

Chapter 6

Custody rules

6.6 Records, accounts and reconciliations

Records and accounts

- 6.6.1** **G** This section sets out the requirements a *firm* must meet when keeping records and accounts of the *safe custody assets* it holds for *clients*.
- 6.6.2** **R** A *firm* must keep such records and accounts as necessary to enable it at any time and without delay to distinguish *safe custody assets* held for one *client* from *safe custody assets* held for any other *client*, and from the *firm's* own *applicable assets*.
[Note: article 2(1)(a) of the *MiFID Delegated Directive*]
- 6.6.3** **R** A *firm* must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the *safe custody assets* held for *clients* and that they may be used as an audit trail.
[Note: article 2(1)(b) of the *MiFID Delegated Directive*]
- 6.6.4** **R** A *firm* must maintain a *client-specific safe custody asset record*.
- 6.6.5** **G** The requirements in **■ CASS 6.6.2 R** to **■ CASS 6.6.4 R** are for a *firm* to keep internal records and accounts of *clients' safe custody assets*. Therefore any records falling under those requirements should be maintained by the *firm*, and should be separate to any records the *firm* may have obtained from any third parties, such as those with whom it may have deposited, or through whom it may have registered legal title to, *clients' safe custody assets*.
- The *FCA* expects that compliance by a *firm* with **■ CASS 6.6** as a whole (to the extent applicable to that *firm*) will be sufficient to comply with the requirement under **■ CASS 6.6.3R** to maintain its records and accounts in a way that ensures they may be used as an audit trail.
- 6.6.6** **R** **Right to use agreements**
A *firm* must keep a copy of every executed *client* agreement that includes that *firm's* right to use *safe custody assets* for its own account (see **■ CASS 6.4.1 R**), including in the case of a *prime brokerage agreement* the disclosure annex referred to in **■ CASS 9.3.1 R**.

General record-keeping

- 6.6.7** **R** Unless otherwise stated, a *firm* must ensure that any record made under the *custody rules* is retained for a period of five years starting from the later of:
- (1) the date it was created; and
 - (2) (if it has been modified since the date it was created), the date it was most recently modified.

- 6.6.8** **R** For each *internal custody record check*, each *physical asset reconciliation* and each *external custody reconciliation* carried out by a firm, it must make a record including:
- (1) the date it carried out the relevant process;
 - (2) the actions the firm took in carrying out the relevant process; and
 - (3) a list of any discrepancies the *firm* identified and the actions the *firm* took to resolve those discrepancies.

Policies and procedures

- 6.6.9** **G** *Firms* are reminded that they must, under **SYSC 6.1.1 R**, establish, implement and maintain adequate policies and procedures sufficient to ensure compliance of the *firm* with the *rules* in this chapter. This should include, for example, establishing and maintaining policies and procedures concerning:
- (1) the frequency and method of the checks and reconciliations the *firm* is required to carry out under this section;
 - (2) the frequency with which the firm is required to review its arrangements in compliance with this chapter; and
 - (3) the resolution of discrepancies and the treatment of *shortfalls* under this section.

Internal custody record checks

- 6.6.10** **G**
- (1) An *internal custody record check* is one of the steps a *firm* takes to satisfy its obligations under:
 - (a) *Principle 10* (Clients' assets);
 - (b) **CASS 6.2.2 R** (Requirement to have adequate organisational arrangements);
 - (c) **CASS 6.6.2 R** to **CASS 6.6.4 R** (Records and accounts); and
 - (d) where relevant, **SYSC 4.1.1 R** (General requirements) and **SYSC 6.1.1 R** (Compliance).
 - (2) An *internal custody record check* is a check as to whether the *firm's* records and accounts of the *safe custody assets* held by the *firm* (including, for example, those deposited with third parties under **CASS 6.3** (Depositing safe custody assets with third parties)) correspond with the *firm's* obligations to its *clients* to hold those *safe custody assets*.

- 6.6.10A R ■ CASS 6.6.11R does not apply to a *firm* following its *failure*.

- 6.6.10B G ■ CASS 6.6.46AR (Frequency of checks and reconciliations after failure) applies to a *firm* following its *failure*.

- 6.6.11 R
 - (1) A *firm* must perform an *internal custody record check*:
 - (a) subject to paragraph (2), as regularly as is necessary but without allowing more than one month to pass between each *internal custody record check*; and
 - (b) as soon as reasonably practicable after the date to which the *internal custody record check* relates.

 - (2) A *firm* that holds no *safe custody assets* other than *physical safe custody assets* must perform an *internal custody record check* as regularly as necessary but, in any case, no less often than its *physical asset reconciliations* under ■ CASS 6.6.22 R.

- 6.6.12 G ■ CASS 6.6.44 R sets out the matters which a *firm* must have regard to when determining the frequency at which to undertake an *internal custody record check*.

- 6.6.13 R A *firm* must perform an internal custody record check using either the *internal custody reconciliation method* or the *internal system evaluation method*. It must not use a combination of these methods.

- 6.6.14 R A *firm* must only use its internal records (for example its depot and *client-specific* ledgers for *safe custody assets* or other internal accounting records) in order to perform an *internal custody record check*.

- 6.6.15 G ■ CASS 6.6.14 R means that a *firm* must not base its *internal custody record checks* on any records that the *firm* may have obtained from any third parties, such as those with whom it may have deposited, or through whom it may have registered legal title to, *clients' safe custody assets*.

- The internal custody reconciliation method for internal custody record checks**
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- 6.6.16 R A *firm* may only use the *internal custody reconciliation method* if:
 - (1) it separately maintains an *aggregate safe custody asset record* and a *client-specific safe custody asset record*; and
 - (2) its *aggregate safe custody asset record* and its *client-specific safe custody asset record* are capable of being compared.

- 6.6.17 R The *internal custody reconciliation method* requires a *firm* to perform a comparison between its *aggregate safe custody asset record* and its *client-specific safe custody asset record*, as at the date of the *internal custody record check*.

The internal system evaluation method for internal custody record checks

- 6.6.18** **G** (1) The *internal system evaluation method* is available to any *firm*, including one that is not able to use the *internal custody reconciliation method* because it does not meet the requirements at ■ CASS 6.6.16R (1) and ■ CASS 6.6.16R (2).
- (2) The purpose of the *internal system evaluation method* is to detect weaknesses in a *firm's* systems and controls and any recordkeeping discrepancies. However, this method is not designed to substitute a *firm's* other measures for ensuring compliance with the *custody rules*, such as monitoring the accuracy of its records (see also ■ CASS 6.2.2 R and ■ CASS 6.6.3 R).
- 6.6.19** **R** The *internal system evaluation method* requires a *firm* to:
- (1) establish a process that evaluates:
- (a) the completeness and accuracy of the *firm's* internal records and accounts of *safe custody assets* held by the *firm* for *clients*, in particular whether sufficient information is being completely and accurately recorded by the *firm* to enable it to:
- (i) comply with ■ CASS 6.6.4 R; and
- (ii) readily determine the total of all the *safe custody assets* that the *firm* holds for its *clients*; and
- (b) whether the *firm's* systems and controls correctly identify and resolve all discrepancies in its internal records and accounts of *safe custody assets* held by the *firm* for *clients*;
- (2) run the evaluation process established under (1) on the date of each *internal custody record check*; and
- (3) promptly investigate and, without undue delay, resolve any causes of discrepancies that the evaluation process reveals.
- 6.6.20** **G** The evaluation process under ■ CASS 6.6.19R (1) should verify that the *firm's* systems and controls correctly identify and resolve at least the following types or causes of discrepancies:
- (1) items in the *firm's* records and accounts that might be erroneously overstating or understating the *safe custody assets* held by a *firm* (for example, 'test' entries and 'balancing' entries);
- (2) negative balances;
- (3) processing errors;
- (4) journal entry errors (eg, omissions and unauthorised system entries); and
- (5) IT errors (eg, software issues that could lead to inaccurate records).

Physical asset reconciliations

- 6.6.21** **G** (1) A *physical asset reconciliation* is a separate process to the *internal custody record check*. Firms that hold *physical safe custody assets* for clients are required to perform both processes.
- (2) The purpose of a *physical asset reconciliation* is to check that a firm's internal records and accounts of the *physical safe custody assets* kept by the firm for clients are accurate and complete, and to ensure any discrepancies are investigated and resolved.
- 6.6.21A** **R** ■ CASS 6.6.22R does not apply to a firm following its failure.
- 6.6.21B** **G** ■ CASS 6.6.46AR (Frequency of checks and reconciliations after failure) applies to a firm following its failure.
- 6.6.22** **R** A firm that holds *physical safe custody assets* must perform a *physical asset reconciliation* for all the *physical safe custody assets* it holds for clients:
- (1) as regularly as is necessary but without allowing more than six months to pass between each *physical asset reconciliation*; and
- (2) as soon as reasonably practicable after the date to which the *physical asset reconciliation* relates.
- 6.6.23** **G** ■ CASS 6.6.44 R sets out the matters which a firm must have regard to when determining the frequency at which to undertake a *physical asset reconciliation*.
- 6.6.24** **R** When performing a *physical asset reconciliation* a firm must:
- (1) count all the *physical safe custody assets* held by the firm for clients as at the date to which the *physical asset reconciliation* relates; and
- (2) compare the count in (1) against what the firm's internal records and accounts state as being in the firm's possession as at the same date.
- 6.6.25** **R** A firm must perform each *physical asset reconciliation* under ■ CASS 6.6.24 R using the *total count method* or the *rolling stock method*.
- 6.6.26** **G** Regardless of the method used, a firm should ensure that all *safe custody assets* held by the firm as *physical safe custody assets* for clients are subject to a *physical asset reconciliation* at the frequency required under ■ CASS 6.6.22 R.
- 6.6.27** **R** If a firm completes a *physical asset reconciliation* in a single stage, such that the firm:

(1) performs a single count under ■ CASS 6.6.24R (1) which encompasses all the *physical safe custody assets* held by the *firm* for *clients* as at the date to which the *physical asset reconciliation* relates; and

(2) compares that count against the *firm's* internal records and accounts in accordance with ■ CASS 6.6.24R (2);

then the *firm* will have used the *total count method* for that *physical asset reconciliation*.

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If a *firm* completes a *physical asset reconciliation* in two or more stages, such that the *firm*:

(1) performs two or more counts under ■ CASS 6.6.24R (1) (each on a separate occasion and relating to a different stock line or group of stock lines forming part of the *firm's* overall holdings of *physical safe custody assets*) which, once all of the counts are complete, encompass all the *physical safe custody assets* held by the *firm* for *clients*; and

(2) compares each of those counts against the *firm's* internal records and accounts in accordance with ■ CASS 6.6.24R (2);

then the *firm* will have used the *rolling stock method* for that *physical asset reconciliation*.

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(1) The *rolling stock method* allows a *firm* to perform its *physical asset reconciliation* in several stages, with each stage referring to a line of stock or group of stock lines in a *designated investment* selected by a *firm* (for example, all the *shares* with an *issuer* whose name begins with the letter 'A' or all the stock lines held in connection with a particular business line).

(2) Where a *firm* uses the *rolling stock method* to perform a *physical asset reconciliation*, all the stages in that *physical asset reconciliation* must be completed in time to ensure the *firm* complies with ■ CASS 6.6.22 R.

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(1) If a *firm* wishes to use the *rolling stock method* to perform a *physical asset reconciliation* it must first establish and document in writing its reasons for concluding that the way in which it will carry out its *physical asset reconciliations* is adequately designed to mitigate the risk of the *firm's* records being manipulated or falsified.

(2) A *firm* must retain any documents created under (1) for a period of at least five years after the date it ceases to use the *rolling stock method* to perform its *physical asset reconciliation*.

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The documents under ■ CASS 6.6.30R (1) should, for example, cover the systems and controls the *firm* will have in place to mitigate the risk of 'teeming and lading' in respect of all the *physical safe custody assets* held by the *firm* for *clients* and across all the *firm's* business lines.

6.6.32 **G** To meet the requirement to have adequate organisational arrangements under **■ CASS 6.2.2 R**, a *firm* should consider performing 'spot checks' as to whether title to an appropriate sample of *physical safe custody assets* that it holds is registered correctly under **■ CASS 6.2.3 R** (Registration and recording of legal title).

External custody reconciliations

6.6.33 **G** The purpose of an *external custody reconciliation* is to ensure the completeness and accuracy of a *firm's* internal records and accounts of *safe custody assets* held by the *firm* for *clients* against those of relevant third parties.

6.6.34 **R** A *firm* must conduct, on a regular basis, reconciliations between its internal records and accounts of *safe custody assets* held by the *firm* for *clients* and those of any third parties by whom those *safe custody assets* are held.

[**Note:** article 2(1)(c) of the *MiFID Delegated Directive*]

6.6.35 **R** In **■ CASS 6.6.34 R**, the third parties whose records and accounts a *firm* is required to reconcile its own internal records and accounts with must include:

- (1) the third parties with which the *firm* has deposited *clients' safe custody assets*;
- (2) where the *firm* has not deposited a *client's safe custody asset* with a third party:
 - (a) the third parties responsible for the registration of legal title to that *safe custody asset*; or
 - (b) a *person* acting as an operator for the purposes of any of the *relevant overseas USRs* if:
 - (i) the *safe custody asset* is an uncertificated unit of a security governed by any of the *relevant overseas USRs*; and
 - (ii) the *firm* has reasonable grounds to be satisfied that the records of that *person* take into account all instructions issued by that *person* which require an issuer to register on a register of securities a transfer of title to any uncertificated units.

6.6.36 **G** Examples of the sorts of third parties referred to at **■ CASS 6.6.35R (2)(a)** include central securities depositories, *operators* of *collective investment schemes*, and administrators of offshore funds.

6.6.36A **R** **■ CASS 6.6.37R** does not apply to a *firm* following its *failure*.

6.6.36B **G** **■ CASS 6.6.46AR** (Frequency of checks and reconciliations after failure) applies to a *firm* following its *failure*.

- 6.6.37** **R** A firm must conduct external custody reconciliations:
- (1) as regularly as necessary but allowing no more than one month to pass between each external custody reconciliation; and
 - (2) as soon as reasonably practicable after the date to which the external custody reconciliation relates.
- 6.6.38** **G** ■ CASS 6.6.44 R sets out the matters which a firm must consider when determining the frequency at which to undertake an external custody reconciliation.
- 6.6.39** **G** Where a firm holds clients' safe custody assets electronically with a central securities depository which is able to provide adequate information to the firm on its holdings on a daily basis, it is best practice under ■ CASS 6.6.37R (1) for the firm to conduct an external custody reconciliation each business day in respect of those assets.
- 6.6.40** **G** Where a firm deposits safe custody assets belonging to a client with a third party or where a third party is responsible for the registration of legal title to that asset, in complying with the requirements of ■ CASS 6.6.34 R, the firm should seek to ensure that the third party provides the firm with adequate information (for example in the form of a statement) as at a date specified by the firm which details the description and amounts of all the safe custody assets credited to the relevant account(s) and that this information is provided in sufficient time to allow the firm to carry out its external custody reconciliations under ■ CASS 6.6.37 R.
- 6.6.41** **G** If a firm acting as trustee or depository of an AIF that is an authorised AIF deposits safe custody assets belonging to a client with a third party, under article 89(1)(c) (Safekeeping duties with regard to assets held in custody) of the AIFMD level 2 regulation, the firm should seek to ensure that the third party provides the firm with adequate information (for example in the form of a statement) as at a date or dates specified by the firm which details the description and amounts of all the safe custody assets credited to the account(s) and that this information is provided in adequate time to allow the firm to carry out the periodic reconciliations required under article 89(1)(c) (Safekeeping duties with regard to assets held in custody) of the AIFMD level 2 regulation.
- 6.6.41A** **G** If a firm acting as trustee or depository of a UK UCITS deposits safe custody assets belonging to a client with a third party, under article 13(1)(c) (Safekeeping duties with regard to assets held in custody) of the UCITS level 2 regulation, the firm should seek to ensure that:
- (1) the third party provides the firm with adequate information (for example in the form of a statement):
 - (a) as at a date or dates specified by the firm; and
 - (b) which details the description and amounts of all the safe custody assets credited to the account(s); and

(2) such information is provided in adequate time to allow the *firm* to carry out the periodic reconciliations required under article 13(1)(c) of the *UCITS level 2 regulation*.

6.6.42 **G** *External custody reconciliations* must be performed for each *safe custody asset* held by the *firm* for its *clients*, except for *physical safe custody assets*. A reconciliation of transactions involving *safe custody assets*, rather than of the *safe custody assets* themselves, will not satisfy the requirement under **■ CASS 6.6.34 R**.

6.6.43 **G** A *firm acting as trustee or depositary of an AIF* that is an *authorised AIF* should perform the reconciliation under article 89(1)(c) (Safekeeping duties with regard to assets held in custody) of the *AIFMD level 2 regulation*:

(1) as regularly as is necessary having regard to the frequency, number and value of transactions which the *firm* undertakes in respect of *safe custody assets*, but with no more than one month between each reconciliation; and

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

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

Frequency of checks and reconciliations under this section

6.6.43A **R** **■ CASS 6.6.44R** to **■ CASS 6.6.46R** do not apply to a *firm* following its *failure*.

6.6.43B **G** **■ CASS 6.6.46AR** (Frequency of checks and reconciliations after failure) applies to a *firm* following its *failure* in respect of the frequency at which the *firm* undertakes its *internal custody record checks* under **■ CASS 6.6.11R**, *physical asset reconciliations* under **■ CASS 6.6.22R**, and *external custody reconciliations* under **■ CASS 6.6.37R**.

6.6.44 **R** When determining the frequency at which it will undertake its *internal custody record checks* under **■ CASS 6.6.11 R**, *physical asset reconciliations* under **■ CASS 6.6.22 R**, and *external custody reconciliations* under **■ CASS 6.6.37 R**, a *firm* must have regard to:

(1) the frequency, number and value of transactions which the *firm* undertakes in respect of *clients' safe custody assets*; and

(2) the risks to which *clients' safe custody assets* are exposed, such as the nature, volume and complexity of the *firm's* business and where and with whom *safe custody assets* are held.

6.6.45 **R** (1) A *firm* must make and retain records sufficient to show and explain any decision it has taken under **■ CASS 6.6.44 R** when determining the frequency of its *internal custody record checks*, *physical asset reconciliations* and *external custody reconciliations*. Subject to (2), such records must be retained indefinitely.

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- (2) If any decision under ■ CASS 6.6.44 R is superseded by a subsequent decision under that *rule* then the record of that earlier decision retained in accordance with (1) need only be retained for a further period of five years from the subsequent decision.
- (1) Subject to (3), a *firm* must review the frequency at which it conducts *internal custody record checks, physical asset reconciliations* and *external custody reconciliations* at least annually to ensure that it continues to comply with ■ CASS 6.6.11 R, ■ CASS 6.6.22 R and ■ CASS 6.6.37 R, respectively, and has given due consideration to the matters in ■ CASS 6.6.44 R.
- (2) For each review a *firm* undertakes under (1), it must record the date and the actions it took in reviewing the frequency of its *internal custody record checks, physical asset reconciliations* and *external custody reconciliations*.
- (3) A *firm* need not carry out a review under (1) in respect of its *internal custody record checks, physical asset reconciliations* and *external custody reconciliations*, if it already conducts the particular process in respect of all relevant *safe custody assets* each *business day*.

Frequency of checks and reconciliations after failure

6.6.46A

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- (1) This *rule* applies to a *firm* following its *failure*.
- (2) A *firm* must perform an *internal custody record check* and a *physical asset reconciliation* that relates to the time of its *failure* as soon as reasonably practicable after its *failure*.
- (3) (a) A *firm* must perform an *external custody reconciliation* that relates to the time of its *failure* as soon as reasonably practicable after its *failure*.
- (b) If any records and accounts of the relevant third parties under ■ CASS 6.6.35R relating to the time of the *firm's failure* are unavailable, the *firm* must use the next available records and accounts to perform the *external custody reconciliation* under sub-paragraph (a).
- (4) A *firm* must perform further *internal custody record checks* and *physical asset reconciliations*:
- (a) as regularly as is necessary to ensure that the *firm* remains in compliance with ■ CASS 6.6.2R, ■ CASS 6.6.3R and ■ CASS 6.6.4R (Records and accounts); and
- (b) as soon as reasonably practicable after the date to which the *internal custody record check* or *physical asset reconciliation* relates.
- (5) A *firm* must perform further *external custody reconciliations* on a regular basis:
- (a) as regularly as is necessary; and
- (b) as soon as reasonably practicable after the date to which the *external custody reconciliation* relates.

(6) A *firm* must determine the frequency at which it will undertake its *internal custody record checks* and *physical asset reconciliations* under paragraph (4), and its *external custody reconciliations* under paragraph (5) with regard to:

- (a) the frequency, number and value of transactions which the *firm* undertakes in respect of *clients' safe custody assets*;
- (b) the risks to which *clients' safe custody assets* are exposed, such as the nature, volume and complexity of the *firm's* business, and where and with whom *safe custody assets* are held; and
- (c) the need to comply with ■ CASS 6.7.

6.6.46B

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(1) The reference point for the *internal custody record check* and *physical asset reconciliation* under ■ CASS 6.6.46A(2) and the *external custody reconciliation* under ■ 6.6.46A(3)(a) should be the precise point in time at which the *firm's* failure occurred.

(2) The reference point for any further *internal custody record checks* and *physical asset reconciliations* under ■ CASS 6.6.46A(4) and any further *external custody reconciliations* under ■ 6.6.46A(5) can be determined by the *firm*.

Independence of person performing checks and reconciliations

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Whenever possible, a *firm* should ensure that checks and reconciliations are carried out by a *person* (for example an *employee* of the *firm*) who is independent of the production or maintenance of the records to be checked and/or reconciled.

Resolution of discrepancies

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In this section, a discrepancy should not be considered to be resolved until it is fully investigated and corrected, and any associated *shortfall* is made good by way of the *firm* ensuring that:

- (1) it is holding (under the *custody rules*) each of the *safe custody assets* that the *firm* ought to be holding for each of its *clients*; and
- (2) its own records, and the records of any relevant other *person* (such as a third party with whom the *firm* deposited the *safe custody assets*) accurately correspond to the position under (1).

6.6.49

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When a *firm* identifies a discrepancy as a result of carrying out an *internal custody record check*, *physical asset reconciliation* or *external custody reconciliation*, the *firm* must:

- (1) promptly investigate the reason for the discrepancy and resolve it without undue delay; and
- (2) take appropriate steps under ■ CASS 6.6.54 R for the treatment of any *shortfalls* until that discrepancy is resolved.

- 6.6.50** **R** When a *firm* identifies a discrepancy outside of its processes for an *internal custody record check, physical asset reconciliation or external custody reconciliation*, the *firm* must:
- (1) take all reasonable steps both to investigate the reason for the discrepancy and to resolve it; and
 - (2) take appropriate steps under **■ CASS 6.6.54 R** for the treatment of *shortfalls* until that discrepancy is resolved.
- 6.6.51** **G** Where the discrepancy identified under **■ CASS 6.6.49 R** or **■ CASS 6.6.50 R** has arisen as a result of a breach of the *custody rules*, the *firm* should ensure it takes sufficient steps to avoid a reoccurrence of that breach (see *Principle 10* (Clients' assets), **■ CASS 6.6.3 R** and, as applicable, **■ SYSC 4.1.1R (1)** and **■ SYSC 6.1.1 R**).
- 6.6.52** **G** Items recorded or held within a suspense or error account fall within the scope of discrepancies in this section.
- 6.6.53** **G** Items recorded in a *firm's* records and accounts that are no longer recorded by relevant third parties (such as 'liquidated stocks') also fall within the scope of discrepancies in this section.

Treatment of shortfalls

- 6.6.54** **R**
- (1) This *rule* applies where a *firm* identifies a discrepancy as a result of, or that reveals, a *shortfall*, which the *firm* has not yet resolved.
 - (2) Subject to paragraphs (3) and (4), until the discrepancy is resolved a *firm* must do one of the following:
 - (a) appropriate a sufficient number of its own *applicable assets* to cover the value of the *shortfall* and hold them for the relevant *clients* under the *custody rules* in such a way that the *applicable assets*, or the proceeds of their liquidation, will be available for distribution for the benefit of the relevant *clients* in the event of the *firm's failure* and, in doing so:
 - (i) ensure that the *applicable assets* are clearly identifiable as separate from the *firm's* own property and are recorded by the *firm* in its *client-specific safe custody asset record* as being held for the relevant *client*;
 - (ii) keep a record of the actions the *firm* has taken under this *rule* which includes a description of the *shortfall*, identifies the relevant affected *clients*, and lists the *applicable assets* that the *firm* has appropriated to cover the *shortfall*; and
 - (iii) update the record made under (ii) whenever the discrepancy is resolved and the *firm* has re-appropriated the *applicable assets*; or
 - (b) (provided that doing so is consistent with the *firm's permissions* and would result in *money* being held for the relevant *client*) in respect of the *shortfall* under **■ CASS 7.17.2 R** (statutory trust) appropriate a sufficient amount of its own *money* to cover the

value of the *shortfall*, hold it for the relevant *client* as *client money* under the *client money rules* and, in doing so:

- (i) ensure the *money* is segregated under CASS 7.13 (Segregation of client money) and recorded as being held for the relevant *client* under CASS 7.15 (Records, accounts and reconciliations);
 - (ii) keep a record of the actions the *firm* has taken under this *rule* which includes a description of the *shortfall*, identifies the relevant affected *clients*, and specifies the amount of *money* that the *firm* has appropriated to cover the *shortfall*; and
 - (iii) update the record made under (ii) whenever the discrepancy is resolved and the *firm* has re-appropriated the *money*; or
- (c) appropriate a number of *applicable assets* in accordance with (a) and an amount of *money* in accordance with (b) which, in aggregate, are sufficient to cover the value of the *shortfall*.
- (3) If the *firm*, where justified, concludes that another *person* is responsible for the discrepancy, regardless of any dispute with that other *person*, or that the discrepancy is due to a timing difference between the accounting systems of that other *person* and that of the *firm*, the *firm* must take all reasonable steps to resolve the situation without undue delay with the other *person*. Until the discrepancy is resolved the *firm* must consider whether it would be appropriate to notify the affected *client* of the situation, and may take steps under (2) for the treatment of *shortfalls* until that discrepancy is resolved.
- (4) A *firm* that has *failed* is not required to take steps under paragraph (2) in relation to the *firm's* own *applicable assets* or *money* in so far as the legal procedure for the *firm's* failure prevents the *firm* from taking any such steps.

6.6.55 **G** In considering whether it should notify affected *clients* under **■ CASS 6.6.54R (3)**, a *firm* should have regard to its obligations under the *client's best interests rule* to act honestly, fairly and professionally in accordance with the best interests of its *clients*, and to *Principle 7* (communications with clients).

6.6.56 **G**

- (1) The value of a *shortfall* for the purposes of **■ CASS 6.6.54 R** may be determined by the previous day's closing mark to market valuation, or if in relation to a particular *safe custody asset* none is available, the most recently available valuation.
- (2) Where a *firm* is taking the measures under **■ CASS 6.6.54R (2)** in respect of a particular *shortfall* it should, as regularly as necessary, and having regard to *Principle 10*:
 - (a) review the value of the *shortfall* in line with (1); and
 - (b) where the *firm* has found that the value of the *shortfall* has changed, adjust either or both the number of own *applicable assets* or the amount of *money* it has appropriated to ensure that in aggregate the assets and monies set aside are sufficient to cover the changed value of the *shortfall*.

- 6.6.56A** **G** ■ CASS 6.6.54R(4) recognises that a *failed firm* is required to investigate and resolve discrepancies, but the extent to which it is able to address *shortfalls* pending the resolution of discrepancies may be limited by insolvency law, for example.

Notification requirements

- 6.6.57** **R** A *firm* must inform the *FCA* in writing without delay if:
- (1) its internal records and accounts of the *safe custody assets* held by the *firm* for *clients* are materially out of date, or materially inaccurate or invalid, so that the *firm* is no longer able to comply with the requirements in ■ CASS 6.6.2 R to ■ CASS 6.6.4 R; or
 - (2) it is a *firm acting as trustee or depositary of an AIF* and has not complied with, or is materially unable to comply with, the requirements in ■ CASS 6.6.2 R or in article 89(1)(b) or 89(1)(c) (Safekeeping duties with regard to assets held in custody) of the *AIFMD level 2 regulation*; or
 - (2A) it is a *firm acting as trustee or depositary of a UK UCITS* and has not complied with, or is materially unable to comply with, the requirements in:
 - (a) ■ CASS 6.6.2R; or
 - (b) article 13(1)(b) or 13(1)(c) (Safekeeping duties with regard to assets held in custody) of the *UCITS level 2 regulation*; or
 - (3) it will be unable, or materially fails, to take the steps required under ■ CASS 6.6.54 R for the treatment of *shortfalls*; or
 - (4) it will be unable, or materially fails, to conduct an *internal custody record check* in compliance with ■ CASS 6.6.11 R to ■ CASS 6.6.19 R; or
 - (5) it will be unable, or materially fails, to conduct a *physical asset reconciliation* in compliance with ■ CASS 6.6.22 R to ■ CASS 6.6.30 R; or
 - (6) it will be unable, or materially fails, to conduct an *external custody reconciliation* in compliance with ■ CASS 6.6.34 R to ■ CASS 6.6.37 R.

Annual audit of compliance with the custody rules

- 6.6.58** **G** *Firms* are reminded that the auditor of the *firm* has to confirm in the report submitted to the *FCA* under ■ SUP 3.10 (Duties of auditors: notification and report on client assets) that the *firm* has maintained systems adequate to enable it to comply with the *custody rules*.