

# Chapter 3

## Collateral

## 3.1 Application and Purpose

### Application

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

### Purpose

- 3.1.5 **G** The purpose of this chapter is to ensure that an appropriate level of protection is provided for those assets over which a *client* gives a *firm* certain rights. The arrangements covered by this chapter are those under which the *firm* is given a right to use the asset, and the *firm* treats the asset as if legal title and associated rights to that asset had been transferred to the *firm* subject only to an obligation to return equivalent assets to the *client* upon satisfaction of the *client's* obligation to the *firm*. The rights covered in this chapter do not include those arrangements by which the *firm* has only a bare security interest in the *client's* asset (in which case the *custody rules* or *client money rules* apply).
- 3.1.6 **G** Examples of the arrangements covered by this chapter include the taking of collateral by a *firm*, under the ISDA English Law (transfer of title) and the New York Law Credit Support Annexes (assuming the right to rehypothecate has not been disapplied).
- 3.1.7 **G** This chapter recognises the need to apply a differing level of regulatory protection to the assets which form the basis of the two different types of arrangement described in **■** CASS 3.1.5 G. Under the bare security interest

arrangement, the asset continues to belong to the *client* until the *firm's* right to realise that asset crystallises (that is, on the *client's* default). But under a "right to use arrangement", the *client* has transferred to the *firm* the legal title and associated rights to the asset, so that when the *firm* exercises its right to treat the asset as its own, the asset ceases to belong to the *client* and in effect becomes the *firm's* asset and is no longer in need of the full range of *client* asset protection. The *firm* may exercise its right to treat the asset as its own by, for example, clearly so identifying the asset in its own books and records.

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

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