

## Chapter 5

# Client money: insurance distribution activity

## 5.6 Client money distribution

### Application

- 5.6.1 **R** (1) ■ CASS 5.6 (the *client money (insurance) distribution rules*) applies to a *firm* that in holding *client money* is subject to ■ CASS 5.3 (statutory trust) or ■ CASS 5.4 (Non-statutory trust) when a *primary pooling event* or a *secondary pooling event* occurs.
- (2) In the event of there being any discrepancy between the terms of the trust as required by ■ CASS 5.4.7 R (1)(c) and the provisions of ■ CASS 5.6, the latter shall apply.

- 5.6.2 **G** (1) The *client money (insurance) distribution rules* have force and effect on any *firm* that holds *client money* in accordance with ■ CASS 5.3 or ■ CASS 5.4. Therefore, they may apply to a *UK branch* of a non-EEA *firm*. In this case, the *UK branch* of the *firm* may be treated as if the *branch* itself is a free-standing entity subject to the *client money (insurance) distribution rules*.
- (2) *Firms* that act in accordance with ■ CASS 5.4 (Non-statutory trust) are reminded that the *client money (insurance) distribution rules* should be given effect in the terms of trust required by ■ CASS 5.4.

### Purpose

- 5.6.3 **G** The *client money (insurance) distribution rules* seek to facilitate the timely return of *client money* to a *client* in the event of the *failure* of a *firm* or third party at which the *firm* holds *client money*.

### Failure of the authorised firm: primary pooling event

- 5.6.4 **G** A *primary pooling event* triggers a notional pooling of all the *client money*, in every type of *client money* account, and the obligation to distribute it.
- 5.6.5 **R** A *primary pooling event* occurs:
- (1) on the *failure* of the *firm*; or
- (2) on the vesting of assets in a trustee in accordance with an 'assets requirement' imposed under 55P(1)(b) or (c) (as the case may be) of the Act; or

- (3) on the coming into force of a *requirement* for all *client money* held by the *firm*; or
- (4) when the *firm* notifies, or is in breach of its duty to notify, the *FCA*, in accordance with ■ CASS 5.5.77 R, that it is unable correctly to identify and allocate in its records all valid claims arising as a result of a *secondary pooling event*.

5.6.6 **R** ■ CASS 5.6.5 R (4) does not apply so long as:

- (1) the *firm* is taking steps, in consultation with the *FCA*, to establish those records; and
- (2) there are reasonable grounds to conclude that the records will be capable of rectification within a reasonable period.

**Pooling and distribution**

5.6.7 **R** If a *primary pooling event* occurs:

- (1) *client money* held in each *client money* account of the *firm* is treated as pooled;
- (2) the *firm* must distribute that *client money* in accordance with ■ CASS 5.3.2 R or, as appropriate, ■ CASS 5.4.7 R, so that each *client* receives a sum which is rateable to the *client money* entitlement calculated in accordance with ■ CASS 5.5.66 R; and
- (3) the *firm* must, as trustee, call in and make demand in respect of any debt due to the *firm* as trustee, and must liquidate any *designated investment*, and any letter of credit or guarantee upon which it relies for meeting any *shortfall* in its *client money* resource and the proceeds shall be pooled together with other *client money* as in (1) and distributed in accordance with (2).

5.6.8 **G** A *client's* main claim is for the return of *client money* held in a *client bank account*. A *client* may claim for any *shortfall* against money held in a *firm's* own account. For that claim, the *client* will be an unsecured creditor of the *firm*.

**Client money received after the failure of the firm**

5.6.9 **R** *Client money* received by the *firm* (including in its capacity as trustee under ■ CASS 5.4 (Non-statutory trust)) after a *primary pooling event* must not be pooled with *client money* held in any *client money* account operated by the *firm* at the time of the *primary pooling event*. It must be placed in a *client bank account* that has been opened after that event and must be handled in accordance with the *client money rules*, and returned to the relevant *client* without delay, except to the extent that:

- (1) it is *client money* relating to a transaction that has not completed at the time of the *primary pooling event*; or
- (2) it is *money* relating to a *client*, for whom the *client money* requirement, calculated in accordance with ■ CASS 5.5.66 R or

■ CASS 5.5.68 R, shows that *money* is due from the *client* to the *firm* including in its capacity as trustee under ■ CASS 5.4 (Non-statutory trust) at the time of the *primary pooling event*.

5.6.10 **G** *Client money* received after the *primary pooling event* relating to an incomplete transaction should be used to complete that transaction.

5.6.11 **R** If a *firm* receives a *mixed remittance* after a *primary pooling event*, it must:

- (1) pay the full sum into the separate *client bank account* opened in accordance with ■ CASS 5.6.9 R; and
- (2) pay the *money* that is not *client money* out of that *client bank account* into the *firm's* own bank account within one *business day* of the *day* on which the remittance is cleared.

5.6.12 **G** Whenever possible the *firm* should seek to split a *mixed remittance* before the relevant accounts are credited.

**Failure of a bank, other broker or settlement agent: secondary pooling events**

5.6.13 **R** If both a *primary pooling event* and a *secondary pooling event* occur, the provisions of this section relating to a *primary pooling event* apply.

5.6.14 **R** A *secondary pooling event* occurs on the *failure* of a third party to which *client money* held by the *firm* has been transferred under ■ CASS 5.5.34 R.

5.6.15 **R** ■ CASS 5.6.20 R to ■ CASS 5.6.31 R do not apply if, on the *failure* of the third party, the *firm* repays to its *clients* or pays into a *client bank account*, at an unaffected bank, an amount equal to the amount of *client money* which would have been held if a *shortfall* had not occurred at that third party.

5.6.16 **G** When *client money* is transferred to a third party, a *firm* continues to owe a fiduciary duty to the *client*. However, consistent with a fiduciary's responsibility (whether as agent or trustee) for third parties under general law, a *firm* will not be held responsible for a *shortfall* in *client money* caused by a third party *failure* if it has complied with those duties.

5.6.17 **G** To comply with its duties, the *firm* should show proper care:

- (1) in the selection of a third party; and
- (2) when monitoring the performance of the third party.

In the case of *client money* transferred to a bank, by demonstrating compliance with ■ CASS 5.5.43 R, a *firm* should be able to demonstrate that it has taken reasonable steps to comply with its duties.

**Failure of a bank**

**5.6.18** **G** When a bank *fails* and the *firm* decides not to make good the *shortfall* in the amount of *client money* held at that bank, a *secondary pooling event* will occur in accordance with ■ CASS 5.6.20 R. The *firm* would be expected to reflect the *shortfall* that arises at the *firm's* bank in the periodic *client money* calculation by reducing the *client money* resource and *client money* requirement accordingly.

**5.6.19** **G** The *client money (insurance) distribution rules* seek to ensure that *clients* who have previously specified that they are not willing to accept the risk of the bank that has *fails*, and who therefore requested that their *client money* be placed in a *designated client bank account* as a different bank, should not suffer the loss of the bank that has *failed*.

**Failure of a bank: pooling**

**5.6.20** **R** If a *secondary pooling event* occurs as a result of the *failure* of a bank where one or more *general client bank accounts* are held, then:

- (1) in relation to every *general client bank account* of the *firm*, the provisions of ■ CASS 5.6.22 R and ■ CASS 5.6.26 R to ■ CASS 5.6.28 G will apply;
- (2) in relation to every *designated client bank account* held by the *firm* with the *failed* bank, the provisions of ■ CASS 5.6.24 R and ■ CASS 5.6.26 R to ■ CASS 5.6.28 G will apply; and
- (3) any *money* held at a bank, other than the bank that has *failed*, in *designated client bank accounts* is not pooled with any other *client money*.

**5.6.21** **R** If a *secondary pooling event* occurs as a result of the *failure* of a bank where one or more *designated client bank accounts* are held then in relation to every *designated client bank account* held by the *firm* with the *failed* bank, the provisions of ■ CASS 5.6.24 R and ■ CASS 5.6.26 R to ■ CASS 5.6.28 G will apply.

**5.6.22** **R** *Money* held in each *general client bank account* of the *firm* must be treated as pooled and:

- (1) any *shortfall* in *client money* held, or which should have been held, in *general client bank accounts*, that has arisen as a result of the *failure* of the bank, must be borne by all the *clients* whose *client money* is held in a *general client bank account* of the *firm*, rateably in accordance with their entitlements;
- (2) a new *client money* entitlement must be calculated for each *client* by the *firm*, to reflect the requirements in (1), and the *firm's* records must be amended to reflect the reduced *client money* entitlement;
- (3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed* bank until the *client* is repaid; and

(4) the *firm* must use the new *client* entitlements, calculated in accordance with (2), when performing the *client money* calculation in accordance with ■ CASS 5.5.63 R to ■ CASS 5.5.69 R.

5.6.23 **G** The term 'which should have been held' is a reference to the *failed* bank's failure (and elsewhere, as appropriate, is a reference to the other *failed* third party's failure) to hold the *client money* at the time of the pooling event.

5.6.24 **R** For each *client* with a *designated client bank account* held at the *failed* bank:

(1) any *shortfall* in *client money* held, or which should have been held, in *designated client bank accounts* that has arisen as a result of the *failure*, must be borne by all the *clients* whose *client money* is held in a *designated client bank account* of the *firm* at the *failed* bank, rateably in accordance with their entitlements;

(2) a new *client money* entitlement must be calculated for each of the relevant *clients* by the *firm*, and the *firm's* records must be amended to reflect the reduced *client money* entitlement;

(3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed* bank until the *client* is repaid; and

(4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), when performing the periodic *client money* calculation, in accordance with ■ CASS 5.5.63 R to ■ CASS 5.5.69 R.

5.6.25 **R** A *client* whose money was held, or which should have been held, in a *designated client bank account* with a bank that has *failed* is not entitled to claim in respect of that money against any other *client bank account* or *client transaction account* of the *firm*.

**Client money received after the failure of a bank**

5.6.26 **R** *Client money* received by the *firm* after the *failure* of a bank, that would otherwise have been paid into a *client bank account* at that bank:

(1) must not be transferred to the *failed* bank unless specifically instructed by the *client* in order to settle an obligation of that *client* to the *failed* bank; and

(2) must be, subject to (1), placed in a separate *client bank account* that has been opened after the *secondary pooling event* and either:

(a) on the written instruction of the *client*, transferred to a bank other than the one that has *failed*; or

(b) returned to the *client* as soon as possible.

5.6.27 **R** If a *firm* receives a *mixed remittance* after the *secondary pooling event* which consists of *client money* that would have been paid into a *general client bank account*, a *designated client bank account* or a *designated client fund account* maintained at the bank that has *failed*, it must:

- (1) pay the full sum into a *client bank account* other than one operated at the bank that has *failed*; and
- (2) pay the *money* that is not *client money* out of that *client bank account* within one *business day* of the day on which the remittance is cleared.

**5.6.28** G Whenever possible the *firm* should seek to split a *mixed remittance* before the relevant accounts are credited.

**Failure of an intermediate broker or settlement agent: pooling**

**5.6.29** R If a *secondary pooling event* occurs as a result of the *failure* of another broker or *settlement agent* to whom the firm has transferred *client's money* then, in relation to every *general client bank account* of the *firm*, the provisions of ■ CASS 5.6.26 R to ■ CASS 5.6.28 G and ■ CASS 5.6.30 R will apply.

**5.6.30** R *Money* held in each *general client bank account* of the *firm* must be treated as pooled and:

- (1) any *shortfall* in *client money* held, or which should have been held, in *general client bank accounts*, that has arisen as a result of the *failure*, must be borne by all the *clients* whose *client money* is held in a *general client bank account* of the *firm*, rateably in accordance with their entitlements;
- (2) a new *client money* entitlement must be calculated for each *client* by the *firm*, to reflect the requirements of (1), and the *firm's* records must be amended to reflect the reduced *client money* entitlement;
- (3) the *firm* must make and retain a record of each *client's* share of the *client money shortfall* at the *failed* intermediate broker or *settlement agent* until the *client* is repaid; and
- (4) the *firm* must use the new *client money* entitlements, calculated in accordance with (2), when performing the periodic *client money* calculation, in accordance with ■ CASS 5.5.63 R to ■ CASS 5.5.69 R.

**Client money received after the failure of a broker or settlement agent**

**5.6.31** R *Client money* received by the *firm* after the *failure* of another broker or *settlement agent*, to whom the *firm* has transferred *client money* that would otherwise have been paid into a *client bank account* at that broker or *settlement agent*:

- (1) must not be transferred to the *failed* third party unless specifically instructed by the *client* in order to settle an obligation of that *client* to the *failed* broker or *settlement agent*; and
- (2) must be, subject to (1), placed in a separate *client bank account* that has been opened after the *secondary pooling event* and either:

- (a) on the written instruction of the *client*, transferred to a third party other than the one that has *failed*; or
- (b) returned to the *client* as soon as possible.

**Notification on the failure of a bank, other broker or settlement agent**

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5.6.32

**R**

The provisions of ■ CASS 5.5.61 R apply.