

Chapter 4

Own funds requirements

4.8 K-CMH requirement

- 4.8.1** **R** The *K-CMH requirement* of a *MIFIDPRU investment firm* is equal to the sum of:
- (1) 0.4% of *average CMH* held by the *firm* in *segregated accounts*; and
 - (2) 0.5% of *average CMH* held by the *firm* in *non-segregated accounts*.
- 4.8.2** **G**
- (1) Generally, a *MIFIDPRU investment firm* should be holding *client money* in one or more *segregated accounts*. Under **MIFIDPRU 4.8.9E**, where a *firm* complies with the applicable requirements of **CASS 7** in relation to an amount of *client money*, there is a presumption that the *client money* is being held in a *segregated account*.
 - (2) As a result, the *K-CMH requirement* for *non-segregated accounts* is most likely to be relevant where:
 - (a) the *K-CMH requirement* applies on a *consolidated basis* and:
 - (i) the *consolidated situation* includes one or more entities to which *CASS* does not apply, such as *third country entities*, that receive *money* from customers; and
 - (ii) the arrangements under which the entity in (i) holds *money* received from customers do not meet the conditions in **MIFIDPRU 4.8.8R** (as they apply on a *consolidated basis* under **MIFIDPRU 2.5.30R**); or
 - (b) a *MIFIDPRU investment firm* has not complied with the **CASS 7** requirements, in which case the *firm* should treat any non-compliant arrangements as *non-segregated accounts* for the purposes of calculating any *K-CMH requirement* that includes that period of non-compliance.
 - (3) However, the scenario in (2)(b) does not affect any obligation that the *firm* has under *CASS*, or under any other *rule*, to take specified action or to notify the *FCA* where the *firm* has identified that it has breached the requirements of *CASS*.
- 4.8.3** **R** When calculating its *CMH* in accordance with this section, a *MIFIDPRU investment firm* must include any amounts that relate to *MiFID business* of the *firm* that is carried on by any *tied agent* acting on its behalf.
- 4.8.4** **G** As a result of the restrictions in **SUP 12.6.5R** and **SUP 12.6.15R**, the *FCA* generally expects that **MIFIDPRU 4.8.3R** would not be directly relevant to

MIFIDPRU investment firms on an individual basis. However, where this section applies on a consolidated basis in accordance with ■ MIFIDPRU 2.5 (Prudential consolidation), the UK parent entity must include any CMH attributable to a tied agent of a third country investment firm included within the consolidated situation.

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- (1) The definition of CMH includes only *client money* which is *MiFID client money*. Therefore, *client money* which is received in connection with business other than *MiFID business* does not need to be included within a MIFIDPRU investment firm's calculation of CMH, except to the extent that ■ MIFIDPRU 4.8.6R applies.
- (2) The definition of *MiFID client money* includes the following:
 - (a) money deposited into a *client bank account* in accordance with ■ CASS 7.13.3R;
 - (b) money originally received in connection with *MiFID business* which a firm has placed in a *qualifying money market fund* in accordance with ■ CASS 7.13.3R(4). This means that while the *units* or *shares* in the relevant *qualifying money market fund* must still be treated by the firm as *client assets* for the purposes of CASS and must be dealt with in accordance with ■ CASS 7.13.26R, the value of those *units* or *shares* must be included in CMH for the purposes of MIFIDPRU;
 - (c) an amount of the firm's own money that the firm has paid into its *client bank account* for the purposes of ■ CASS 7.13.65R where the firm is applying *alternative approach mandatory prudent segregation*; and
 - (i) *prudent segregation*;
 - (ii) *alternative approach mandatory prudent segregation*; or
 - (iii) *clearing arrangement mandatory prudent segregation*; and
 - (d) money received from a *client* in connection with *MiFID business* which a firm has allowed a third party (such as an exchange, a *clearing house* or an *intermediate broker*) to hold in accordance with ■ CASS 7.14 (Client money held by a third party).
- (3) Where a firm controls money under a *mandate* in accordance with ■ CASS 8, the money is not *MiFID client money* if it is not *client money* received or held by the firm. A firm is not required to include any money it controls but does not hold within its calculation of CMH.
- (4) Although money that is not *MiFID client money* does not contribute to the K-CMH requirement, a MIFIDPRU investment firm should still consider any potential material harms that may arise in connection with receiving money from *clients* as part of their ICARA process under ■ MIFIDPRU 7. This includes any material harms that may arise in relation to amounts received that are not treated as *client money*, such as under a *title transfer collateral arrangement*.

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If a MIFIDPRU investment firm is unsure whether *client money* should be classified as *MiFID client money*, it must treat the relevant amount as *MiFID client money* for the purposes of this section until the firm is satisfied that the amount is not *MiFID client money*.

4.8.7 **G** ■ MIFIDPRU 4.8.6R applies only for the purposes of determining how the *client money* concerned should be treated for the purposes of *MIFIDPRU*. It does not affect how the *client money* should be treated for the purposes of other provisions in the *Handbook* (such as *CASS* or *COBS*) or under any other legislation.

4.8.8 **R** An arrangement is a *segregated account* if it is an arrangement in respect of which a *firm* ("A") ensures that all of the following conditions are met:

- (1) A keeps records and accounts enabling A, at any time and without delay, to distinguish assets held for one *client* from assets held for any other *client* and from A's own assets;
- (2) A maintains its records and accounts in a way that ensures their accuracy, and in particular that they correspond to the assets held for *clients* and may be used as an audit trail;
- (3) A conducts, on a regular basis, reconciliations between A's internal accounts and records and those of any third parties by whom those assets are held;
- (4) A takes the necessary steps to ensure that deposited *client* funds are held in an account or accounts identified separately from any accounts used to hold funds belonging to A;
- (5) A operates adequate organisational arrangements to minimise the risk of the loss or diminution of *client* assets or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence; and
- (6) the applicable national law provides that, in the event of A's insolvency or entry into resolution or administration, assuming that A has complied with (1) to (5), *client* funds cannot be used to satisfy claims against A, other than claims by the relevant *clients*.

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- (1) This *rule* applies for the purposes of ■ MIFIDPRU 4.8.8R.
- (2) A *MIFIDPRU investment firm* which holds *client money* must comply with, among other requirements, the applicable requirements on:
 - (a) organisational requirements in relation to *client money* in ■ CASS 7.12;
 - (b) segregation of *client money* in ■ CASS 7.13 or *client money* held by a third party in ■ CASS 7.14;
 - (c) records, accounts and reconciliations in ■ CASS 7.15; and
 - (d) acknowledgement letters in ■ CASS 7.18.
- (3) Compliance with (2) in relation to an arrangement may be relied on as tending to establish compliance with the conditions for that arrangement to be classified as a *segregated account* in ■ MIFIDPRU 4.8.8R.
- (4) Contravention of (2) in relation to an arrangement may be relied on as tending to establish contravention of the conditions for that

arrangement to be classified as a *segregated account* in ■ MIFIDPRU 4.8.8R.

- 4.8.10** **G** The effect of ■ MIFIDPRU 4.8.9E is that if a *MIFIDPRU investment firm* complies with the provisions of CASS specified in ■ MIFIDPRU 4.8.9E(2) for a particular arrangement for *client money*, it can proceed on the basis that the *client money* is being held in a *segregated account* for the purposes of the *K-CMH requirement*. However, if the *firm* does not comply with the relevant CASS provisions in relation to a *client money* arrangement, this will generally be evidence that the relevant *client money* should be treated as being held in a *non-segregated account* for the purposes of calculating the *K-CMH requirement*.
- 4.8.11** **G** Where consolidation under ■ MIFIDPRU 2.5 (Prudential consolidation) applies to an *investment firm group*, ■ MIFIDPRU 2.5.30R and ■ MIFIDPRU 2.5.31R explain how to calculate the consolidated *K-CMH requirement*.
- 4.8.12** **R** A *firm* must calculate its *K-CMH requirement* on the first *business day* of each *month*.
- 4.8.13** **R** A *firm* must calculate the amount of its *average CMH* by:
- (1) taking the total *CMH* as measured at the end of each *business day* during the previous 9 *months*;
 - (2) excluding the daily values for the most recent 3 *months*; and
 - (3) calculating the arithmetic mean of the daily values for the remaining 6 *months*.
- 4.8.14** **R** For the purpose of the calculation in ■ MIFIDPRU 4.8.13R, a *firm* must measure *CMH* in accordance with, to the extent applicable:
- (1) any records, accounts and reconciliations that the *firm* maintains to comply with the requirements of ■ CASS 7.15 (Records, accounts and reconciliations); and
 - (2) any values contained in accounting records.
- 4.8.15** **R** Where a *firm* has been holding *CMH* for less than 9 *months*, it must calculate its *average CMH* using the modified calculation in ■ MIFIDPRU TP 4.11R(1) with the following adjustments:
- (1) in ■ MIFIDPRU TP 4.11R(1)(b), *n* is the relevant number of *months* for which the *firm* has been holding *CMH* (with the *month* during which the *firm* begins that activity counted as *month zero*);
 - (2) during *month zero* of the calculation, the *firm* must:
 - (a) use a best efforts estimate of expected *CMH* for that *month* based on the *firm's* projections when beginning the new activity; and

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- (b) use the estimate in (a) as its *average CMH*;
 - (3) during *month 1* of the calculation and each *month* thereafter, the *firm* must apply the approach in (1) using observed historical data from the preceding *month*;
 - (4) the modified calculation ceases to apply on the date that falls 9 *months* after the date on which the *firm* began holding *CMH*.
- (1) Under ■ MIFIDPRU 4.8.13R(1), a *firm* must measure its *CMH* at the end of each *business day*. The relevant amount should reflect any subsequent adjustment that the *firm* must apply as a result of any requirement to carry out internal reconciliations in relation to *client money* (for example, under ■ CASS 7.15). Therefore, where an internal reconciliation subsequently identifies that the amount of *CMH* recorded for a particular *business day* is incorrect, the *firm* should update the relevant amount to reflect the correct figure.
- (2) Where the *K-CMH requirement* applies on a *consolidated basis*, the *guidance* in (1) also applies in relation to any reconciliations carried out in accordance with the requirements of the jurisdiction in which any *third country* entity included in the *consolidated situation* is based.