

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 this chapter does not apply to an *incoming EEA firm*, other than an *insurer*, with respect to its *passport activities*. The application of this chapter is also dependent on the location from which the activity is undertaken (see **■** CASS 1.3.2 R and **■** CASS 1.3.3 R).
- 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*.

3.2 Requirements

Application

- 3.2.1 **R** [deleted]
- 3.2.2 **R** A *firm* that receives or holds a *client's* assets under an arrangement to which this chapter applies and which exercises its right to treat the assets as its own must ensure that it maintains adequate records to enable it to meet any future obligations including the return of equivalent assets to the *client*.
- 3.2.3 **G** If the *firm* has the right to use the *client's* asset under a "right to use arrangement" but has not yet exercised its right to treat the asset as its own, the *client money rules* or the *custody rules* will continue to apply as appropriate until such time as the *firm* exercises its right, at which time **■** CASS 3.2.2 R will apply.
- 3.2.4 **G** When appropriate, *firms* that enter into the arrangements with *retail clients* covered in this chapter will be expected to identify in the statement of *custody assets* sent to the *client* in accordance with **■** COBS 16.4 (Statements of client designated investments or client money), article 63 of the *MiFID Org Regulation* (see **■** COBS 16A.5) or **■** CASS 9.5 (Reporting to clients on request) details of the assets which form the basis of the arrangements. Where the *firm* utilises global netting arrangements, a statement of the assets held on this basis will suffice.