regulatory and market-led solutions to address client money and assets, markets and investment firm resolution issues. This paper considers seven of the client money and assets proposals<sup>2</sup> addressing:
  - increased re-hypothecation disclosure and transparency in the prime brokerage community;
  - enhanced client money and asset protection; and
  - increased CASS oversight.

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1 *Developing effective resolution arrangements for investment banks* (May 2009) ([http://www.hm-treasury.gov.uk/consult\\_investment\\_banks.htm](http://www.hm-treasury.gov.uk/consult_investment_banks.htm)) and *Establishing resolution arrangements for investment banks* (December 2009) ([http://www.hm-treasury.gov.uk/consult\\_investment\\_banks2.htm](http://www.hm-treasury.gov.uk/consult_investment_banks2.htm)).

2 Specifically, we consider proposals 12 to 18 as numbered in Annex A of *Establishing resolution arrangements for investment banks* (December 2009).

## Further work in 2010

- 1.5 During the course of the year, we will publish further consultations to enhance the existing regime.
- 1.6 In CP06/14<sup>3</sup> and PS07/2<sup>4</sup>, we raised concerns about the risk of a firm inappropriately using title transfer arrangements. We have observed that some firms have entered into agreements with clients that transfer ownership rights over money to the firm, for example by way of title transfer, or they inappropriately claim money to be 'due and payable' so the firm then claims this as their own. We are concerned that this practice results in clients not receiving protections they are entitled to and that we expect.
- 1.7 While we have written to certain firms expressing our concerns regarding this treatment, we propose to clarify the relevant provisions in a quarterly CP, to be published in July 2010.
- 1.8 The Treasury has also asked us to consider our existing Handbook provisions, which require firms to maintain accounts and records in compliance with CASS and provide us with an annual client assets audit report.<sup>5</sup> In September 2010 we will publish a CP which considers refining the scope and increasing the standard of audit reporting.
- 1.9 We have continued to work with firms that have established special purpose vehicles (SPVs). These are designed to enable client assets which have not been transferred to the firm by way of title transfer, over which the firm has no security interest, or that are being treated as excess collateral, to be released to clients promptly upon a firm's insolvency. Now that SPVs have been established by a small number of firms, we will review how effective these arrangements are in 2010.
- 1.10 We are considering the Treasury's proposals for a resolution regime for investment firms. We will engage with the industry in 2010/11 on developing new policies and supervisory arrangements to create a client money and assets trustee and/or agency.
- 1.11 Finally, we also remind firms of our Client Money and Assets Report published in January 2010, which reflects the ongoing significance that we attach to this area.<sup>6</sup> This report conveyed the following key messages to firms:
  - clients must have confidence that their client money and assets are safe and will be returned within a reasonable timeframe in the event a firm becomes insolvent;
  - clients must have confidence that firms holding their client money and assets have strong management oversight and control over their business;
  - we consider the protection of client money and assets to be a fundamentally important part of regulation and, as a result of the more difficult economic climate and our own firm supervision, we are intensifying our oversight in this area; and

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3 Please see [http://www.fsa.gov.uk/Pages/Library/Policy/CP/2006/06\\_14.shtml](http://www.fsa.gov.uk/Pages/Library/Policy/CP/2006/06_14.shtml)

4 Please see [http://www.fsa.gov.uk/Pages/Library/Policy/Policy/2007/07\\_02.shtml](http://www.fsa.gov.uk/Pages/Library/Policy/Policy/2007/07_02.shtml)

5 Please see SUP 3.10

6 For example please see the 'Dear CEO' Letter ([http://www.fsa.gov.uk/pubs/ceo/ceo\\_letter0119.pdf](http://www.fsa.gov.uk/pubs/ceo/ceo_letter0119.pdf)), Client Money Report ([http://www.fsa.gov.uk/pubs/other/cass\\_risk.pdf](http://www.fsa.gov.uk/pubs/other/cass_risk.pdf)) and recent enforcement action, for example: (<http://www.fsa.gov.uk/pages/Library/Communication/PR/2010/024.shtml>)

6 CP10/9: Enhancing the Client Assets Sourcebook (March 2010)



- we have taken steps to rectify procedures at firms that have fallen short of our requirements. Targeted supervision and regulatory intervention will increase throughout 2010.

### **Increasing re-hypothecation disclosure and transparency in the prime brokerage community**

- 1.12 Following LBIE's insolvency, it became clear that the failure of a major prime broker and its impact on clients' money and assets was generally not understood by the market. Accordingly, in Chapter 2 we propose creating a requirement that all prime brokerage agreements (PBAs) contain a disclosure annex and that client money and asset holdings are reported daily to all prime brokerage clients.

#### **a) Introducing a disclosure annex for prime brokerage agreements**

- 1.13 We note that not all professional clients fully appreciated the consequences of their prime broker failing and the impact this would have on their client money and assets. Accordingly, we propose to introduce a requirement for contractual re-hypothecation provisions in a PBA to be summarised in a disclosure annex attached to the PBA. Although brief, the annex will highlight relevant definitions, including that of net client indebtedness and the contractual limit on re-hypothecation. It will include a statement setting out the risk to the client upon the prime broker's default and cross-reference detailed provisions in the PBA, which may help reduce the time required for legal due diligence undertaken by an insolvency practitioner (IP) following a prime broker's collapse.
- 1.14 To avoid doubt, we highlight that the contractual obligations will remain in the PBA and the annex operates only as a summary to increase disclosure of these provisions. The annex itself will not have legal effect, but firms will need to ensure it is clear, fair and not misleading.

#### **b) Reporting to prime brokerage clients**

- 1.15 It is our understanding that upon LBIE's insolvency, clients generally did not have access to up-to-date information concerning their accounts. Market uncertainty arose in the month following the appointment of the joint administrators, particularly where there was a lack of clarity regarding:
- whether clients' instructions issued pre-insolvency had been executed;
  - which of the clients' assets had been fully and/or properly segregated; and
  - which of the clients' assets had been re-hypothecated.
- 1.16 Having monitored market practice over the past year, we understand prime brokers now offer daily reporting to their clients. This reflects a significant investment in IT

systems by prime brokers and increases transparency for clients. To complement the PBA annex, we propose standardising daily reporting to all clients to ensure clients can properly manage their exposures.

### **Enhancing client money and asset protection**

- 1.17 In Chapter 3 we propose policies to provide greater protection to clients and increase market stability in the event of a firm's failure. We propose to restrict placing client's money in client bank accounts held with institutions within the same group to 20%, excluding the total balance of client transaction accounts. That is, we consider at least 80% should be diversified outside the group to manage clients' exposure in the event of the firm's default.
- 1.18 Our second policy proposal in Chapter 3 is to prohibit using general liens in custodian agreements. We understand that LBIE's insolvency has highlighted this market practice which has led to delays in recovering assets from affiliated and third party depots.

#### **a) Restricting the placement of client money deposits held in client bank accounts within a group**

- 1.19 There is no standard market practice for depositing client money within a group structure. For example, a number of investment firms take an explicit decision to hold client money deposits outside of the group, while other firms deposit significant amounts intra-group. We seek a policy outcome which ensures an appropriate level of diversification to protect clients' money.
- 1.20 The issue under consideration is not that client money is ultimately held by the firm as a deposit. However, when it is deposited within the group, there is an increased contagion risk that both the firm and the group bank will fail concurrently (or one will fail shortly after the other). The resulting risk is that a firm will place an inappropriate amount of client money intra-group, usually as a source of liquidity with a lower cost of capital than external sources.
- 1.21 Furthermore, as a group's financial position deteriorates, there is a risk that the firm will deposit more client money intra-group to support its operations. This may cause clients to have an inappropriate level of exposure to the group's credit risk as a whole instead of just the individual firm. Accordingly, we are consulting on the basis of restricting intra-group client money deposits to 20% of the firm's total client money held in client bank accounts.

#### **b) Prohibiting the use of general liens in custodian agreements**

- 1.22 Some firms in the UK appear to have inappropriately allowed custodians and sub-custodians to include a general lien in contractual agreements. As we have observed from LBIE's insolvency, liens covering wider indebtedness of the group (i.e. covering liabilities unrelated to the assets in question or the company that

placed the assets with the custodian or sub-custodian) have contributed to significant delays in IPs' ability in recovering assets from depots which are not directly under their control. Accordingly, we propose to prohibit using certain liens in custodian agreements.

### **Increased FSA oversight of CASS**

- 1.23 In Chapter 4 we propose to create a CASS oversight controlled function (CF), which will also be a Significant Influence Function (SIF). We also propose to re-introduce a Client Money and Asset Return (CMAR).

#### **a) Establishing a CASS oversight controlled function**

- 1.24 During the past year we have observed during firm visits that responsibility for client money and assets is often split between several staff across the compliance, operations, finance and corporate treasury functions. A small number of firms continue to adopt best practice and appoint a client assets manager or committee, which directly oversees and controls the various staff and processes involved.
- 1.25 The Treasury's December CP considered how we may enhance, through our approved persons regime, regulatory control over those individuals responsible for firms' protection of client money and assets. We included content to this effect in our January CP, *Effective Corporate Governance*.<sup>7</sup> We consider this produces cost effective oversight for both firms and us.
- 1.26 The draft rules will require one person at certain firms to have ultimate oversight responsibility for client money and assets, even though the firm may structure its business so several people across numerous departments have client money and assets roles. This person will perform a controlled function we propose to introduce – the Client Assets Oversight function. The creation of this CF will support our oversight and credible deterrence strategy.

#### **b) Re-introducing a client money and assets return**

- 1.27 Our predecessor self-regulatory organisations (SROs), particularly the Securities and Futures Authority (SFA), required firms with relevant client assets permissions to report on their client asset positions. The SFA required firms to report how much client assets and money they held, where they held it, the top five banks used for holding client money and other information in a segregated accounts reporting statement (SARS).
- 1.28 We propose a new return framework, the CMAR. The CMAR will be reviewed and authorised by the newly established CASS oversight CF on a monthly basis for medium and large firms and bi-annually for small firms (based upon a bespoke CASS stratification of firms). We have been mindful of minimising the administrative burden placed upon firms, and included only those questions from which we will obtain information to assist us in monitoring compliance with CASS.

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<sup>7</sup> Please see page 7, CP10/3 *Effective corporate governance* [http://www.fsa.gov.uk/pubs/cp/cp10\\_03.pdf](http://www.fsa.gov.uk/pubs/cp/cp10_03.pdf)

- 1.29 The CMAR will provide us with an overview of firm-specific CASS positions and an overview of UK firms' CASS holdings, enabling us to make regulatory interventions on a firm-specific or thematic basis. The requirement to produce the CMAR may also help ensure the information from the previous reporting period is available immediately to an appointed IP and a firm's clients in the event of an insolvency appointment.

### **European Commission**

- 1.30 Please note that our proposals regarding prime brokers reporting to their clients on a daily basis and requiring re-hypothecation provisions to be contained in a separate disclosure annex, together with the restriction on firms holding client money held intra-group, are subject to discussions we are having with the European Commission. We will update our website with the Commission's views on these proposals in due course.

### **Regulatory measures proposed and cost benefit analysis**

- 1.31 Related Handbook changes are set out in Chapters 2, 3 and 4. Our analysis of the costs and benefits of our proposals, and their compatibility with our statutory objectives, can be found in Annex 1.

### **Who should read this CP?**

This paper will be of particular interest to:

- regulated firms, particularly firms engaging in prime brokerage and custodian services;
- the auditing community;
- groups which deposit client money intra-group; and
- individuals who may be approved and/or exercise significant influence over a firm responsible for client money and assets.

This paper will be of minimal interest to General Insurance Intermediaries.

### **Next steps**

- 1.32 Consultation on these proposals will close on 30 June 2010. We intend to consider feedback with a view to publishing a policy statement during the third quarter of 2010.

### **Consumers**

- 1.33 The proposals in this paper enhance the CASS regime, which aims at securing an appropriate level of consumer protection. However, we consider the proposals to be most relevant to regulated firms who hold and control client money and assets.

# 2 Increasing re-hypothecation disclosure and transparency in the prime brokerage community

## Scope

- 2.1 Our policy proposals in this section only apply to UK authorised prime brokers, focusing on issues highlighted by LBIE's collapse. Please note these proposals will not apply to incoming European Economic Area (EEA) firms conducting investment business, as under the Markets in Financial Instruments Directive (MiFID), client asset regulation is a home state responsibility.
- 2.2 During 2010 we will consider whether the proposals in this chapter should be applied more broadly to other market participants who enter into rights of use arrangements to ensure there is a level playing field in the market.

## The Treasury's proposals

- 2.3 With a view to increasing transparency, we note the Treasury's papers discussed the possibility of increased record-keeping requirements in CASS. However, CASS already contains significant obligations concerning this, which largely stems from implementing MiFID's high-level record-keeping requirements.<sup>8</sup> Accordingly, we do not believe additional record-keeping will enhance CASS, and therefore do not propose introducing new rules in this regard.
- 2.4 We also note that our proposal to create a disclosure annex (discussed below) will require firms to review existing documentation, including version control and ensure that such agreements are signed and dated.

- Q1. Do you agree that existing CASS record-keeping requirements are sufficient? If not, please outline where you consider these could be enhanced.

## Other policy options

- 2.5 We have taken into account views we received in pre-consultation exercises, together with feedback submitted to the Treasury concerning their May 2009 CP. We also

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<sup>8</sup> Article 51 of the level 2 directive.

surveyed market participants and met with relevant trade associations to gather further views.

2.6 We also discussed:

- increasing transparency by creating a disclosure annex to the PBA and other legal documentation containing contractual re-hypothecation provisions;
- increasing transparency via a daily report made available by prime brokers to their clients; and
- whether a standardised definition of net client indebtedness should be created, and if agreed, whether a maximum percentage cap should be applied to this formula.

2.7 Having considered preliminary views and cost data supplied by firms in our pre-consultation exercises, we do not currently propose creating a standardised definition of net client indebtedness and applying a cap. However, should we identify issues with a firm's compliance, we may vary a firm's permission with a view to restricting its ability to re-hypothecate clients' assets.

2.8 We would like to take this opportunity to thank firms for their time in preliminary consultation exercises.

### **a) Increasing transparency via a disclosure annex**

2.9 The market failure highlighted by LBIE's prime brokerage business unit relates to its sophisticated clients' lack of understanding of the consequences of their prime broker's insolvency. It also relates to the impact this has on the clients' right to recover assets over which LBIE had exercised its contractual right to re-hypothecate. This reflects a poor standard of due diligence in the market before LBIE's insolvency.

2.10 This was evidenced in the weeks following LBIE's collapse, through correspondence we received from LBIE's clients, showing they did not fully appreciate how their prime broker's insolvency would impact the recovery of their assets. As noted in the Treasury's papers,<sup>9</sup> we agree trade associations have a role to play in assisting their members, and we will work with them to improve market awareness.

2.11 While we have monitored the prime brokerage market since LBIE's collapse and have observed that awareness of the risks to clients' assets which have been re-hypothecated on the prime broker's failure has increased during this period (to the extent that a multi-prime model has been adopted by some clients), we consider further mandated disclosure will ensure all participants give appropriate attention to the practice and legal implications of re-hypothecation.

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<sup>9</sup> *Developing effective resolution arrangements for investment banks* (May 2009) ([http://www.hm-treasury.gov.uk/consult\\_investment\\_banks.htm](http://www.hm-treasury.gov.uk/consult_investment_banks.htm)) and *Establishing resolution arrangements for investment banks* (December 2009) ([http://www.hm-treasury.gov.uk/consult\\_investment\\_banks2.htm](http://www.hm-treasury.gov.uk/consult_investment_banks2.htm)).

2.12 For the purposes of this section, we have drafted the following glossary definitions:

*prime brokerage agreement* an agreement between a *prime brokerage firm* and a *client for prime brokerage services*.

*prime brokerage firm* a *firm* that provides *prime brokerage services* and which may do so acting as *principal*.

*prime brokerage services* a package of services which comprise each of the following:

- (a) *custody or arranging safeguarding and administration of assets*;
- (b) clearing services; and
- (c) financing, the provision of which includes each of the following:
  - (i) capital introduction;
  - (ii) margin financing;
  - (iii) *stock lending*;
  - (iv) stock borrowing;
  - (v) entering into repurchase or reverse repurchase transactions;

and which, in addition, may comprise consolidated reporting, other operational support and related services.

2.13 We propose to introduce a requirement for contractual re-hypothecation provisions to be summarised in a disclosure annex attached to each PBA. Although brief, the annex will highlight the relevant definitions, including net client indebtedness, the contractual limit on re-hypothecation and it will also include a statement setting out the risk to the client's assets upon the prime broker's default. It will cross-reference the detailed provisions in the PBA, which may help reduce the amount of time spent conducting the legal due diligence undertaken by an IP's legal advisor following a prime broker's collapse.

2.14 For the avoidance of doubt, we highlight that contractual obligations will remain in the PBA and the annex operates only as a summary to increase disclosure of these provisions. Firms noted in our pre-consultation meetings that they will incur re-papering costs. However, we consider that an additional benefit of this proposal is that prime brokers will be required to review their records and locate the latest signed and dated agreement entered into with clients, thereby mitigating the risk of poor document version control and confirming proper execution of documentation.

2.15 We understand that prime brokers' clients can use the PBA disclosure annex to increase transparency to aid their understanding and assist in their disclosure to underlying clients. The new annex may also help a future requirement of the Alternative Investment Fund Managers Directive (AIFMD) on disclosure in this area, and the proposal does not offend any principle of UK contract law.

2.16 We therefore propose to require prime brokers to re-paper existing agreements to create a PBA disclosure annex and summarise the relevant definitions, including net client indebtedness and the contractual limit on re-hypothecation (including cross-references to the relevant sections in the agreement). It must also include a statement setting out the risk to the client's assets upon the prime broker's default. This requirement will be subject to a six month transitional period.

- Q2: Do you agree with our proposed glossary definitions regarding prime brokerage as stated above?
- Q3. Do you agree that we should introduce a requirement that the re-hypothecation clauses be summarised in a separate annex to the PBA and/or other relevant contractual documentation which contains such provisions?
- Q4: Are there any other transparency and/or disclosure issues we should consider?

## **b) Reporting to prime brokerage clients**

- 2.17 Derived from MiFID obligations, our Conduct of Business sourcebook requires client reporting on at least an annual basis, where money or designated investments are held on the client's behalf.<sup>10</sup> There is no standardised approach within the prime brokerage market to report to clients more frequently; rather this is a commercial agreement between parties. Depending on client demand, client reporting may happen on the day after a transaction completes, several days after a transaction completes or on a less frequent basis. Following a pre-consultation exercise, we are not aware of prime brokers that offer their clients real-time reporting.
- 2.18 We understand that upon LBIE's insolvency, clients did not have access to recent information about their accounts. Market uncertainty arose in the month following the appointment of the joint administrators to LBIE, particularly where there was a lack of clarity regarding:
- whether clients' instructions issued pre-insolvency had been executed;
  - which of the clients' assets had been fully and/or properly segregated; and
  - which of the clients' assets had been re-hypothecated.
- 2.19 We acknowledge a daily reporting requirement will not include those transactions which are processed between the last daily report and the time of insolvency. However, we do believe it will assist in reducing the period of uncertainty.
- 2.20 Having monitored market practice over the past year, we understand most prime brokers now offer their clients daily reporting. This was not generally the case prior to LBIE's insolvency and reflects a considerable investment in IT systems by prime brokers to achieve this.
- 2.21 While we may rely on market practice, we are concerned that if we do not introduce a minimum reporting requirement as a rule, a sense of complacency may set in as the market recovers and lessons from LBIE are forgotten.
- 2.22 Although not directly relevant to the current market failure, we observed in pre-consultation exercises that not all clients requested equal reporting frequencies.

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<sup>10</sup> Please see Article 51 of MiFID Level 2 as implemented by COBS 16.



Consequently, prime brokers could more aggressively re-hypothecate those clients' assets which were subject to less frequent reports (compared to active hedge funds that required daily reporting to enable them to access their assets, for example, to vote at annual general meetings). Accordingly, we believe all clients should have access to the same reporting period, allowing them to manage their own exposures.

2.23 We propose to introduce a requirement that prime brokers should offer daily reporting to all clients.

Q5. Do you agree that we should introduce a requirement that prime brokers offer daily reporting to all clients?

Q6: Do you agree that we should require that the daily report contain at the least, the cash value of the following:

- cash loans and accrued interest;
- securities to be redelivered by the client under open short positions;
- current settlement amount to be paid under any futures contracts;
- collateral held by the firm in respect of securities transactions, including if the firm has exercised a right of use in respect of safe custody assets;
- short sale cash proceeds held by the firm in respect of the short positions;
- cash margin held by the firm in respect of open futures contracts;
- mark-to-market close-out exposure of any over the counter (OTC) transaction secured by safe custody assets or client money;
- total secured obligations;
- all other safe custody investments held for that client;
- the location of all safe custody assets, including the sub-custodian where the assets are held; and
- a list of all the institutions at which the firm holds or may hold client money including money held in client bank accounts and client transaction accounts.

Q7: Do you consider that the content of the report provides clients with enough information to manage their exposures?

Q8: Do you agree that this report should be made available to clients on a daily basis?

# 3 Enhancing client money and asset protection

- 3.1 In this chapter we consider restricting two practices we believe pose an unacceptable risk to protecting client money and assets, and financial stability.

## **a) Restricting the placement of client money deposits within a group**

### **Scope**

- 3.2 Please note that our policy proposals in this section apply to UK authorised firms that place client money in client bank accounts held with a group bank, credit institution or qualifying money market fund. These requirements will not apply to incoming EEA firms conducting investment business, as under MiFID regulating client assets is a home state responsibility. We will consider extending these proposals to general insurance intermediaries when we begin reviewing CASS 5 – Insurance Mediation Activity in the first quarter of 2011.

### **Intra-group client money deposits**

- 3.3 CASS contains guidance requiring firms to conduct an appropriate level of due diligence on institutions with which client money is held and to ensure deposits are appropriately diversified. We currently allow firms to hold client money with a deposit taker within the same group as the firm subject to appropriate due diligence and diversification.
- 3.4 There is no standard market practice for depositing client money within a group structure. For example, a number of investment firms take an explicit decision to hold client money deposits outside of the group, while other firms deposit significant amounts intra-group. Existing handbook provisions seek policy outcomes that ensure an appropriate level of diversification is achieved to protect clients' money.
- 3.5 CASS contains provisions regarding a firm's selection of a bank, credit institution or qualifying money market fund. A firm must exercise all due skill, care and diligence in selecting, appointing and periodically reviewing the institution where the client money is deposited and arrangements for holding this money. Handbook guidance also provides a list of matters a firm should consider in the process.

- 3.6 The money deposited at a group bank is held on trust by the firm for the firm's clients, but it is treated as an ordinary banking deposit at the bank. Put another way, all client money at the end of a chain will eventually be held as a deposit. There is always a risk that a bank with which the deposit is held will enter insolvency proceedings and at this point it becomes possible that not all money deposited in client bank accounts as client money will be available for return to the underlying clients. Accordingly, the regime does not envisage a 100% return to clients in the event that client money is lost due to a bank's insolvency, with CASS providing that clients will generally share rateably in the loss.
- 3.7 The issue under consideration is not that the funds are held as a deposit, but that when held within a group, there is an increased contagion risk that both the investment firm and the group bank or affiliate will fail simultaneously (or one will fail shortly after the other).
- 3.8 The resulting risk is that a firm will place an inappropriate amount of client money intra-group, usually as a source of liquidity, which has a lower cost of capital than external sources. Furthermore, as a group's financial position deteriorates, there is a risk that firms within the group will deposit more client money intra-group to fund operations. This may give clients an inappropriate level of exposure to the bank's credit risk. It also may lead to clients unfairly bearing the risk of the group as a whole, rather than just the individual firm. The existing sourcebook provisions which address this mismatch of firms' and their clients' incentives can be strengthened so the risk to clients is mitigated in the event of a firm's default.
- 3.9 Imposing a hard limit on the proportion of client money which can be held intra-group is attractive and will mitigate concentration risk. However, limiting the level of client monies held within a group may increase overall credit risk where outside options are less highly rated. We have considered consulting on the basis of a 20% limit in order to fully identify stakeholders' concerns, particularly if there is a knock-on effect on liquidity.
- 3.10 We have worked with firms during 2009 to reduce the concentration of client money held intra-group. During pre-consultation firms estimated that the proposals would result in an increase of approximately 10–25 basis points for additional costs, together with removing stable funding and increasing compliance and operational overheads.
- 3.11 Accordingly, we propose limiting the amount of client money held by a firm which can be deposited in intra-group client bank accounts to 20%. We understand firms may require some flexibility in holding money intra-group (for example, where a firm's client specifically requests their money is held with that specific institution) and propose to address this on a case by case basis. We also propose changing existing guidance into a rule to provide a clear basis for our expectations.
- 3.12 We take this opportunity to highlight that our proposal to re-introduce a client money and asset return to the FSA (see below) which includes content regarding intra-group client money deposits.

- Q9: Do you agree that we should impose a 20% maximum limit on intra-group client money deposits in client bank accounts and that we should change existing guidance into a rule? Do you have views on alternative limits?
- Q10: Will a 20% limit impact on your firm's liquidity. If so, how?
- Q11: Do you consider it is appropriate to exclude client money held in client transaction accounts?
- Q12: We also invite your views on amending all the guidance currently contained within CASS 7.4.9G into a rule.

## **b) Prohibiting the use of general liens in custodian agreements**

### **Scope**

- 3.13 Our proposals apply to all UK authorised investment firms and overseas branches of these UK firms. These requirements will not apply to incoming EEA firms conducting investment business as under MiFID regulating client assets is a home state responsibility.
- 3.14 Some firms in the UK appear to have inappropriately allowed custodians and sub-custodians to include general liens covering, for example, group indebtedness to the custodian or sub-custodian in contractual agreements, or they have failed to pay due regard to this issue. As we have observed from LBIE's insolvency, liens have contributed to significant delays or obstacles in an IP's ability to recover assets from depots not under their direct control.
- 3.15 CASS 6.3.3G requires a firm to consider the terms of its agreements with third parties with which it will deposit a client's safe custody assets. As part of this guidance, the firm should consider restrictions over the third party's right to claim a lien, right of retention or sale over any safe custody asset in the account, as well as identifying client assets separately from assets belonging to the firm.
- 3.16 We believe the sourcebook can be enhanced with hard rules rather than guidance in this regard. This would enable us to effectively monitor compliance and take enforcement action where appropriate.
- 3.17 Accordingly, we are consulting on the basis of changing the existing guidance into a rule. We propose creating a rule that prohibits using general liens over client assets which are held under custodian agreements, except to cover the situation when a firm (or if the client has a direct relationship with the custodian, the client) does not pay custodian fees and charges to the third party holding the custody assets.

- Q13: Do you agree that we should introduce a rule prohibiting the use of general liens in custodian agreements and amending existing guidance to clarify our requirements?
- Q14: Do you think that we should go further and prohibit all liens in custodian agreements?
- Q15: Do you foresee any unintended consequences in implementing this proposal?

# 4 Increased CASS oversight

- 4.1 In this chapter we propose to create a client assets controlled function as part of the significant influence regime and re-introduce a client money and assets return (CMAR) to the FSA.

## **a) Establishing a new CASS controlled function**

### **Scope**

- 4.2 Please note that our policy proposals in this section apply to UK authorised firms and overseas branches of these UK firms. These requirements will not apply to incoming EEA firms conducting investment business, as under MiFID regulating client assets is a home state responsibility. We understand a ‘restricted’ CF regime applies to general insurance intermediaries, and we intend to consider extending the application of this function to these stakeholders in our review of CASS 5 – Insurance Mediation Activity in the first quarter of 2011.

### **The fragmentation of CASS oversight**

- 4.3 From our programme of specialist CASS firm visits during the past year, we have observed that responsibility for client money and assets is often split between a number of staff across the compliance, operations, finance and/or corporate treasury functions. A small number of firms continue to adopt best practice in this regard and appoint a client assets manager or committee, who have direct oversight and control of the process.
- 4.4 We initially considered a proposal to amend the reference in CF29 to ‘client money and custody assets’ to clarify our expectations. However, the Treasury’s December publication requested that we consider enhancing our regulatory control over individuals responsible for firms’ protection of clients’ money and assets through our approved persons regime. Consequently, we stated our intentions in the January CP, *Effective Corporate Governance*.<sup>11</sup> Following pre-consultation we believe this

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11 [http://www.fsa.gov.uk/pages/Library/Policy/CP/2010/10\\_03.shtml](http://www.fsa.gov.uk/pages/Library/Policy/CP/2010/10_03.shtml) at page 4.

produces cost effective oversight for firms and us, and is consistent with our credible deterrence enforcement strategy.

## Creating proportionate oversight

- 4.5 We propose rules that require one person at each firm to have ultimate oversight responsibility for client assets and money, even though the firm may structure its business so several people across numerous departments have relevant roles. The new controlled function will be both a ‘required function’ and a ‘significant influence function’ in the firm and will be known as the CASS oversight controlled function. This function will include general oversight of the firm’s compliance with CASS, reporting to the firm’s governing body in respect of that oversight and completing and submitting the client money and asset return to us. To ensure that our supervision of individuals responsible for CASS oversight is proportionate, we also propose the following basis for stratification of clients, noting that meeting the threshold in either client money or custody assets (or both) will trigger compliance with the relevant provisions:

<b>Firm size</b>	Firm population (excluding general insurance intermediaries)	Highest amount of <b>client money</b> held by the firm during the previous calendar year	Highest value of <b>custody assets</b> held by the firm during the previous calendar year
<b>Large</b>	50	more than £1 billion	more than £100 billion
<b>Medium</b>	350	between £1 million and £1 billion	between £10 million and £100 billion
<b>Small</b>	2,000	less than £1 million	less than £10 million

- 4.6 This stratification reflects that a traditional split between small and relationship-managed firms does not provide us with a suitable framework, where merely requiring a controlled function will necessarily assist in mitigating client money and assets risk at the firm. For example, relationship-managed firms may not in fact hold client money and/or assets, whereas on the other hand, small firms within our Small Firms and Contact Division may hold significant sums of client money and/or assets.
- 4.5 Firms will be required to review their highest client money requirement and/or value of custody assets held during the course of the previous calendar year and determine which category they fall into.
- 4.6 We propose that firms classified as ‘small’ under the above framework continue relying on existing client money and asset compliance oversight via the firm’s governing body, by allocating to a specific director appointed to a governing function specific responsibility for CASS oversight. We propose the firm must notify us with details of the relevant director within 10 business days of allocation. However, following the introduction of the CASS oversight CF please note that the director appointed at a small firm will be deemed to carry out the CASS oversight controlled function (although the director will not be specifically approved to do this) and will be subject to the provisions found in our Statements of Principle and Code of Practice for Approved Persons sourcebook.

- 4.7 We propose that firms classified as ‘medium’ under the above framework appoint a new CASS oversight CF, although this CF would not generally be subject to the competency-based approach to interviewing for the role outlined in CP10/3.<sup>12</sup>
- 4.8 We propose that firms classified as ‘large’ under the above framework appoint a new CASS oversight CF; they are likely to be subject to the competency-based approach to interviewing for the role outlined in CP10/3.
- 4.9 If we proceed with the proposal following this consultation we propose a transitional period ending on 1 July 2011 so firms can identify individuals affected and arrange for their approval. Where an application is properly submitted to us at least three months before 1 July 2011, should the application not have been decided by 1 July 2011, the transitional period will extend until the application has been finally decided. There will be no grandfathering provisions and therefore, currently approved persons will have to apply for the controlled function. During the transitional period between the date the rules are published and 1 July 2011, medium and large firms must allocate to a relevant member of the firm’s governing body overall responsibility for CASS oversight and reporting to the firm’s governing body in respect of that oversight. This will not be a controlled function but firms will be required to notify us of the member of the governing body allocated this responsibility within 10 business days of allocation.

Q16: Do you agree that we should establish the CASS oversight controlled function?

Q17: Do you agree that one person within the firm holding the controlled function should have ultimate oversight and control?

Q18: Do you agree with our stratification of firms as small, medium and large with regard to client money and/or asset holdings? If not, please provide us with your thoughts as to an appropriate method of stratification.

Q19: Do you consider an assessment based on the previous calendar year is appropriate? If not, why?

## **b) Re-introducing a client money and assets return**

### **Scope**

- 4.10 Our predecessor SROs, particularly the SFA, required firms with relevant client assets permissions to report on client asset positions. The SFA required firms to report how much client assets and money they held, where they held it, the top five banks used for holding client money and other information in a SARS.
- 4.11 We propose a new reporting framework, the CMAR. The CMAR will be reviewed and authorised by the newly established CASS oversight CF on a monthly basis for medium and large firms, and by the relevant director bi-annually for small firms.

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12 [http://www.fsa.gov.uk/pages/Library/Policy/CP/2010/10\\_03.shtml](http://www.fsa.gov.uk/pages/Library/Policy/CP/2010/10_03.shtml) at page 23



The decision of whether a firm is small, medium or large will be made consistently with our approach to the controlled function as discussed earlier in the paper.

- 4.12 Please find attached a copy of the proposed CMAR in Annex 4.
- 4.13 The CMAR will give us an overview of firm-specific CASS positions and an overview of UK investment firms' CASS holdings, enabling us to make regulatory interventions on a timely, firm-specific or thematic basis. The requirement to produce this information may also help ensure information is available to the IPs and clients of the firm in the event of a firm's failure.
- 4.14 Accordingly, we propose to re-introduce a reporting framework to the FSA.

Q20: Do you agree with our proposal for the CMAR?

Q21: Would you experience any difficulty in supplying the information requested in the CMAR? If so, please provide us with examples to illustrate.

Q22: Do you consider monthly reporting for large and medium firms and bi-annual reporting for small firms appropriate frequencies?



# Cost benefit analysis and compatibility statement

1. When proposing new rules, we are obliged (under section 155 of the Financial Services and Markets Act 2000 (FSMA)) to publish a cost benefit analysis (CBA), unless we consider that the proposals will give rise to no costs or to an increase in costs of minimal significance. As a matter of policy, we also provide a CBA for significant proposed guidance relating to rules. The CBA is an estimate of the costs and an analysis of the benefits that will arise from the proposals. It is a statement of the differences between the baseline (broadly speaking, the current position) and the position that will arise if we implement the proposals.
2. This CBA reflects analysis undertaken within the FSA. It draws on the data and information provided to us in pre-consultation surveys by firms holding client assets, prime brokers and trade associations in the course of 2009 and 2010. The main source of information for this CBA is our January 2010 survey of relevant prime brokers, banks and investment firms. We sent this survey to 24 firms and received 17 responses.

## **Market and regulatory failure analysis**

3. The events that surrounded LBIE's failure illustrated a number of information problems in relation to the treatment of client assets. Apart from potential client detriment, it is likely that these information problems also had knock-on effects on financial markets more widely. It is therefore likely that they contributed to the systemic impacts of LBIE's failure.
4. *Re-hypothecation* – LBIE's insolvency revealed that prime brokerage clients' were not sufficiently informed about the consequences of a potential prime broker insolvency. They also did not understand the impact an insolvency would have on their rights to recover assets over which a prime broker exercised a contractual right to re-hypothecate. This reflects a generally poor standard of due diligence prior to LBIE's collapse. While standards of due diligence appear to have improved in the aftermath of the LBIE failure, there is a significant risk that this more cautious approach with regard to counterparty risk will not be sustained sufficiently long enough to guard against similar problems in the future. Behavioural economics provides some explanation for this concern, as it has been shown that decision

makers tend to rely too much on recent events/information and pay too little attention to events that they believe to be very unlikely. The policy proposals on increasing re-hypothecation disclosure and transparency in Chapter 2 aims to address these information problems.

5. *Client money and asset protection* – Following LBIE’s failure, our review of current practices regarding client money has shown that arrangements for segregation and diversification of client money are unclear in many cases. Not all clients had sufficient information about intra-group holdings of client money or a sufficient understanding of the associated risks. LBIE’s failure has illustrated this issue where approximately \$1 billion was held with a group bank (Lehman Brothers Bankhaus AG) and the consequences for the affected clients. Ideally, clients would be monitoring firms’ approaches to the handling of client money on an ongoing basis, taking this fully into account when choosing a firm that would be holding and depositing client money on their behalf. Firms, as part of a group, would then face the full cost (clients’ switching) when providing inadequate levels of client protection. However, clients are not sufficiently informed about the handling of their assets, because information gathering and switching are costly. The policy proposals in Chapter 3 on enhancing client money and asset protection aim to address these issues.
6. *Regulator’s oversight over client assets* – LBIE’s failure also revealed a lack of information available to regulators and IPs about client assets handling, record keeping and the location of assets. Our recent review of the client assets regime<sup>1</sup> demonstrated deficiencies in investment firms’ procedures with respect to management oversight and control for client assets. The policy proposals in Chapter 4 on improving our oversight of CASS aim to address this issue.
7. *Consequential effects of information problems* – The information problems in relation to the treatment of client assets described above are very likely to have increased some firms’ ability to take on inappropriate risks prior to the recent crisis. They have also exacerbated the impact of a wind-down on markets. Apart from losses to affected clients, this can contribute to systemic risk and increase the costs of a financial crisis as uncertainty about the solvency of major financial firms can spread, causing liquidity in wholesale markets to dry up.<sup>2</sup>

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1 [www.fsa.gov.uk/pubs/other/cass\\_risk.pdf](http://www.fsa.gov.uk/pubs/other/cass_risk.pdf)

2 There are a large number of descriptions of the market impacts of the LBIE failure. E.g. Brunnermeier (2009) provides an account of the reasons why liquidity in wholesale financial markets has dried up during the financial crisis and specifically refers to the issues around the LBIE failure. See Markus K. Brunnermeier (2009). ‘Deciphering the Liquidity and Credit Crunch, 2007–2008’, *Journal of Economic Perspectives*, Volume 23, Number 1, Winter 2009, pp. 77–100.

## **Increasing re-hypothecation disclosure and transparency in the prime brokerage community**

### **a) Disclosure annex for prime brokerage clients**

#### *Benefits*

8. A prime brokerage agreement (PBA) disclosure annex will provide for a prominent disclosure of contractual arrangements relating to re-hypothecation and a description of the risks associated with the re-hypothecation of assets. This will provide clients with more accessible information and transparency about the risks they take when they permit re-hypothecation of their assets. It will also assist client comparisons between the re-hypothecation practices of different prime brokers. As well as assisting the prime broker's clients, who are usually hedge funds and institutional investors, it will also enable that client to provide a more comprehensive overview of the PBA to their underlying clients. Furthermore, there is an added benefit in that prime brokers will need to review version control, signatories and filing of existing agreements. Where these improvements have already been made, the main additional benefit of the proposed rule is to ensure that this practice is maintained in the future.

#### *Costs*

9. The proposals will affect all FSA regulated prime brokers.
10. The cost associated with creating the annex is likely to be limited to the one-off costs for adjusting PBAs and reviewing existing agreements. Four firms have provided quantitative answers to our survey. The average one-off costs reported amount to approximately £80,000;<sup>3</sup> the median was £17,500.<sup>4</sup> Considering that approximately 35 prime brokers are affected, and applying the median figure, we estimate the total one-off cost to the industry to be around £610,000. Once the standard PBA and all variations required for existing clients are amended, respondents to our survey noted that there would be no material on-going costs when taking on new clients.

### **b) Reporting to prime brokerage clients**

#### *Benefits*

11. Reporting by prime brokers to their clients on a daily basis helps clients manage their exposure to their prime broker, especially when a right of use has been exercised over their assets. It will also enable clients to make more efficient use of their assets (for example ensuring that shares are not re-hypothecated while they want to exercise voting rights on them).

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3 However, excluding one firm's figures (which was more than 20 times higher than other responses) the average one-off cost reduces to £14,000.

4 For those firms who noted that costs could be significant but who have not provided numbers, we have applied the highest number reported by respondents in calculating the average.

12. Daily reporting will also help to reduce uncertainty for clients in case of a future failure of a prime broker. It is our understanding that upon the insolvency of LBIE, clients did not have access to up-to-date information relating to their accounts. While a daily reporting requirement will not address those transactions which are processed between the last daily report and the time of insolvency, it will assist in reducing the period of uncertainty.
13. In case of a future prime broker insolvency, the availability of data on a daily basis will also provide an appointed IP with more accurate information at the point of insolvency. This may reduce the length of insolvency proceedings.
14. While some prime brokers have already implemented daily reporting to all clients others have not. The benefit of the proposed rule is to extend daily reporting to all prime brokers and their clients and to ensure this practice is maintained in future.

### *Costs*

15. This proposal is relevant to all FSA regulated prime brokers.
16. Following LBIE's insolvency, some clients requested additional reporting from their prime brokers. Accordingly, we understand that most prime brokers now provide some form of daily reporting to many of their clients. Most firms have therefore already incurred some or all of the costs of this proposal.
17. Three firms responded to our survey stating that they had no daily reporting capability, or that their systems required an update to accommodate daily reporting to all clients. Six prime brokers have reported to us that they have systems in place already capable of producing the required reports. Where firms need to upgrade their systems, responses to our survey suggest that on average the investment required would amount to up to £150,000. However, we note that estimates for systems upgrades varied widely. In terms of ongoing costs, we have received an estimate of £50,000 p.a. by one firm, which already provides daily reporting.

## **Enhancing client money and asset protection**

### **a) Restricting the placement of client money deposits within a group**

#### *Benefits*

18. The UK currently allows money held in accordance with CASS 7 to be held at an intra-group deposit taker. The money deposited at an intra-group bank would be held on trust for clients of the securities intermediary, but will be an ordinary banking deposit at the bank. Where the intermediary deposits client money with a group bank, and for a given level of default risk, the correlation between the failure of one firm in the group and another is usually higher than the correlation between failure of the intermediary and a third party bank. From the point of view of an individual bank (see also analysis of costs below), it is generally cheaper (increased liquidity and higher return) to hold money within the group as opposed to with third parties.

Therefore firms have an incentive to maximise the amount of client monies held within group rather diversifying as might be optimal from a client perspective.

19. Existing Handbook guidance did not provide enough clarity about the appropriate degree of diversification of client assets. As a result, the proposal is to introduce a rule requiring a 20% limit on the proportion of client money that can be held intra-group.
20. Whether or not a hard limit results in a net economic benefit or a net cost depends to a large extent on how risky third party banks are compared to the group bank(s). In particular in times of market stress firms may be forced to place client money at higher risk third party institutions. However, a temporary waiver process may ease this concern.

### *Costs*

21. This proposal would only apply to UK authorised and regulated firms who hold client money accordance with CASS 7. Incoming EEA branches conducting investment business would be excluded because they apply their home state client asset regulations under MiFID.
22. Deposit taking institutions have the discretion to either accept money as a deposit or as client money held on trust. Deposit takers only need to apply the CASS regime if they treat the money they receive as client money.
23. The incremental cost to firms depends on the extent to which they currently hold client money intra-group or with third parties. Responses to our survey have shown that current practices vary widely between firms.
24. One respondent to our survey noted that firms that need to significantly reduce the proportion of client assets held within the group will incur a one-off cost of searching for third-party banks as well as carrying out initial due diligence and opening new accounts with these institutions. As regards ongoing costs, these include the active monitoring of creditworthiness of each deposit taker; regular monitoring that limits are maintained and the identification and review of third parties who may be appropriate for placing client assets with and renegotiation of agreements as may be needed. However, according to our survey responses firms currently have these policies in place. As a result, incremental on-going costs in this respect are likely to be small.
25. The main indirect costs are:
  - cost of loss in discretion to optimise levels of diversification depending on market conditions;
  - increased funding cost (via reduced liquidity) to banks;
  - potential aggregate effects on liquidity in the banking system; and
  - potential effects on competition.

26. *Diversification* – A hard 20% limit on intra-group deposits can lead to a cost through a potentially suboptimal level of diversification. Depending on market factors, outside options for diversification may be more risky than intra-group deposits, in particular for very highly rated banks.
27. This risk is likely to be more pertinent in times of market turbulence than in a business as usual scenario. In stressed markets, firms may find it difficult to find sufficient numbers of low risk third party banks with which to place client money. In such a scenario a firm may find itself in a situation where providing clients with optimal risk diversification leads to a breach of our rules. However, it is not possible to quantify these costs as they depend on market circumstances which vary over time.
28. *Funding cost* – Client money placed with third party banks are deemed short-term funding (overnight deposits) and therefore tend to command lower interest rates than funds held within group. This is because, when placing client money with group banks, the group bank will normally provide an assessment of the funds' liquidity attribute, typically resulting in a higher internally applied rate. The rate itself, as well as the differential, will depend on market conditions. Using the information provided to us by firms in our survey the aggregate cost to those firms currently holding in excess of 20% of client money within the group will be in a range from £10m to £25m annually. This is on the basis that the differential between returns on overnight deposits with third party banks and with group banks is between 10 and 25 basis points.
29. However, it is noted that some of this cost is a transfer. Therefore the cost estimate provided above is an upper bound estimate. This is because all firms holding client money under the UK regime found in CASS 7 will need to apply the 20% intra-group limit, and will tend to place client money with third-party banks. As a result, the same groups that gain less interest on externally held client money will also pay out at a lower rate to third party firms, which increase their deposits with them. However, it is difficult to assess the exact extent to which this will be the case and therefore to the extent to which a 20% intra-group limit leads to transfers or to an actual increase in the cost of capital of the affected firms.
30. Depending on the competitive situation, the increase in funding costs may ultimately be passed on to clients.
31. *Liquidity* – One respondent to our survey noted that the proposal will reduce overall liquidity within banks. The respondent gave no indication as to how material this is likely to be in the context of its own business, and no other firm has noted the issue. As a result we consider it likely that the impact will not be material.
32. *Competition* – The proposal could potentially have impacts on competition as a result of the following factors:
  - where passported EEA firms are active in the same market as firms subject to our proposal they are subject to different client assets regimes as determined by their home regulators; and
  - existing differences between firms regarding the proportion of client money currently held within the group.



33. However, only one respondent to our survey has raised competition concerns in relation to a reduction of client money that can be held at group level. The firm mentioned that it will have to pass the reduced return on client money on to their clients and that some of its clients may therefore switch to competitors.

## **b) Prohibiting the use of general liens in custodian agreements**

### *Benefits*

34. Despite existing guidance to the contrary, custodian networks currently tend to have general liens over client assets held by another custodian or sub-custodian. This means that when one custodian or sub-custodian fails, the (fully segregated) client assets held by the insolvent firm are netted against any liabilities that firm has with the client's intermediary. In the course of the LBIE insolvency process, such liens were found to have contributed to significant delays or obstacles in the UK IPs' ability to recover assets from depots not under their direct control.
35. Introducing a rule to ban general liens in custodian contracts under English law aims to ensure that client assets are not exposed to the risks resulting from such general liens.

### *Costs*

36. This proposal potentially affects the approximately 1,300 UK authorised firms with a safeguarding and administering permission.
37. Firms will incur a one-off legal cost to amend contracts with their network of custodians. We consider that for firms with a worldwide network of custodians the costs would not be dissimilar to the costs for the PBA disclosure annex. As stated above, the median cost is £17,500 per firm. The total one-off cost to the industry therefore is approximately £23 million. However, we believe this an upper bound estimate of the cost. Not all firms will be affected in practice and some firms may not have a worldwide custodian network and therefore have fewer contracts to amend. Once the contracts have been amended to reflect the new rules on liens there would be no further ongoing costs.

## **Increased CASS oversight**

### **a) Establishing a CASS oversight controlled function**

#### *Benefits*

38. We have found that a lack of central oversight has contributed to some firms' failings in relation to adequate protection of clients' assets.<sup>5</sup> A separate controlled function (CF) for all client assets aims to provide enhanced clarity regarding who the person is within a large or medium sized firm responsible for client assets matters.

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5 [www.fsa.gov.uk/pubs/other/cass\\_risk.pdf](http://www.fsa.gov.uk/pubs/other/cass_risk.pdf)

39. A single person in every firm that holds client money and/or assets under CASS 6 and/or CASS 7 will be responsible and accountable for CASS compliance across all relevant business units, thus providing central oversight. This may enhance firms' compliance with our client assets requirements through enforcement.
40. The extent to which benefits can be realised depends inter alia on how well the new requirements are supervised and enforced. Some of the competencies required of the new CF for large firms may not be directly relevant for CASS. In addition, as a firm's head of compliance and senior management in general are already charged with the responsibility for overall compliance (including with the client asset rules), the improvement in compliance as a direct result of this proposal – other than any effects as a result of easier regulatory enforcement – could be limited.

### *Costs*

41. This proposal applies to all UK firms holding client assets in accordance with CASS 6 and/or CASS 7 and overseas branches of these UK firms. These requirements will not apply to incoming EEA firms conducting investment business, as under MiFID the regulation of client assets is a home state responsibility.
42. There will be implementation and ongoing costs associated with introducing a CASS oversight CF both for firms in applying for the new CF and for us in approving the applicants. As part of the wider Mortgage Intermediary Review and the Significant Influence Controlled Functions Review, we consider that adding a CASS oversight CF to the existing project will have incremental one-off information systems (IS) costs, of approximately £350,000 to us.
43. Resourcing implications for Authorisations during implementation will need to be considered in the 2011-12 budget planning round. It is estimated to cost us £44<sup>6</sup> to process each application. In addition, for applications from 'large' firms, which may require a Significant Influence Function (SIF) interview, we estimate a further cost of £1,050 per applicant.<sup>7</sup> Small firms will not be affected by this policy proposal.
44. Initially we consider that approximately 350 medium firms and 50 large firms will require authorisation in 2011-12. This will result in an estimated one-off cost to us of £70,000.<sup>8</sup> On an ongoing basis, if we assume a 10% turnover in staff, we will have to process approximately 40 applications each year, of which approximately 5 will be from large firms that require competency-based interviews. The ongoing cost for us is therefore estimated to be £7,000 p.a.
45. We estimate that the administration cost to a firm of preparing and submitting an application is £200,<sup>9</sup> and large firms, in addition, will incur £1,850<sup>10</sup> per application

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6 *Real Assurance Estimation of FSA Administrative Burdens* (June 2006); [http://www.fsa.gov.uk/pubs/other/Admin\\_Burdens\\_Report\\_20060621.pdf](http://www.fsa.gov.uk/pubs/other/Admin_Burdens_Report_20060621.pdf)

7 See CP10/03 – *Effective Governance*. Assuming that the average cost to FSA of each SIF interview is between £500 and £1600 (based on the hourly rates for various panel combinations, based on 4 persons attending and spending approximately 2.5 hours each on the interview process).

8  $44 \times (350 + 50) + 1050 \times 50 = £70,100$

9 According to the *Real Assurance Estimation of FSA Administrative Burdens* (June 2006)

10 See CP10/03 – *Effective Governance*. Assuming an hourly rate for a director's time of £365 (based on basic salary rate of 2 large banks) and approximately an average of 5 hours for the SIF interview process. Some firms may wish to use the services of external agencies to help prepare candidates for an interview, but we have not included this discretionary cost in our estimates.

associated with preparing and attending an interview. The firms will therefore incur a one-off cost of £170,000,<sup>11</sup> and an ongoing cost of £17,000 p.a.

46. One firm noted that they may need to employ additional persons at senior level who could take on such a responsibility. The other firms were generally supportive of the CASS oversight CF and some firms suggested that the proposal would formalise their existing SIF arrangements. Most firms stated that the costs would be minimal.

## **b) Re-introducing a client money and assets return**

### *Benefits*

47. Regular reporting to us will ensure that firms have systems in place to actually produce the information required by regulation and that it can be provided to IPs, clients and regulators quickly in the event of a failure. It will also enable us to monitor client asset related risks.

### *Costs*

48. This proposal applies to UK firms holding client assets in accordance with CASS 6 and/or CASS 7 and overseas branches of these UK firms. These requirements will not apply to incoming EEA firms conducting investment business, as under MiFID the regulation of client assets is a home state responsibility.
49. This proposal will lead to one-off systems costs and ongoing costs both for firms and us. Please see **Annex 4** for a draft version of the Client Money and Assets Return (CMAR) we intend to re-introduce.
50. *Our costs*– We have budgeted £3 million for the development of this tool. Ongoing costs of monitoring this report will be part of our general supervisory costs.
51. *Costs to firms* – This proposal affects approximately 50 large, 350 medium and 2000 small firms. Large and medium sized firms have to submit us a report on a monthly basis, small firms have to submit a scaled down report twice per year.
52. Firms have indicated to us in early trials that the information is already available, and should take less than four hours each month to complete and return to us.
53. For small firms we assume they will face no one-off systems cost for producing the report and it will take them four hours to produce the report. This would lead to ongoing costs per firm of approximately £160<sup>12</sup> p.a. For all affected small firms the yearly ongoing cost would therefore be approximately £320,000.
54. For large and medium sized firms we use similar assumptions as a lower bound cost estimate. Ongoing costs (assuming a monthly return and the same wage rate as above) would be approximately £960 per firm and approximately £380,000 for all large and medium sized firms.

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11  $200 \times (350 + 50) + 1850 \times 50 = £172,500$

12 Assuming an hourly rate of £20 for an in-house compliance officer.

55. We use the results of our survey as an upper bound estimate for large and medium firms. In our survey firms almost invariably stated higher costs compared to the indications provided to us in early trials. The average one-off cost was £5,000 and the average ongoing cost £8,500.<sup>13</sup> This upper bound estimate would lead to one-off costs for large and medium-sized firms of approximately £2 million and ongoing costs of approximately £3.4 million.

Q23: What are your views on the benefits and costs of the proposed policy measures?

## Compatibility statement

### Introduction

1. In this annex, we explain our reasons for concluding that our proposals outlined in this CP are compatible with our statutory objectives and the principles of good regulation.

### Compatibility with our statutory objectives

#### *Market confidence/Financial stability*

2. We expect our proposals to have a positive impact on market confidence by ensuring that market participants understand their position in the event of insolvency – restoring confidence to the market now and improving confidence in the event of a significant future insolvency.
3. Introducing the PBA annex will ensure that firms have reviewed and properly documented their contractual agreements into their systems and controls (for example ensuring that any re-hypothecation limit is applied to a client’s assets based on a transparent definition of indebtedness).
4. Improved transparency with regard to daily reporting will allow the clients of prime brokers to better manage their exposures on an ongoing basis. Daily reporting would also ensure that clients and any appointed IP would have greater information at the point of insolvency, which may reduce the length of insolvency proceedings. Reporting to us will enable us to target horizontal and vertical client money and assets work reducing the likelihood that a firm failure would lead to a loss or diminution of client assets because of poor compliance. Requiring firms to submit this information on an ongoing basis would additionally improve firms’ books and records that could be relied upon in the event of a firm failure.
5. Reducing the amount of client money held intra-group reduces the counterparty risk clients are exposed to. In the event of firm failure, we would expect the greater level of diversification to reduce the potential losses a client could be exposed to under current guidance in the sourcebook.

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<sup>13</sup> Based on 10 responses for one-off costs and 13 responses for ongoing costs. One firm reported extremely high ongoing costs, which we treated as an outlier and did not include in the calculation of the average.

6. Requiring that a CASS oversight CF have oversight of the entire 'CASS process' at a firm will ensure that the firm will give due consideration to how their systems and controls adequately protect clients' assets in accordance with Principle 10. The proposal will place an obligation on a senior and competent individual to ensure that the entire process operating over a number of business units effectively protects clients' assets. It will also enable us to pursue enforcement action where necessary, supporting our credible deterrence strategy.
7. The policy proposals should not increase financial stability risk, and could help to reduce financial instability in the event of a significant firm insolvency.

### *Consumer protection*

8. Broadly, our proposals are designed to enhance CASS where there are failures in the prime-brokerage market. The CASS regime aims to secure an appropriate level of consumer protection. However, our proposals in this CP mainly affect sophisticated clients, and not retail clients. The proposals focus on improving transparency and disclosure, reporting and firms' systems and controls. Taken together, the proposals should enhance protection afforded to a client's assets through prudential measures and improvements in information available following a firm's failure. Our proposals should limit loss during the insolvency of a group, and potentially reduce the length of an insolvency procedure. While clients may not be in a position to assess a firm's compliance with CASS, our proposals will lead to a greater focus upon the regime generally both by us, CASS oversight CFs and firms.

### *Financial crime*

9. When a firm is approaching insolvency, there is an increased risk that the firm will attempt to use clients' assets to prevent the firm and/or group from failing. Equally there is always a risk that individuals in the firm may illegally appropriate client assets and/or use the firm for the purposes of financial crime. Requiring a firm to appoint a CASS oversight CF with oversight of the entire process may reduce these risks.

### *Public Awareness*

10. Our proposals will not contribute significantly to meeting this objective. It should be noted however, that understanding of how the client asset regime operates in practice is important to ensure that market participants understand the risks they undertake when conducting investment business in the UK. The enhancements we are proposing should reassure the investment business market that the protection of client assets is a cornerstone of UK regulation and, in conjunction with the Treasury and the Bank of England, we will be progressing several initiatives to ensure the regime is as strong as possible through regulation, market-led solutions and, if necessary, primary legislation.

## **Compatibility with the need to have regard to the principles of good regulation**

11. In pursuing our functions under FSMA, we are required to have regard to additional matters we refer to as ‘principles of good regulation’. We set out below the principles and how our approach supports them.

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

12. The disclosure PBA annex, daily reporting to clients and prohibition on using general liens in custodian networks will not directly impact us. We will however be indirectly impacted because we will review CASS audit reports containing more information than at present. We consider this an efficient and economic use of our resources given the market failures witnessed.
13. With regard to the new CASS oversight CF and reporting to us, we will spend more resources on overseeing firms with relevant client asset and money permissions. However, additional resources will increase supervisors’ confidence regarding corporate governance, systems and controls arrangements in firms, potentially reducing the need for regulatory intervention at a later stage. It will also provide us with clear oversight of firms through the CMAR and any systemic issues that may arise, as well as providing a basis for thematic and vertical work.

### *Role of management*

14. We are required to take account of the responsibilities of those who manage the affairs of firms, and the proposed changes emphasise the importance of adequately protecting client assets. The changes will bring an increased focus on the systems and controls firms rely on to achieve protection and concentrate oversight into one SIF. This will generally improve the oversight of CASS in many firms, enhancing consumer protection.

### *Proportionality*

15. In our opinion the costs associated with our proposals are proportionate to the benefits they will deliver. We have supported our proposals with a detailed cost benefit analysis. We have refrained from proposing more restrictive rules where evidence does not support intervention, or where evidence would fail the cost benefit analysis. For example, we have considered, but are not proposing, to standardise the definition of net client indebtedness and introduce a maximum limit on re-hypothecation, nor are we prohibiting the deposit of client money in group banks *per se*. Improvements in information available and the oversight we can exercise over firms will reduce uncertainty, potential consumer detriment and market instability.

### *Innovation*

16. We do not consider our proposals will restrict innovation.

*International character of financial services, the competitive position of the UK and the need to minimise adverse impacts on competition*

17. We have given extensive consideration during a number of pre-consultation surveys with both buy and sell side firms, industry representatives, trade associations and independent legal advisers to ensure that our policy proposals will not negatively impact the UK as an attractive market in which to conduct investment business. The scope of our proposals is explained at **Annex 3**.
18. Overall, we do not consider the proposed policy changes will have an adverse effect on competition, because they generally reflect the nature of existing governance structures rather than enforce a change in those structures. Indeed, the key objectives of the proposals are to ensure that market participants make informed choices about their investment decisions and the choice of their market counterparties.
19. However, in relation to restricting the use of group banks, the proposal may affect the cost of doing business compared with that of other EEA incoming passported branches as these are subject to different client assets regimes as determined by their home regulators. We also note that current practices regarding the proportion of client assets held within group vary widely.





# List of consultation questions

- Q1: Do you agree that existing CASS record-keeping requirements are sufficient? If not, please outline where you consider these could be enhanced.
- Q2: Do you agree with our proposed glossary definitions regarding prime brokerage as stated above?
- Q3. Do you agree that we should introduce a requirement that the re-hypothecation clauses be summarised in a separate annex to the PBA and/or other relevant contractual documentation which contains such provisions?
- Q4: Are there any other transparency and/or disclosure issues we should consider?
- Q5: Do you agree that we should introduce a requirement that prime brokers offer daily reporting to all clients?
- Q6: Do you agree that we should require that the daily report contain at the least, the cash value of the following:
- cash loans and accrued interest;
  - securities to be redelivered by the client under open short positions;
  - current settlement amount to be paid under any futures contracts;
  - collateral held by the firm in respect of securities transactions, including if the firm has exercised a right of use in respect of safe custody assets;
  - short sale cash proceeds held by the firm in respect of the short positions;

- cash margin held by the firm in respect of open futures contracts;
- mark-to-market close-out exposure of any OTC transaction secured by safe custody assets or client money;
- total secured obligations;
- all other safe custody investments held for that client;
- the location of all safe custody assets, including the sub-custodian where the assets are held; and
- a list of the institutions at which the firm holds or may hold client money including money held in client bank accounts and client transaction accounts.

- Q7: Do you consider that the content of the report provides clients with enough information to manage their exposures?
- Q8: Do you agree that this report should be made available to clients on a daily basis?
- Q9: Do you agree that we should impose a 20% maximum limit on intra-group client money deposits in client bank accounts and that we should change existing guidance into a rule? Do you have views on alternative limits?
- Q10: Will a 20% limit impact on your firm's liquidity. If so, how?
- Q11: Do you consider it is appropriate to exclude client money held in client transaction accounts?
- Q12: We also invite your views on amending all the guidance currently contained within CASS 7.4.9G into a rule.
- Q13: Do you agree that we should introduce a rule prohibiting the use of general liens in custodian agreements and amending existing guidance to clarify our requirements?
- Q14: Do you think that we should go further and prohibit all liens in custodian agreements?
- Q15: Do you foresee any unintended consequences in implementing this proposal?

- Q16: Do you agree that we should establish the CASS oversight controlled function?
- Q17: Do you agree that one person within the firm holding the controlled function should have ultimate oversight and control?
- Q18: Do you agree with our stratification of firms as small, medium and large with regard to client money and/or asset holdings? If not, please provide us with your thoughts as to an appropriate method of stratification.
- Q19: Do you consider an assessment based on the previous calendar year is appropriate? If not, why?
- Q20: Do you agree with our proposal for the CMAR?
- Q22: Would you experience any difficulty in supplying the information requested in the CMAR? If so, please provide us with examples to illustrate.
- Q21: Do you consider monthly reporting for large and medium firms and bi-annual reporting for small firms appropriate frequencies?
- Q23: What are your views on the benefits and costs of the proposed policy measures?



# Scope of policy proposals

Proposal	Firms affected
Chapter 2: Increasing re-hypothecation disclosure and transparency in the prime brokerage community	
Increasing transparency via a disclosure annex	Only firms conducting prime brokerage business. The proposals do not apply to general insurance intermediaries (GIIs).
Reporting to prime brokerage clients	Only firms conducting prime brokerage business. The proposals do not apply to GIIs.
Chapter 3: Enhancing client money and asset protection	
Restricting the placement of client money deposits within a group	All firms except GIIs.
Prohibiting the use of general liens in custodian agreements	This applies to all firms holding safe custody assets under Chapter 6 of CASS.
Chapter 4: Increased CASS oversight	
Establishing a new CASS controlled function	All firms except GIIs.
Re-introduction of a client money and assets return	All firms except GIIs.



# Client money and assets return

## Section 1 - Firm Information

Please complete the following details:

- Firm Name
- The FSA firm reference number
- The Reporting period end date
- Please identify the currency of the report (all figures in 000s)
- Name of CASS audit firm
- Does the firm control client money?
- Does the firm hold client money?
- Does the firm safeguard and administer safe custody assets?

Type of business	Number of clients	Approx value of client money	Approx value of custody assets

## Section 2a - Segregation of client money

Alternative Approach:

Does the firm use an alternative approach to segregate client money (see CASS 7.4.14G)?

If yes, please explain your use of an alternative approach

Where you hold client money?				
Type	Name	Balances (000's)	Legal jurisdiction	Is this a 'connected entity'?

## Section 2b - Segregation of safe custody assets

Where you hold safe custody assets					
Location	Name of entity	Number of lines of stock	Value of assets (000's)	Legal jurisdiction	Connected entity

## Section 3 - Client money requirement

Client money requirement  
of which:

Unallocated to individual clients but identified as client money  
Unallocated to individual clients and unidentified as client money  
Uncleared payments, e.g. unrepresented cheques sent to clients  
Excess cash in segregated accounts

Balances (000's)

## Section 4a - Safe custody assets reconciliations

	26-89 days	90-179 days	180-359 days	360+
Custody asset reconciliation discrepancies				

Please describe the types of reconciliations undertaken and the frequency of those reconciliations:

## Section 4b - Client money reconciliations

Type	Frequency			
Client money (Internal) calculation	a			
External reconciliation	c			
	6-29 days	30-59 days	60-90 days	90+ days
Client money reconciliation discrepancies				



## Section 5 - Record keeping & breaches

### *Record keeping*

Type of Account	Total number of accounts held at beginning of reporting period	Number of new accounts opened during the reporting period	Number of accounts closed during the reporting period	Total number of accounts at the end of the reporting period	Number of trust status letters and/ or acknowledgement letters in place which cover these accounts
Client bank account					
Client transaction account					

Please explain any discrepancies.

### *Breaches*

Have you reported any notifiable CASS breaches during the regulatory period?

Are there any other CASS issues you wish to draw to our attention?

## Section 6 – Outsourcing

Do you outsource and/or offshore any of your client money and/or custody asset operations? If so, please explain them.



# Draft Handbook text

**CLIENT ASSETS (PRIME BROKERAGE, OVERSIGHT AND OTHER  
AMENDMENTS) INSTRUMENT 2010**

**Powers exercised**

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 59 (Approved persons);
  - (2) section 138 (General rule-making power);
  - (3) section 139 (Miscellaneous ancillary matters);
  - (4) section 156 (General supplementary powers); and
  - (5) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

**Commencement**

- C. This instrument comes into force in accordance with the following table.

	[ ] 2010	1 July 2011
Annex A	Part 1	Part 2
Annex B	Part 1	Part 2
Annex C	Entire annex	-
Annex D	Part 1	Part 2
Annex E	-	Entire annex

**Amendments to the Handbook**

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

(1)	(2)
Glossary of definitions	Annex A
Senior Management Arrangements, Systems and Controls sourcebook (SYSC)	Annex B
Conduct of Business sourcebook (COBS)	Annex C
Client Assets sourcebook (CASS)	Annex D
Supervision manual (SUP)	Annex E

**Notes**

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

**Citation**

- F. This instrument may be cited as the Client Assets (Prime Brokerage, Oversight and Other Amendments) Instrument 2010.

By order of the Board  
[ ] 2010

## Annex A

### Amendments to the Glossary of definitions

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

**Part 1: Comes into force on [ ] 2010**

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

- CASS large firm* has the meaning in *CASS* 1.2.16R (*CASS* firm classification).
- CASS medium firm* has the meaning in *CASS* 1.2.16R (*CASS* firm classification).
- CASS small firm* has the meaning in *CASS* 1.2.16R (*CASS* firm classification).
- prime brokerage agreement* an agreement between a *prime brokerage firm* and a *client* for *prime brokerage services*.
- prime brokerage firm* a *firm* that provides *prime brokerage services* and which may do so acting as *principal*.
- prime brokerage services* a package of services which comprise each of the following:
- (a) *custody* or *arranging safeguarding and administration of assets*;
  - (b) clearing services; and
  - (c) financing, the provision of which includes each of the following:
    - (i) capital introduction;
    - (ii) margin financing;
    - (iii) *stock lending*;
    - (iv) stock borrowing;
    - (v) entering into repurchase or reverse repurchase transactions;

and which, in addition, may comprise consolidated reporting and other operational support.

Amend the following as shown.

- director*
- (1) (except in *COLL*, *DTR*, *LR* and *PR*) (in relation to any of the following (whether constituted in the *United Kingdom* or under the law of a country or territory outside it)):
- (a) an unincorporated association;
  - (b) a *body corporate*;
  - (c) (in *SYSC*, *MIPRU* 2 (Insurance mediation activity: responsibility, knowledge, ability and good repute), *CASS* and *SUP* 10 (Approved persons)) a *partnership*;
  - (d) (in *SYSC*, *CASS* and *SUP* 10 (Approved persons)) a *sole trader*;
- any *person* appointed to direct its affairs, including a *person* who is a member of its *governing body* and (in accordance with section 417(1) of the *Act*):
- (i) a *person* occupying in relation to it the position of a director (by whatever name called); and
  - (ii) a *person* in accordance with whose directions or instructions (not being advice given in a professional capacity) the directors of that body are accustomed to act.

...

**Part 2: Comes into force on 1 July 2011**

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

- CASS oversight function*      *controlled function* CF10A in the *table of controlled functions*, described more fully in *SUP* 10.7.9R to *SUP* 10.7.12AR.
- CMAR*                      a Client Money and Asset Return, containing the information specified in *SUP* 16 Annex 27R.

## Annex B

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

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

**Part 1: Comes into force on [ ] 2010**

**1 Application and purpose**

...

**1 Annex 1 Detailed application of SYSC**

...

<b>Provision</b>	<b>COLUMN A</b>	<b>COLUMN B</b>
<b>SYSC 6</b>	<b>Application to a common platform firm</b>	<b>Application to all other firms apart from insurers, managing agents and the Society</b>
...	...	...
<u>SYSC 6.4.1R</u>	<u>Rule</u>	<u>Rule</u>
<u>SYSC 6.4.2R</u>	<u>Rule</u>	<u>Rule</u>
<u>SYSC 6.4.3R</u>	<u>Rule</u>	<u>Rule</u>
<u>SYSC 6.4.4R</u>	<u>Rule</u>	<u>Rule</u>

...

**6 Compliance, internal audit, ~~and financial crime~~ and client money and asset protection**

**6.1 Compliance**

...

6.1.4A R (1) A firm which is not a *common platform firm* and which carries on *designated investment business* with or for ~~retail clients~~ *retail clients* or ~~professional clients~~ *professional clients* must allocate to a *director* or *senior manager* the function of:

- (a) having responsibility for oversight of the *firm's* compliance;  
and



- (b) reporting to the *governing body* in respect of that responsibility.
- (2) In SYSC 6.1.4AR(1) "compliance" means compliance with the ~~rules~~ *rules* in:
  - (a) *COBS* (Conduct of Business sourcebook); and
  - (b) *COLL* (Collective Investment Schemes sourcebook) and *CIS* (Collective Investment Schemes sourcebook) (where appropriate); and
  - (c) ~~*CASS* (Client Assets sourcebook);~~ [deleted]
- ...

...

After SYSC 6.3 insert the following new section. The text is not underlined.

#### **6.4 Client money and asset protection**

- 6.4.1 R *A firm* to which *CASS* applies, other than a *firm* which is only required to hold *client money* in accordance with *CASS* 5 (Client money: insurance mediation activity), must allocate to a *director* carrying out a *governing function* responsibility for:
  - (1) oversight of the *firm's* compliance with *CASS*; and
  - (2) reporting to the *firm's governing body* in respect of that oversight.
- 6.4.2 R The *FSA* must be notified in writing within 10 *business days* of the person to whom these responsibilities have been allocated in accordance with *CASS* 6.4.1R.
- 6.4.3 R In *SYSC* 6.4.1R, the reference to the *governing function* only includes the *director function*, the *chief executive function*, the *partner function* and the *director of unincorporated association function*.
- 6.4.4 R *SYSC* 6.4.1R to *SYSC* 6.4.3R do not apply to *firms* only required to hold *client money* in accordance with *CASS* 5 (Client money: insurance mediation activity).

...

Amend the following as shown.

Sch 2 Notification requirements

Sch 2.1 G

~~There are no notification or reporting requirements in SYSC.~~

<b>Handbook reference</b>	<b>Matter to be notified</b>	<b>Contents of notification</b>	<b>Trigger event</b>	<b>Time allowed</b>
SYSC 6.4.2R	The person to whom the responsibilities in SYSC 6.4.1R have been allocated	The name of the person	As soon as the allocation has been made	10 <i>business days</i>

**Part 2: Comes into force on 1 July 2011**

**1 Application and purpose**

...

**1 Annex 1 Detailed application of SYSC**

...

<b>Provision</b>	<b>COLUMN A</b>	<b>COLUMN B</b>
<b>SYSC 6</b>	<b>Application to a common platform firm</b>	<b>Application to all other firms apart from insurers, managing agents and the Society</b>
...	...	...
SYSC 6.4.2R	...	...
<u>SYSC 6.4.2AG</u>	<u>Guidance</u>	<u>Guidance</u>
...	...	...

...

**6 Compliance, internal audit, financial crime and client money and asset protection (SYSC 6)**

...

**6.4 Client money and asset protection**

- 6.4.1 R ~~A firm to which CASS applies, other than a firm which is only required to hold client money in accordance with CASS 5 (Client money: insurance~~

~~mediation activity~~), *CASS large firm* and a *CASS medium firm* must allocate to a *director* ~~carrying out a governing function responsibility for~~ or *senior manager* the function of:

- (1) oversight of the *firm's* compliance with *CASS*; ~~and~~
- (2) reporting to the *firm's governing body* in respect of that oversight; and
- (3) completing and submitting a *CMAR* to the *FSA* in accordance with *SUP* 16.13.

6.4.2 R The *FSA* must be notified in writing within ~~10 business days~~ of the person to whom these responsibilities have been allocated in accordance with ~~*CASS* 6.4.1R~~. A *CASS small firm* must:

- (1) allocate a *director* carrying out a governing function the responsibilities in *SYSC* 6.4.1R which shall be regarded as forming part of that governing function; and
- (2) notify the *FSA* in writing of the *director* to whom these responsibilities have been allocated within 10 business days of that allocation.

6.4.2A G *SYSC* 6.4.1R describes the controlled function known as the *CASS oversight function*. The table of controlled functions in *SUP* 10.4.5R together with *SUP* 10.7.9R to *SUP* 10.7.12AR specify the *CASS oversight function* as a required function for a *firm* to which *CASS* applies, other than a *firm* which is only required to hold *client money* in accordance with *CASS* 5 (Client money: insurance mediation activity).

6.4.3 R In ~~*SYSC* 6.4.1R~~ *6.4.2R*, the reference to the *governing function* only includes the *director function*, the *chief executive function*, the *partner function* and the *director of unincorporated association function*.

...

## Sch 2 Notification requirements

### Sch 2.1 G

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<i>SYSC</i> 6.4.2R	The <del>person</del> <i>director</i> to whom the responsibilities in <i>SYSC</i> 6.4.1R have been allocated	The name of the <del>person</del> <i>director</i>	As soon as the allocation has been made	10 <i>business days</i>

## Annex C

## Amendments to the Conduct of Business sourcebook (COBS)

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

**This annex comes into force on [ ] 2010.**

#### 16.4 Statements of client designated investments or client money

##### Annual reports

- 16.4.1 R (1) A *firm* that holds *client designated investments* or *client money* for a *client* must send that *client* at least once a year a statement in a *durable medium* of those *designated investments* or that *client money* unless such a statement has been provided in a *periodic statement*.
- ...
- 16.4.2 R A *firm* must include in a statement of *client* assets referred to ~~under this section~~ in COBS 16.4.1R the following information:
- ...
- 16.4.3 R In cases where the portfolio of a *client* includes the proceeds of one or more unsettled transactions, the information in a statement provided ~~under this section~~ in accordance with COBS 16.4.1R may be based either on the trade date or the settlement date, provided that the same basis is applied consistently to all such information in the statement.
- ...
- 16.4.4 R A *firm* which holds *designated investments* or *client money* and is *managing investments* for a *client* may include the statement ~~under this section~~ provided in accordance with COBS 16.4.1R in the *periodic statement* it provides to that *client*.
- ...
- 16.4.5 G In reporting to a *client* in accordance with ~~this section~~ COBS 16.4.1R to COBS 16.4.3R, a *firm* should consider whether to provide details of any assets loaned or charged including:
- (1) which *investments* (if any) were at the end of the relevant period loaned to any third party and which *investments* (if any) were at that date charged to secure borrowings made on behalf of the portfolio; and
  - (2) the aggregate of any interest payments made and income received

during the period in respect of loans or borrowings made during that period.

Daily reporting for prime brokers

- 16.4.6 R (1) A prime brokerage firm must make available to each of its clients to whom it provides prime brokerage services a statement in a durable medium showing the value at the close of each business day of the items in (3).
- (2) The statement must be made available to those clients not later than the close of the next business day to which it relates.
- (3) The statement must include:
- (a) designated investments and client money held by that prime brokerage firm for those clients;
- (b) the cash value of the following:
- (i) cash loans and accrued interest;
- (ii) securities to be redelivered by the client under open short positions;
- (iii) current settlement amount to be paid under any futures contracts;
- (iv) collateral held by the firm in respect of secured transactions, including if the firm has exercised a right of use in respect of safe custody assets;
- (v) short sale cash proceeds cash held by the firm in respect of the short positions;
- (vi) cash margin held by the firm in respect of open futures contracts;
- (vii) mark-to-market close-out exposure of any OTC transaction secured by safe custody assets or client money;
- (viii) total secured obligations;
- (ix) all other safe custody investments held for that client; and
- (x) total client money held for that client;
- (c) the location of all safe custody assets, including the sub-custodian where those assets are held; and

- (d) a list of all the institutions at which the *firm* holds or may hold *client money*, including money held in *client bank accounts* and *client transaction accounts*.

## Annex D

### Amendments to the Client Assets sourcebook (CASS)

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

#### Part 1: Comes into force on [ ] 2010

#### 1.2 General application: who? what?

...

##### Management oversight of CASS compliance

1.2.14 **G** Every firm should ensure that a director or, where relevant, a manager, is allocated overall responsibility for ensuring compliance with CASS. The relevant person responsible will depend on the classification of the firm and the business which it carries out. In summary:

- (1) A firm to which CASS applies, other than a firm which only holds client money in accordance with CASS 5 (Client money: insurance mediation activity), should allocate to a director carrying out a governing function the responsibilities in SYSC 6.4.1R; and
- (2) firms which are required to hold client money in accordance with CASS 5 (Client money: insurance mediation activity) should allocate to a manager overall responsibility for complying with CASS 5 in accordance with CASS 5.4.4R(3).

##### CASS firm classification

1.2.15 **G** The application of the responsibilities in SYSC 6.4.1R is based on the classification of a firm in accordance with CASS 1.2.16R.

1.2.16 **R** (1) Subject to (4) and (6) below, a firm to which CASS applies is classified as a CASS large firm, CASS medium firm or a CASS small firm according to the amount of client money or safe custody assets which it holds, as listed in the table in CASS 1.2.17R.

- (2) The amounts in the table in CASS 1.2.17R:
  - (i) refer to the higher of the highest client money or the highest total value of safe custody assets held at any point during the previous calendar year ending on 31 December; and
  - (ii) exclude any client money held in accordance with CASS 5 (Client money: insurance mediation activity).

- (3) If a CASS medium firm or a CASS small firm exceeds the categorisation limit in the table in CASS 1.2.17R for either client money or safe custody assets that firm will be a higher category 'CASS firm type' for the next calendar year.
- (4) A firm may elect to be treated as:
- (i) a CASS medium firm if it is classified as a CASS small firm; or
- (ii) a CASS large firm if it is classified as a CASS medium firm;
- provided that this election is made by including it in the notice to the FSA provided under CASS 1.2.18R.
- (5) A firm which did not hold client money or safe custody assets in the previous calendar year will be classified in accordance with CASS 1.2.16R on the basis of its highest projected holding of client money and its highest projected holding of safe custody assets for the forthcoming calendar year.
- (6) CASS 1.2.16R does not apply to a firm which only holds client money in accordance with CASS 5 (Client money: insurance mediation activity).

1.2.17     R     CASS firm types

<u>CASS firm type</u>	<u>Highest client money held throughout the firm's last calendar year</u>	<u>Highest value of safe custody assets held by the firm throughout the firm's last calendar year</u>
<u>CASS large firm</u>	<u>£1 billion or more</u>	<u>£100 billion or more</u>
<u>CASS medium firm</u>	<u>between £1 million and £1 billion</u>	<u>between £10 million and £100 billion</u>
<u>CASS small firm</u>	<u>less than £1 million</u>	<u>less than £10 million</u>

1.2.18     R     A firm must each calendar year notify the FSA of its classification as a CASS large firm, CASS medium firm or a CASS small firm and the amount of client money and safe custody assets on which that classification is based:

- (1) for the forthcoming calendar year, by 31 January of that year; or
- (2) where a firm did not previously hold client money or safe custody assets, prior to holding either of these.

1.2.19     G     CASS 1.2.16R(4) provides a firm with an ability to opt in to a higher category of 'CASS firm type'. This may be useful for a firm whose holding of client money and safe custody assets is near the categorisation limit for a particular 'CASS firm type'.



...

### 3 Collateral

...

3.1.8 G Prime brokerage firms are reminded of the additional obligations in CASS 6.4A which apply to prime brokerage agreements.

...

#### Prime brokerage agreements

6.1.9A G Prime brokerage firms are reminded of the additional disclosure requirement in CASS 6.4.4R which applies to prime brokerage agreements.

...

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

...

6.3.3 G A firm should consider carefully the terms of its agreements with third parties with which it will deposit *safe custody assets* belonging to a *client*. The following terms are examples of the issues *firms* should address in this agreement:

...

- (4) ~~the restrictions over the third party's right to claim a lien, right of retention or sale over any *safe custody asset* standing to the credit of the account; [deleted]~~

...

...

6.3.5 R A firm's agreement with a third party with which it deposits *safe custody assets* belonging to a *client* may not include the grant to that third party (or to any of its *associates*) of a lien or a right of retention or sale over the *safe custody assets*, or over any *client money* derived from those *safe custody assets*, other than a lien or right of retention or sale in respect of the *firm's* obligations to pay that third party's charges in respect of those *safe custody assets*.

### 6.4 Use of safe custody assets

...

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. [deleted]~~

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

After CASS 6.4 insert the following new section. The text is not underlined.

#### **6.4A Prime brokerage**

- 6.4A.1 R (1) Every *prime brokerage agreement* that includes a *prime brokerage firm's* right to use *safe custody assets* for its own account must include a disclosure annex.
- (2) The disclosure annex must set out a summary of the key provisions within the *prime brokerage agreement* permitting the use of *safe custody assets*, including:
- (a) the contractual limit, if any, on the *safe custody assets* which a *prime brokerage firm* is permitted to use;
  - (b) all related contractual definitions upon which that limit is based;
  - (c) a list of numbered references to the provisions within that *prime brokerage agreement* which permit the *firm* to use the *safe custody assets*; and
  - (d) a statement of the key risks to that *client's safe custody assets* if they are used by the *firm*, including but not limited to the risks to the *safe custody assets* on the *failure* of the *firm*.
- 6.4A.2 G (1) *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.
- (2) A *prime brokerage firm* should not enter into right-to-use arrangements for a *client's safe custody assets* unless the *prime brokerage firm's director* responsible for the *firm's* oversight of *CASS* and management responsible for those *safe custody assets* are all satisfied that the *prime brokerage firm* has adequate systems and controls to discharge its obligations under *Principle 10* which include the following:
- (a) the daily reporting obligation in *COBS 16.4.6R*; and

- (b) the record-keeping obligations in CASS 6.5.

Amend the following as shown.

**6.5 Records, accounts, ~~and reconciliations~~ and reporting to the FSA**

...

- 6.5.2A R Where a *firm* uses *safe custody assets* as permitted in CASS 6.4.1R, 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]

- 6.5.2B R A *firm* must keep a record of every *client* agreement that includes that *firm*'s right to use *safe custody assets* for its own account, including in the case of *prime brokerage agreements* the disclosure annex referred to in CASS 6.4A.1R.

Reporting to the FSA

- 6.5.2C G In accordance with SUP 16.12, all *firms* to which this chapter applies should report to the FSA details of the *safe custody assets* which they hold.

...

**7.4 Segregation of client money**

...

- 7.4.9A R A *firm* must not deposit or hold funds representing more than 20 per cent of the aggregate balance at any point in time on its *client bank accounts* in any *single BCD credit institution*, bank authorised in a third country, or *qualifying money market fund* (or any combination thereof) where the entity, or the entity operating the *qualifying money market fund*, is in the same *group* as the *firm*.

- 7.4.9B G All *firms* should report to the FSA on their compliance with the diversification rule in CASS 7.4.9AR as part of their wider reporting duties under SUP 16.12.

...

**7.6 Records, accounts, ~~and reconciliations~~ and reporting to the FSA**

...

Reporting to the FSA

7.6.2A G In accordance with SUP 16.12, all firms to which this chapter applies should report to the FSA details of the client money which they hold.

...

## TP 1 Transitional Provisions

### 1.1

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...					
7	CASS 5.5.65R	...	...	...	...
8	<u>CASS 6.3.5R</u>	R	<u>A firm's agreements with third parties with which it deposits safe custody assets belonging to its clients entered into before [ ] 2010 do not need to comply with the requirements in CASS 6.3.5R.</u>	<u>[ ] 2010 for 6 months</u>	<u>[ ] 2010</u>
9	<u>CASS 6.4A.1R</u>	R	<u>A prime brokerage agreement entered into before [ ] 2010 does not require the disclosure annex described in CASS 6.4A.1R.</u>	<u>[ ] 2010 for 6 months</u>	<u>[ ] 2010</u>

## Sch 1 Record keeping requirements

...

### Sch 1.3 G

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
...	...	...	...	...
CASS 6.4.3R	Details of <i>clients</i>	Details of the <i>client</i>	Maintain up	5 years (from

	and <i>safe custody assets</i> used for the <i>firm's</i> own account or the account of another <i>client</i> of the <i>firm</i>	on whose instructions the use of the <i>safe custody assets</i> has been effected and the number of <i>safe custody assets</i> used belonging to each <i>client</i>	to-date records	the date the record was made)
CASS 6.5.1R	...	...	...	...
CASS 6.5.2R	...	...	...	...
<u>CASS 6.5.2AR</u>	<u>Details of <i>clients</i> and <i>safe custody assets</i> used for the <i>firm's</i> own account or the account of another <i>client</i> of the <i>firm</i></u>	<u>Details of the <i>client</i> on whose instructions the use of the <i>safe custody assets</i> has been effected and the number of <i>safe custody assets</i> used belonging to each <i>client</i></u>	<u>Maintain up to date records</u>	<u>5 years (from the date the record was made)</u>
<u>CASS 6.5.2BR</u>	<u><i>Client</i> agreements that include a <i>firm's</i> right to use <i>safe custody assets</i> for its own account</u>	<u>Details of <i>client</i> agreements that include a <i>firm's</i> right to use <i>safe custody assets</i> for its own account</u>	<u>Maintain up to date records</u>	<u>5 years (from the date the record was made)</u>
...	...	...	...	...

...

## Sch 2 Notification requirements

### Sch 2.1 G

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<u>CASS 1.2.18R</u>	<u>Classification as a <i>CASS large firm</i>, <i>CASS medium firm</i> or a <i>CASS small firm</i></u>	<u>In accordance with <i>CASS 1.2.16R</i>:</u> <u>(1) the relevant classification;</u> <u>(2) the amount of <i>client money</i> and <i>safe custody assets</i> held, or projected to be held, on which that</u>	<u>1 January</u>	<del>{deleted}</del> 31 January (or where a <i>firm</i> did not previously hold <i>client money</i> or <i>safe custody assets</i> , prior to holding

		<u>classification is based; and</u> <u>(3) if a <i>firm</i> makes an election under CASS 1.2.16R(4), that election.</u>		<u>either of these)</u>
...	...	...	...	...

**Part 2: Comes into force on 1 July 2011**

**1.2 General application: who? what?**

...

Management oversight of CASS compliance

- 1.2.14 G Every *firm* should ensure that a *director* or *senior manager* or, where relevant, a *manager*, is allocated overall responsibility for ensuring compliance with *CASS*. The relevant person responsible will depend on the classification of the *firm* and the business which it carries out. In summary:
- (1) ~~A *firm* to which *CASS* applies, other than a *firm* which only holds *client money* in accordance with *CASS* 5 (Client money: insurance mediation activity), *CASS* large firms and *CASS* medium firms~~ should allocate to appoint a *director* carrying out a *governing function* the responsibilities in or a *senior manager* to the *CASS oversight function* in accordance with *SYSC* 6.4.1R;
  - (2) *CASS* small firms should appoint a *director* to the *CASS oversight function* in accordance with *SYSC* 6.4.2R; and
  - ~~(2)~~ *firms* which are required to hold *client money* in accordance with
  - (3) *CASS* 5 (Client money: insurance mediation activity) should allocate to a *manager* overall responsibility for complying with *CASS* 5 in accordance with *CASS* 5.4.4R(3).

CASS firm classification

- 1.2.15 G The application of ~~the responsibilities in *SYSC* 6.4.1R is:~~
- (1) the *CASS oversight function*; and
  - (2) the requirement to report to the *FSA* in *SUP* 16.13 and the frequency of that report;
- are both based on the classification of a *firm* in accordance with *CASS* 1.2.16R.

...

**6.4A Prime brokerage**

...

- 6.4A.2 G (1) *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.

- (2) A *prime brokerage firm* should not enter into right-to-use arrangements for a *client's safe custody assets* unless the *prime brokerage firm's* ~~director~~ *CASS oversight function* responsible for the *firm's* oversight of *CASS* and management responsible for those *safe custody assets* are all satisfied that the *prime brokerage firm* has adequate systems and controls to discharge its obligations under *Principle 10* which include the following:
- (a) the daily reporting obligation in *COBS 16.4.6R*; and
  - (b) the record-keeping obligations in *CASS 6.5*.

## 6.5 Records, accounts, reconciliations and reporting to the FSA

...

Reporting to the FSA

- 6.5.2C G In accordance with *SUP* ~~16.12~~ 16.13, all *firms* to which this chapter applies should report to the *FSA* details of the *safe custody assets* which they hold.

...

## 7.4 Segregation of client money

...

- 7.4.9B G All *firms* should report to the *FSA* on their compliance with the diversification rule in *CASS 7.4.9AR* as part of their wider reporting duties under *SUP* ~~16.12~~ 16.13.

...

## 7.6 Records, accounts, reconciliations and reporting to the FSA

...

Reporting to the FSA

- 7.6.2A G In accordance with *SUP* ~~16.12~~ 16.13, all *firms* to which this chapter applies should report to the *FSA* details of the *client money* which they hold.



## Annex E

## Amendments to the Supervision manual (SUP)

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

**This annex comes into force on 1 July 2011.**

## 10.4 Specification of functions

...

### 10.4.5 R Controlled functions

Type	CF	Description of controlled function
...		
<i>Required functions*</i>		
...		
	<u>10A</u>	<u>CASS oversight function</u>
...		

...

## 10.7 Required functions

...

### CASS oversight function (CF10A)

- 10.7.9 ~~G~~ ~~R~~ ~~[deleted]~~ In the case of a CASS large firm or a CASS medium firm, the CASS oversight function is the function of acting in the capacity of a person who is allocated (under SYSC 6.4.1R) the function set out in SYSC 6.4.1R.
- 10.7.10 ~~G~~ ~~R~~ ~~[deleted]~~ In the case of a CASS small firm, the CASS oversight function is the function of acting in the capacity of a person who is allocated (under SYSC 6.4.2R) the function set out in SYSC 6.4.1R.
- 10.7.11 ~~G~~ ~~R~~ ~~[deleted]~~ In the case of a CASS small firm, a governing function includes, in the case of a person who is appointed to carry out the CASS oversight function (under SYSC 6.4.2R), the CASS oversight function.
- 10.7.12 G ~~[deleted]~~ The effect of SUP 10.7.11R is that a person who is approved to perform a governing function and who is also appointed under SYSC 6.4.2R to carry out the CASS oversight function will not have to be specifically

approved to perform the CASS oversight function. However, when such a person carries out the CASS oversight function, that person will be performing a controlled function and so will be subject to APER.

10.7.12A R In SUP 10.7.9R to 10.7.12R, references to the governing functions only include the director function, the chief executive function, the partner function and the director of unincorporated association function.

...

**16 Reporting requirements**

...

16.1.3 R Application of different sections of SUP 16

(1) Section(s)	(2) Categories of firm to which section applies	(3) Applicable rules and guidance
...		
<u>SUP 16.13</u>	<u>A firm to which CASS applies, other than a firm which only holds client money in accordance with CASS 5 (Client money: insurance mediation activity)</u>	<u>Entire section</u>
...		

...

16.3.2 G This chapter has been split into the following sections, covering:

...

- (8) product sales data reporting (SUP 16.11); ~~and~~
- (9) integrated regulatory reporting (SUP 16.12); and
- (10) client money and asset return (SUP 16.13).

...

After SUP 16.12 insert the following new section. The text is not underlined.

**16.13 Client money and asset return**

Application

16.13.1 R This section applies to a *firm* to which *CASS* applies, other than a *firm* which only holds *client money* in accordance with *CASS* 5 (Client money: insurance mediation activity).

Purpose

16.13.3 G The purpose of the *rules* and *guidance* in this section is to ensure that the *FSA* receives regular and comprehensive information about the *client money* and *safe custody assets* held by a *firm* on behalf of its *clients*.

Report

- 16.13.4 R (1) A *CASS large firm* and a *CASS medium firm* must submit a completed *CMAR* to the *FSA* within 10 *business days* of the end of each *month*.
- (2) A *CASS small firm* must submit a completed *CMAR* to the *FSA* within 10 *business days* of the conclusion of each six *month* period ending on 31 March and 30 September.

...

After SUP 16 Annex 26G insert the following new annex. The text is not underlined.

**16 Annex 27 R Client Money and Asset Return (CMAR)**

This annex consists only of one or more forms. Forms are to be found through the following address:

*Client Money and Asset Return: [insert link to form included below]*

...

Sch 2 Notification requirements

...

Sch 2.2 G

...

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
...	...	...	...	...
SUP 16.10.4R	...	...	...	...
SUP 16.13.1R to SUP 16.13.4R	<u>CMAR</u>	The items listed in the form contained in	For <i>CASS large firms</i> and <i>CASS medium firms</i> ,	For <i>CASS large firms</i> and <i>CASS medium firms</i> ,

		<u>CASS 16 Annex 27R</u>	<p><u>the end of each month.</u></p> <p><u>For CASS small firms, the conclusion of each six month period ending on 31 March and 30 September.</u></p>	<p><u>within 10 business days of the end of each month.</u></p> <p><u>For CASS small firms, within 10 business days of the conclusion of each six month period ending on 31 March and 30 September.</u></p>
...				

(continued)

## Client Money and Asset Return

### Section 1 - Firm Information

Please complete the following details:

- Firm Name
- The FSA firm reference number
- The Reporting period end date
- Please identify the currency of the report (all figures in 000s)
- Name of CASS audit firm
- Does the firm control Client Money?
- Does the firm hold Client Money?
- Does the firm safeguard and administer safe custody assets?

Type of business	Number of clients	Approx value of Client Money	Approx value of Custody Assets

### Section 2a - Segregation of Client Money

#### Alternative Approach:

Does the firm use an Alternative Approach to segregate client money (see CASS 7.4.14 G)?  
If yes, please explain your use of an Alternative Approach

#### Where you hold client money?

Type	Name	Balances (000's)	Legal jurisdiction	Is this a "connected entity"?
------	------	------------------	--------------------	-------------------------------

### Section 2b - Segregation of Safe Custody Assets

#### Where you hold safe custody assets

Location	Name of entity	Number of lines of stock	Value of assets (000's)	Legal jurisdiction	Connected entity
----------	----------------	--------------------------	-------------------------	--------------------	------------------

### Section 3 - Client Money Requirement

Client Money Requirement  
of which:

- Unallocated to individual clients but identified as client money
- Unallocated to individual clients and unidentified as client money
- Uncleared payments, e.g. unrepresented cheques sent to clients
- Excess cash in segregated accounts

Balances (000's)

### Section 4a - Safe Custody Assets Reconciliations

	26-89 days	90-179 days	180-359 days	360+
Custody asset reconciliation discrepancies				

Please describe the types of reconciliations undertaken and the frequency of those reconciliations:

### Section 4b - Client Money Reconciliations

Type	Frequency			
	6-29 days	30-59 days	60-90 days	90+ days
Client money (Internal) calculation	a			
External reconciliation	c			
Client money reconciliation discrepancies				

### Section 5 - Record Keeping & Breaches Record Keeping

Type of Account	Total number of accounts held at beginning of reporting period	Number of new accounts opened during the reporting period	Number of accounts closed during the reporting period	Total number of accounts at the end of the reporting period	Number of trust status letters and/or acknowledgement letters in place which cover these accounts
Client Bank Account					
Client Transaction Account					

Please explain any discrepancies.

### Breaches

Have you reported any notifiable CASS breaches during the regulatory period?

Are there any other CASS issues you wish to draw to our attention?

### Section 6 – Outsourcing

Do you outsource and/or offshore any of your client money and/or custody asset operations? If so, please explain them.



**PUB REF: 002168**

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