

# Chapter 6

## Custody rules



6.1 Application

6.1.1	<div>R</div>	<p>This chapter (the <i>custody rules</i>) applies to a <i>firm</i>:</p> <ul style="list-style-type: none"><li>(1) [deleted]<ul style="list-style-type: none"><li>(a) [deleted]</li><li>(b) [deleted]</li></ul></li><li>(1A) when it holds <i>financial instruments</i> belonging to a <i>client</i> in the course of its <i>MiFID business</i>;</li><li>(1B) when it is <i>safeguarding and administering investments</i>, in the course of business that is not <i>MiFID business</i>;</li><li>(1C) when it is <i>acting as trustee or depositary of an AIF</i>;</li><li>(1D) when it is <i>acting as trustee or depositary of a UK UCITS</i>; and</li><li>(1E) in respect of any arrangement for a <i>client</i> to transfer full ownership of a <i>safe custody asset</i> (or an asset which would be a <i>safe custody asset</i> but for the arrangement) to the <i>firm</i> which is:<ul style="list-style-type: none"><li>(a) in the course of, or in connection with, the <i>firm's designated investment business</i>; and</li><li>(b) for the purpose of securing or otherwise covering present or future, actual or contingent or prospective obligations, and the application of the <i>custody rules</i> to a <i>firm</i> under this paragraph is set out in the <i>rules and guidance</i> in ■ CASS 6.1.6 R to ■ CASS 6.1.9 G; and</li></ul></li><li>(1F) when it is a <i>small AIFM</i> carrying on <i>excluded custody activities</i>.</li><li>(2) [deleted]</li></ul>
6.1.1-A	<div>R</div>	<p>In applying the <i>custody rules</i> to a <i>small AIFM's excluded custody activities</i>, any reference to a <i>firm</i> carrying on the <i>regulated activities</i> of <i>safeguarding and administering investments, safeguarding and administering assets (without arranging) or arranging safeguarding and administration of assets</i> includes those <i>excluded custody activities</i> that would, but for the exclusion in article 72AA of the <i>RAO</i>, amount to whichever of those <i>regulated activities</i> is referred to.</p>
6.1.1A	<div>G</div>	<p>The <i>regulated activity</i> of <i>safeguarding and administering investments</i> covers both the <i>safeguarding and administration of assets (without arranging)</i></p>

and arranging safeguarding and administration of assets, when those assets are either *safe custody investments* or *custody assets*. A *safe custody investment* is, in summary, a *designated investment* which a *firm* receives or holds on behalf of a *client*. *Custody assets* include *designated investments*, and any other assets that the *firm* holds or may hold in the same portfolio as a *designated investment* held for or on behalf of a *client*.

## 6.1.1B

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- (1) *Firms* to which the *custody rules* apply by virtue of ■ CASS 6.1.1R (1B) or (1E) must also apply the *custody rules* to those *custody assets* which are not *safe custody investments* in a manner appropriate to the nature and value of those *custody assets*.
- (2) *Firms* to which the *custody rules* apply by virtue of ■ CASS 6.1.1R (1C) must also apply the *custody rules*:
  - (a) to those *custody assets* which are not *AIF custodial assets* but are *safe custody investments*; and
  - (b) in a manner appropriate to the nature and value of those *custody assets*, to those *custody assets* which are neither *AIF custodial assets* nor *safe custody investments*.
- (3) *Firms* to which the *custody rules* apply by virtue of ■ CASS 6.1.1R(1D) must also apply them:
  - (a) to those *custody assets* which are not *UCITS custodial assets* but are *safe custody investments*; and
  - (b) in a manner appropriate to the nature and value of those *custody assets*, to those *custody assets* which are neither *UCITS custodial assets* nor *safe custody investments*.

## 6.1.1C

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In accordance with article 42 of the *Regulated Activities Order*, a *firm* ("I") will not be *arranging safeguarding and administration of assets* if it introduces a *client* to another *firm* whose *permitted activities* include the *safeguarding and administration of investments*, or to an *exempt person* acting as such, with a view to that other *firm* or *exempt person*:

- (1) providing a *safe custody service* in the *United Kingdom*; or
- (2) arranging for the provision of a *safe custody service* in the *United Kingdom* by another *person*;

and the other *firm*, *exempt person* or other *person* who is to provide the *safe custody service* is not in the same *group* as I, and does not remunerate I.

## 6.1.2

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*Firms* are reminded that dividends (actual or payments in lieu), *stock lending* fees and other payments received for the benefit of a *client*, and which are due to the *clients*, should be held in accordance with the *client money chapter* where appropriate.

## 6.1.3

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		<b>Business in the name of the firm</b>
6.1.4	R	<p>The <i>custody rules</i> do not apply where a <i>firm</i> carries on business in its name but on behalf of the <i>client</i> where that is required by the very nature of the transaction and the <i>client</i> is in agreement.</p> <p>[Note: recital 51 to <i>MiFID</i>]</p>
6.1.5	G	<p>For example, this chapter does not apply where a <i>firm</i> borrows <i>safe custody assets</i> from a client as principal under a <i>stock lending</i> agreement.</p>
		<b>Title transfer collateral arrangements</b>
6.1.6	R	<p>(1) [deleted]</p> <p>(2) [deleted]</p> <p>A <i>firm</i> must not enter into a <i>TTCA</i> in respect of an asset belonging to a <i>retail client</i>.</p> <p>Where a <i>firm</i> entered into a <i>TTCA</i> in respect of an asset belonging to a <i>retail client</i> (or one which would belong to a <i>retail client</i> but for the arrangement) before 3 January 2018, the <i>firm</i> must terminate that <i>TTCA</i>.</p> <p>[Note: article 16(10) of <i>MiFID</i> and article 5(5) of the <i>MiFID Delegated Directive</i>]</p> <p>Except for ■ CASS 6.1.6BR to ■ CASS 6.1.9G and provided that the <i>TTCA</i> is not with a <i>retail client</i>, the <i>custody rules</i> do not apply to a <i>firm</i> in respect of an asset which is subject to a <i>TTCA</i> and which would otherwise be a <i>safe custody asset</i>.</p> <p>[Note: recital 52 to <i>MiFID</i>]</p>
6.1.6A	R	[deleted]
6.1.6B	R	<p>(1) A <i>firm</i> must ensure that any <i>TTCA</i> is the subject of a written agreement made on a <i>durable medium</i> between the <i>firm</i> and the <i>client</i>.</p>

- (2) Regardless of the form of the agreement in (1) (which may have additional commercial purposes), it must cover the *client's* agreement to:
  - (a) the terms for the arrangement relating to the transfer of the *client's* full ownership of the *safe custody asset* to the *firm*;
  - (b) any terms under which the ownership of the *safe custody asset* is to transfer from the *firm* back to the *client*; and
  - (c) (to the extent not covered by the terms under (b)), any terms for the termination of:
    - (i) the arrangement under (a); or
    - (ii) the overall agreement in (1).
- (3) A *firm* must retain a copy of the agreement under (1) from the date the agreement is entered into and until five years after the agreement is terminated.

**6.1.6C** G The terms referred to in ■ CASS 6.1.6BR (2)(b) may include, for example, terms under which the arrangement relating to the transfer of full ownership of the *safe custody asset* to the *firm* is not in effect from time to time, or is contingent on some other condition.

- 6.1.6D** R
- (1) A *firm* must properly consider and document the use of *TTCAs* in the context of:
    - (a) the relationship between the *client's* obligation to the *firm*; and
    - (b) the *safe custody assets* subjected to *TTCAs* by the *firm*.
  - (2) A *firm* must be able to demonstrate that it has complied with the requirement under (1).
  - (3) When considering, and documenting, the appropriateness of the use of *TTCAs*, a *firm* must take into account the following factors:
    - (a) whether there is only a very weak connection between the *client's* obligation to the *firm* and the use of *TTCAs*, including whether the likelihood of a *client's* liability to the *firm* is low or negligible;
    - (b) the extent by which the amount of *safe custody assets* subject to a *TTCA* is in excess of the *client's* obligations (including where the *TTCA* applies to all *safe custody assets* from the point of receipt by the *firm*) and whether the *client* might have no obligations at all to the *firm*; and
    - (c) whether all the *client's safe custody assets* are made subject to *TTCAs*, without consideration of what obligation the *client* has to the *firm*.
  - (4) Where a *firm* uses a *TTCA*, it must highlight to the *client* the risks involved and the effect of any *TTCA* on the *client's safe custody assets*.

[Note: article 6 of the *MiFID Delegated Directive*]

- 6.1.6E** G A *firm* may choose to combine its *client* communication under ■ CASS 6.1.6DR(4) with any communication made in order to comply with article 15.1(a)(ii) of the *SFTR* or ■ CASS 9.3.1R(2)(d).
- 6.1.7** G [deleted]
- 6.1.8** G *Firms* are reminded of the *client's best interests rule*, which requires them to act honestly, fairly and professionally in accordance with the best interests of their *clients* when structuring their business particularly in respect of the effect of that structure on *firms'* obligations under this chapter.
- Termination of title transfer collateral arrangements**
- 6.1.8A** R
- (1) If a *client* communicates to a *firm* that it wishes (whether pursuant to a contractual right or otherwise) to terminate a *TTCA* and the *client's* communication is not in writing, the *firm* must make a written record of the *client's* communication which also records the date the communication was received.
  - (2) A *firm* must keep a *client's* written communication, or a written record of the *client's* communication in (1), for five years, starting from the date the communication was received by the *firm*.
  - (3) (a) If a *firm* agrees to the termination of a *TTCA*, it must notify the *client* of its agreement in writing. The notification must state when the termination is to take effect and whether or not the *client's safe custody asset* will be held under the *custody rules* by the *firm* thereafter.  
(b) If a *firm* does not agree to terminate a *TTCA*, it must notify the *client* of its disagreement in writing.
  - (4) A *firm* must keep a written record of any notification it makes to a *client* under (3) for a period of five years, starting from the date the notification was made.
- 6.1.8B** G ■ CASS 6.1.8AR (3)(a) refers only to a *firm's* agreement to terminate an existing *TTCA*. Such agreement by a *firm* does not necessarily need to amount to the termination of its entire agreement with the *client*.
- 6.1.8C** G When a *firm* notifies a *client* under ■ CASS 6.1.8AR (3)(a) of when the termination of a *TTCA* is to take effect, it should take into account:
- (1) any relevant terms relating to such a termination that have been agreed with the *client*; and
  - (2) the period of time it reasonably requires to return the *safe custody asset* to the *client* or to update the registration under (Holding of client assets) ■ CASS 6.2 and update its records under ■ CASS 6.6 (Records, accounts and reconciliations).

- 6.1.8D** **R** If a *TTCA* is terminated, then the exemption at **■ CASS 6.1.6R(4)** no longer applies.
- 6.1.8E** **G**
- (1) Following the termination of a *TTCA* , where a *firm* does not immediately return the *safe custody assets* to the *client* the *firm* should consider whether the *custody rules* apply in respect of the *safe custody assets* pursuant to **■ CASS 6.1.1R**.
  - (2) Where the *custody rules* apply to a *firm* for *safe custody assets* in these circumstances then the *firm* is required to comply with those *rules* and should, for example, update the registration under **■ CASS 6.2**(Holding of client assets), update its records under **■ CASS 6.6** (Records, accounts and reconciliations) and treat any *shortfall* in accordance with **■ CASS 6.6.54 R** (in each case as appropriate).
- 6.1.9** **G** *Firms* are reminded that, in certain cases, the *collateral rules* apply where a *firm* receives collateral from a *client* in order to secure the obligations of the *client*.
- Prime brokerage agreements**
- 6.1.9A** **G** A *prime brokerage firm* is reminded of the additional obligations in **■ CASS 9.3.1 R** which apply to *prime brokerage agreements*.
- Affiliated companies - MiFID business**
- 6.1.10** **G** The fact that a *client* is an *affiliated company* in respect of *MiFID business* does not affect the operation of the *custody rules* in relation to that *client*.
- Affiliated companies - non-MiFID business**
- 6.1.10A** **G** [deleted]
- 6.1.10B** **R** In respect of a *firm's* business falling under **■ CASS 6.1.1R (1B)**, the *custody rules* do not apply to the *firm* when it is *safeguarding and administering investments* on behalf of an *affiliated company*, unless:
- (1) the *firm* has been notified that the *designated investment* belongs to a *client* of the *affiliated company*; or
  - (2) the *affiliated company* is a *client* dealt with at arm's length.
- 6.1.11** **G** [deleted]
- Delivery versus payment transaction exemption**
- 6.1.12** **R**
- (1) Subject to (2) and **■ CASS 6.1.12B R** and with the written agreement of the relevant *client*, a *firm* need not treat this chapter as applying in respect of a delivery versus payment transaction through a *commercial settlement system* if:

- (a) in respect of a *client's* purchase, the *firm* intends for the asset in question to be due to the *client* within one *business day* following the *client's* fulfilment of its payment obligation to the *firm*; or
  - (b) in respect of a *client's* sale, the *firm* intends for the asset in question to be due to the *firm* within one *business day* following the *firm's* fulfilment of its payment obligation to the *client*.
- (2) If the payment or delivery by the *firm* to the *client* has not occurred by the close of business on the third *business day* following the date on which a *firm* makes use of the exemption under (1), the *firm* must stop using that exemption for the transaction.
- (3) If the period referred to in ■ CASS 6.1.12R (2) has expired before such a delivery versus payment transaction through a *commercial settlement system* has settled, a *firm* may, until settlement and provided that doing so is consistent with the *firm's permissions* and it complies with (4), segregate the *firm's* own *money* as *client money* (in accordance with the *client money rules*) of an amount equivalent to the value at which that *safe custody asset* is reasonably expected to settle instead of holding the *client's safe custody assets* (in accordance with the *custody rules*).
- (4) Where a *firm* intends to segregate *money* as *client money* instead of the *client's safe custody asset* under (3) it must, before doing so, ensure that this would result in *money* being held for the relevant *client* in respect of the *shortfall* under ■ CASS 7.17.2R (statutory trust).
- (5) Where a *firm* segregates an amount of *client money* instead of the *client's safe custody assets* under (3) it must also:
- (a) ensure the *money* is segregated under ■ CASS 7.13 (Segregation of client money) and recorded as being held for the relevant *client(s)* under ■ CASS 7.15 (Records, accounts and reconciliations);
  - (b) keep a record of the actions the *firm* has taken under this *rule* which includes a description of the *safe custody asset* in question, identifies the relevant affected *client*, and specifies the amount of *money* that the *firm* has appropriated as *client money* to cover the value of the *safe custody asset*; and
  - (c) update the record made under (5)(b) when the transaction in question has settled and the *firm* has re-appropriated the *money*.

## 6.1.12A

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- (1) The amount of *client money* a *firm* segregates for the purposes of ■ CASS 6.1.12R (3) may be determined by the previous day's closing mark to market valuation of the relevant *safe custody asset* or, if in relation to a particular *safe custody asset* none is available, the most recent available valuation.
- (2) Where a *firm* is segregating *money* for the purposes of ■ CASS 6.1.12R (3) it should, as regularly as necessary, and having regard to *Principle 10*:
- (a) review the value of the *safe custody asset* in question in line with (1); and
  - (b) where the *firm* has found that the value of the *safe custody asset* has changed, adjust the amount of *money* it has appropriated to



ensure that these monies are sufficient to cover the latest value of the *safe custody asset*.

**6.1.12B** **R** A *firm* cannot, in respect of a particular delivery versus payment transaction, make use of the exemption under **■ CASS 6.1.12 R** in either or both of the following circumstances:

- (1) it is not a direct member or participant of the relevant *commercial settlement system*, nor is it sponsored by such a member or participant, in accordance with the terms and conditions of that *commercial settlement system*;
- (2) the transaction in question is being settled by another *person* on behalf of the *firm* through an account held at the relevant *commercial settlement system* by that other *person*.

**6.1.12C** **G** Where a *firm* does not meet the requirements in **■ CASS 6.1.12 R** or **■ CASS 6.1.12B R** for use of the exemption in **■ CASS 6.1.12 R**, the *firm* is subject to the *custody rules* in respect of any *safe custody asset* it holds in connection with the delivery versus payment transaction in question.

**6.1.12D** **G**

- (1) In line with **■ CASS 6.1.12 R**, where a *firm* receives a *safe custody asset* from a *client* in respect of a delivery versus payment transaction the *firm* is carrying out through a *commercial settlement system* in respect of a *client's* sale, and the *firm* has not fulfilled its payment obligation to the *client* by close of business on the third *business day* following the date of the *client's* fulfilment of its delivery obligation to the *firm*, the *firm* should consider whether the *custody rules* apply in respect of the *safe custody asset* pursuant to **■ CASS 6.1.1R (1A)** to **■ CASS 6.1.1R (1D)**.
- (2) Upon settlement of a delivery versus payment transaction a *firm* is carrying out through a *commercial settlement system* (including when it is settled within the three business day period referred to in **■ CASS 6.1.12 R**), in respect of:
  - (a) a *client's* purchase, the *custody rules* apply to the relevant *safe custody asset* the *firm* receives upon settlement; and
  - (b) a *client's* sale, the *client money rules* will apply to the relevant *money* received on settlement.

**6.1.12E** **R**

- (1) If a *firm* makes use of the exemption under **■ CASS 6.1.12 R**, it must obtain the *client's* written agreement to the *firm's* use of this exemption.
- (2) In respect of each *client*, the written agreement in (1) must be retained during the time that the *firm* makes use, or intends to make use, of the exemption under **■ CASS 6.1.12 R** in respect of that *client's* *safe custody assets*.

**6.1.13** **G** [deleted]

6.1.14 **G** [deleted]

### Temporary handling of safe custody assets

6.1.15 **G** The *custody rules* do not apply if a *firm* temporarily handles a *safe custody asset* belonging to a *client*. A *firm* should temporarily handle a *safe custody asset* for no longer than is reasonably necessary. In most transactions this would be no longer than one *business day*, but it may be longer or shorter depending upon the transaction in question. For example, when a *firm* executes an order to sell shares which have not been registered on a de-materialised exchange, handling documents for longer periods may be reasonably necessary. However, in the case of *safe custody assets* in *bearer form*, the *firm* is expected to handle them for less than one *business day*. When a *firm* temporarily handles *safe custody assets*, it is still obliged to comply with *Principle 10* (Clients' assets).

6.1.16 **G** When a *firm* temporarily handles a *safe custody asset*, in order to comply with its obligation to act in accordance with *Principle 10* (Clients' assets), the following are guides to good practice:

- (1) a *firm* should keep the *safe custody asset* secure, record it as belonging to that *client*, and forward it to the *client* or in accordance with the *client's* instructions as soon as practicable after receiving it; and
- (2) a *firm* should make and retain a record of the fact that the *firm* has handled that *safe custody asset* and of the details of the *client* concerned and of any action the *firm* has taken.

### Exemptions which do not apply to MiFID business

6.1.16A **R** The exemptions in ■ CASS 6.1.16B R to ■ CASS 6.1.16D G do not apply to a *MiFID investment firm* which holds *financial instruments* belonging to a *client* in the course of *MiFID business*.

6.1.16B **R** [deleted]

### Managers of AIFs and UCITS

- 6.1.16BA **G**
- (1) The *custody rules* do not apply to a *firm* that is *managing an AIF* or *managing a UK UCITS* in relation to *excluded custody activities*, except where the *firm* is a *small AIFM*.
  - (2) The *custody rules* can apply to a *firm* that is *managing an AIF* or *managing a UK UCITS* in relation to activities that are not *excluded custody activities*. For example, where the *firm*:
    - (a) holds *financial instruments* belonging to a *client* in the course of its *MiFID business* (see ■ CASS 6.1.1R (1A)); or
    - (b) is *safeguarding and administering investments*, in the course of business that is not *MiFID business* (see ■ CASS 6.1.1R (1B)).

Personal investment firms

- 6.1.16C R
- The *custody rules* do not apply to a *personal investment firm* when it temporarily holds a *designated investment*, other than in *bearer form*, belonging to a *client*, if the *firm*:
- (1) keeps it secure, records it as belonging to that *client*, and forwards it to the *client* or in accordance with the *client's* instructions, as soon as practicable after receiving it;

(2) retains the *designated investment* for no longer than the *firm* has taken reasonable steps to determine is necessary to check for errors and to receive the final *document* in connection with any series of transactions to which the *documents* relate; and

(3) makes a record, which must then be retained for a period of 5 years after the record is made, of all the *designated investments* handled in accordance with (1) and (2) together with the details of the *clients* concerned and of any action the *firm* has taken.

- 6.1.16D G
- Administrative convenience alone should not lead a *personal investment firm* to rely on ■ CASS 6.1.16C R. *Personal investment firms* should consider what is in the *client's* interest and not rely on ■ CASS 6.1.16C R as a matter of course.

Trustees and depositaries (except depositaries of AIFs and UCITS)

- 6.1.16E R
- The specialist regime in ■ CASS 6.1.16F R to ■ CASS 6.1.16I G does not apply to a *MiFID investment firm* which holds *financial instruments* belonging to a client in the course of *MiFID business*.

- 6.1.16F R
- When a *trustee firm* or *depositary* acts as a *custodian* for a trust or *collective investment scheme*, (except for a *firm acting as trustee or depositary of an AIF* and a *firm acting as trustee or depositary of a UK UCITS*), and:
- (1) the trust or *scheme* is established by written instrument; and

(2) the *trustee firm* or *depositary* has taken reasonable steps to determine that the relevant law and provisions of the trust instrument or *scheme* constitution will provide protections at least equivalent to the *custody rules* for the trust property or *scheme* property;

the *trustee firm* or *depositary* need comply only with the *custody rules* listed in the table below.

Reference	Rule
CASS 6.1.1 R to CASS 6.1.9 G and CASS 6.1.15 G to CASS 6.1.16C R	Application
CASS 6.1.16E R to CASS 6.1.16I G	Trustees and depositaries
CASS 6.1.22 G to CASS 6.1.24 G	General purpose
CASS 6.2.1 R and CASS 6.2.2 R	Protection of clients' safe custody assets
CASS 6.2.3 R and CASS 6.2.3B G	Registration and recording of legal title

Reference	Rule
CASS 6.2.7 R	Holding
CASS 6.3.1 R to CASS 6.3.4B G	Depositing safe custody assets with third parties
CASS 6.4.1 R and CASS 6.4.2 G	Use of safe custody assets
CASS 6.6	Records, accounts and reconciliations

**6.1.16G** G The reasonable steps referred in ■ CASS 6.1.16FR (2) could include obtaining an appropriate legal opinion to that effect.

**6.1.16H** R [deleted]

**6.1.16I** G A *trustee firm* or *depository* that just *arranges safeguarding and administration of assets* may also take advantage of the exemption in ■ CASS 6.1.16J R (Arrangers).

### Depositories of AIFs

**6.1.16IA** R (1) Subject to (2), when a *firm* is *acting as trustee or depository of an AIF* the *firm* need comply only with the *custody rules* in the table below:

Reference	Rule
CASS 6.1.1 R, CASS 6.1.9 G, CASS 6.1.9A G and CASS 6.1.16IB G	Application
CASS 6.1.22 G to CASS 6.1.24 G	General purpose
CASS 6.2.3 R and CASS 6.2.3B G to CASS 6.2.6 G	Registration and recording of legal title
CASS 6.2.7 R	Holding
CASS 6.6.2 R, CASS 6.6.4 R, CASS 6.6.6 R, CASS 6.6.7 R, CASS 6.6.57R (2) and CASS 6.6.58 G	Records, accounts and reconciliations

(2) When a *firm* is *acting as trustee or depository of an AIF* that is an *authorised AIF* the *firm* must, in addition to the *custody rules* in (1), also comply with the *custody rules* in the table below:

Reference	Rule
CASS 6.1.1BR (2)	Application
CASS 6.6.8 R, CASS 6.6.11 R to CASS 6.6.32 G, CASS 6.6.41 G, CASS 6.6.43 G and CASS 6.6.47 G.	Records, accounts and reconciliations

**6.1.16IB** G *Firms acting as trustee or depository of an AIF* are reminded of the obligations in ■ FUND 3.11 (Depositories) and Chapter IV (Depository) of the AIFMD level 2 regulation which apply in addition to those in ■ CASS 6.

**6.1.16IC** G A *firm* (Firm A) to which another *firm acting as trustee or depository of an AIF* (Firm B) has delegated safekeeping functions in accordance with ■ FUND 3.11.28 R (Delegation: safekeeping) will not itself be *acting as trustee*

or depositary of an AIF for that AIF. ■ CASS 6.1.16IA R will not apply to Firm A in respect of that AIF. However, Firm A may be safeguarding and administering investments in respect of that AIF.

Depositories of UCITS

6.1.16ID R When a firm is acting as trustee or depositary of a UK UCITS, the firm need comply only with the custody rules in the table below:

Reference	Rule
CASS 6.1.1R, CASS 6.1.1BR(3), CASS 6.1.9G, CASS 6.1.16IEG	Application
CASS 6.1.22G to CASS 6.1.24G	General purpose
CASS 6.2.3R, CASS 6.2.3AR, CASS 6.2.3BG, CASS 6.2.7R	Holding of client assets
CASS 6.6.2R, CASS 6.6.4R, CASS 6.6.7R, CASS 6.6.41AG, CASS 6.6.57R(2A), CASS 6.6.58G	Records, accounts and reconciliations

6.1.16IE G Firms acting as trustee or depositary of a UK UCITS are reminded of the obligations in ■ COLL 6.6B (UCITS depositaries) which apply as well as those in ■ CASS 6.

6.1.16IF G

(1) A firm (Firm A) to which another firm acting as trustee or depositary of a UK UCITS (Firm B) has delegated safekeeping functions under ■ COLL 6.6B.25R (Delegation: safekeeping) will not itself be acting as trustee or depositary of a UK UCITS for that UCITS scheme.

(2) ■ CASS 6.1.16IDR will not apply to Firm A for that UCITS scheme.

(3) However, Firm A may be safeguarding and administering investments in respect of that UCITS scheme.

Arrangers

6.1.16J R Only the custody rules in the table below apply to a firm when arranging safeguarding and administration of assets.

Reference	Rule
CASS 6.1.1 R to CASS 6.1.9 G and CASS 6.1.15 G to CASS 6.1.16B R	Application
CASS 6.1.16J R	Arrangers
CASS 6.1.16K R	Records
CASS 6.1.22 G to CASS 6.1.24 G	General purpose
CASS 6.3.4A R and CASS 6.3.4B G	Third-party custody agreements

6.1.16K R When a firm arranges safeguarding and administration of assets, it must ensure that proper records of the arrangements are made and retained for a period of 5 years after they are made.

- 6.1.17
- R
- (1) [deleted]
- (1A) [deleted]
- (2) [deleted]
- (3) [deleted]

6.1.18

G

[deleted]

6.1.19

G

[deleted]

6.1.20

G

[deleted]

6.1.20A

G

[deleted]

6.1.21

R

[deleted]

General purpose

6.1.22

G

*Principle 10* (Clients' assets) requires a *firm* to arrange adequate protection for *clients'* assets when it is responsible for them. As part of these protections, the *custody rules* require a *firm* to take appropriate steps to protect *safe custody assets* for which it is responsible.

6.1.23

G

The *rules* in this chapter are designed primarily to restrict the commingling of *client* and the *firm's* assets and minimise the risk of the *client's safe custody assets* being used by the *firm* without the *client's* agreement or contrary to the *client's* wishes, or being treated as the *firm's* assets in the event of its insolvency.

6.1.24

G

The *custody rules* also, where relevant, implemented the provisions of *MiFID* which regulated the obligations of a *firm* when it held *financial instruments* belonging to a *client* in the course of its *MiFID business*.

## 6.2 Holding of client assets

### Requirement to protect clients' safe custody assets

6.2.1

**R**

A *firm* must, when holding *safe custody assets* belonging to *clients*, make adequate arrangements so as to safeguard *clients'* ownership rights, especially in the event of the *firm's* insolvency, and to prevent the use of *safe custody assets* belonging to a *client* on the *firm's* own account except with the *client's* express consent.

[Note: article 16(8) of *MiFID*]

### Requirement to have adequate organisational arrangements

6.2.2

**R**

A *firm* must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of *clients' safe custody assets*, or the rights in connection with those *safe custody assets*, as a result of the misuse of the *safe custody assets*, fraud, poor administration, inadequate record-keeping or negligence.

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

### Registration and recording of legal title

6.2.3

**R**

Subject to ■ CASS 6.2.3A-1R, a *firm* must effect appropriate registration or recording of legal title to a *safe custody asset* belonging to a *client* in the name of:

- (1) the *client*, unless the *client* is an *authorised person* acting on behalf of its *client*, in which case it may be registered in the name of the *client* of that *authorised person*;
- (2) a *nominee company* which is controlled by:
  - (a) the *firm*;
  - (b) an *affiliated company*;
  - (c) a *recognised investment exchange*; or
  - (d) a third party with whom *financial instruments* are deposited under ■ CASS 6.3 (Depositing assets and arranging for assets to be deposited with third parties);
- (3) any other third party, if the *firm* is not a *trustee firm* but is prevented from registering or recording legal title in the way set out in (1) or (2) and provided that:

- (a) the *safe custody asset* is subject to the law or market practice of a jurisdiction outside the *United Kingdom* and the *firm* has taken reasonable steps to determine that it is in the *client's* best interests to register or record it in that way, or that it is not feasible to do otherwise, because of the nature of the applicable law or market practice; and
  - (b) the *firm* has notified the *client* in writing;
- (4) the *firm* if either:
- (a) it is not a *trustee firm* but is prevented from registering or recording legal title in the way set out in (1), (2) or (3) and provided that:
    - (i) the *safe custody asset* is subject to the law or market practice of a jurisdiction outside the *United Kingdom* and the *firm* has taken reasonable steps to determine that it is in the *client's* best interests to register or record it in that way, or that it is not feasible to do otherwise, because of the nature of the applicable law or market practice; and
    - (ii) the *firm* has notified the *client* if a *professional client*, or obtained prior written consent if a *retail client*.
  - (b) it is a *trustee firm* and is prevented from registering or recording legal title in the way set out in (1) or (2).

**6.2.3A-1** R A *firm* need not comply with ■ CASS 6.2.3 R for any *safe custody asset*:

- (1) that it has deposited with a third party in accordance with ■ CASS 6.3 (Depositing assets and arranging for assets to be deposited with third parties); and
- (2) for which, because of the arrangements with that third party for depositing the *safe custody asset*, it is not practicable for the *firm* to effect appropriate registration or recording of legal title itself.

**6.2.3A** R If:

- (1) the *safe custody asset* is an *emission auction product* that is a *financial instrument*; and
- (2) it is not practicable or possible for a *firm* to effect registration or recording of legal title in this asset in the manner set out in ■ CASS 6.2.3 R,

the *firm* must register or record legal title in its name provided it has notified the *client* in writing.

**6.2.3B** G A *firm*, when complying with ■ CASS 6.2.3R (3) or ■ CASS 6.2.3R (4)(a), will be expected to demonstrate that adequate investigations have been made of the jurisdiction concerned by reference to local sources, which may include an appropriate legal opinion.



- 6.2.4** **R** A *firm* must accept the same level of responsibility to its *client* for any *nominee company* controlled by the *firm*, or any nominee company controlled by an *affiliated company* of the *firm*, with respect of any requirements of the *custody rules*.
- 6.2.5** **R** A *firm* may only register or record legal title to its own *applicable asset* in the same name as that in which legal title to a *client's safe custody asset* is registered or recorded if the *firm's applicable asset* is separately identified from the *client's safe custody asset* in the *firm's* records, and either or both of the conditions in (1) and (2) are met.
- (1) The *firm's* holding of its own *applicable asset* arises incidentally to:
    - (a) *designated investment business* it carries on for the account of any *client*; or
    - (b) steps taken by the *firm* to comply with an applicable *custody rule*; and, in the case of either (a) or (b), the situation where registration or recording of legal title of the *firm's applicable asset* is in the same name as the *client's safe custody asset* under this *rule* remains in place only to the extent that it is reasonably necessary.
  - (2) The registration or recording of legal title of the *firm's* own *applicable asset* in the same name as the *client's safe custody asset* is only as a result of the law or market practice of a jurisdiction outside of the *United Kingdom*.
- 6.2.6** **G**
- (1) Consistent with a *firm's* requirements to protect *clients' safe custody assets* and have adequate organisation arrangements in place (■ CASS 6.2.1 R and ■ CASS 6.2.2 R), before a *firm* registers or records legal title to its own *applicable asset* in the same name as that in which legal title to a *client's safe custody asset* is registered or recorded under ■ CASS 6.2.5 R, it should consider whether there are any means to avoid doing so.
  - (2) Examples of where the conditions under ■ CASS 6.2.5R (1) might be met include in the course of a *firm*:
    - (a) correcting a dealing error that relates to a transaction for the account of a *client*; or
    - (b) maintaining a small balance of the *firm's* own *applicable assets* for purely operational or compliance purposes (eg, as a float to cover potential custody *shortfalls*) in an amount that is proportionate to the total amount of *safe custody assets* held for *clients*; or
    - (c) allocating *safe custody assets* to *clients* following settlement of a bulk order; or
    - (d) facilitating a *client* transaction that involves fractional entitlements; or
    - (e) making good a *shortfall*.
- 6.2.7** **R** A *firm* must ensure that any documents of title to *applicable assets* in *bearer form*, belonging to the *firm* and which it holds in its physical possession, are

kept separately from any document of title to a *client's safe custody assets* in *bearer form*.

### Allocated but unclaimed safe custody assets

- 6.2.7A** **R** ■ CASS 6.2.8G to ■ CASS 6.2.16G do not apply to a *firm* following its *failure*.
- 6.2.7B** **G** ■ CASS 6.7.2R to ■ CASS 6.7.7R (Disposal of safe custody assets) applies to a *firm* following its *failure* in respect of allocated but unclaimed *safe custody assets*.
- 6.2.8** **G** The purpose of ■ CASS 6.2.10 R is to set out the requirements a *firm* must comply with if it chooses to divest itself of a *client's* unclaimed *safe custody assets*.
- 6.2.9** **G** Before acting in accordance with ■ CASS 6.2.10 R to ■ CASS 6.2.16 G, a *firm* should consider whether its actions are permitted by law and consistent with the arrangements under which the *safe custody assets* are held. These provisions relate to a *firm's* obligations as an *authorised person*.
- 6.2.10** **R** A *firm* may either (i) liquidate an unclaimed *safe custody asset* it holds for a *client*, at market value, and pay away the proceeds or (ii) pay away an unclaimed *safe custody asset* it holds for a *client*, in either case, to a registered charity of its choice provided:
- (1) this is permitted by law and consistent with the arrangements under which that *safe custody asset* is held;
  - (2) it has held that *safe custody asset* for at least 12 years;
  - (3) in the 12 years preceding the divestment of that *safe custody asset*, it has not received instructions relating to any *safe custody assets* from or on behalf of the *client* concerned;
  - (4) it can demonstrate that it has taken reasonable steps to trace the *client* concerned and return that *safe custody asset*; and
  - (5) the *firm* complies with ■ CASS 6.2.14 R: the undertaking requirement.
- 6.2.11** **E** (1) Taking reasonable steps in ■ CASS 6.2.10R (4) includes following this course of conduct:
- (a) determining, as far as reasonably possible, the correct contact details for the relevant *client*;
  - (b) writing to the *client* at the last known address either by post or by electronic mail to inform it:
    - (i) of the name of the *firm* with which the *client* first deposited the *safe custody asset* in question;
    - (ii) of the *firm's* intention to pay the *safe custody asset* to charity under ■ CASS 6.2.10 R if it does not receive instructions from the *client* within 28 days;

- (c) where the *client* has not responded after the 28 days referred to in (b) attempting to communicate the information set out in (b) to the *client* on at least one further occasion by any means other than that used in (b) including by post, electronic mail, telephone or media advertisement;
- (d) subject to (e) and (f), where the *client* has not responded within 28 days following the most recent communication, writing again to the *client* at the last known address either by post or by electronic mail to inform them that:
  - (i) as the *firm* received no instructions from the *client*, it will in 28 days pay the *safe custody asset* to charity under ■ CASS 6.2.10 R; and
  - (ii) an undertaking will be provided by the *firm* or a member of its *group* to pay to the *client* concerned a sum equal to the value of the *safe custody asset* at the time it was liquidated or paid away in the event of the *client* seeking to claim the *safe custody asset* in future;
- (e) if the *firm* has carried out the steps in (b) or (c) and in response has received positive confirmation in writing that the *client* is no longer at a particular address, the *firm* should not use that address for the purposes of (d);
- (f) if, after carrying out the steps in (a), (b) and (c), the *firm* has obtained positive confirmation that none of the contact details it holds for the relevant *client* are accurate or, if utilised, the communication is unlikely to reach the *client*, the *firm* does not have to comply with (d); and
- (g) waiting a further 28 days following the most recent communication under this *rule* before divesting itself of the *safe custody asset* under ■ CASS 6.2.10 R.

(2) Compliance with (1) may be relied on as tending to establish compliance with ■ CASS 6.2.10R (4).

(3) Contravention of (1) may be relied on as tending to establish contravention of ■ CASS 6.2.10R (4).

**6.2.12** G For the purpose of ■ CASS 6.2.11E (1)(a), a *firm* may use any available means to determine the correct contact details for the relevant *client*, including telephoning the *client*, searching internal records, media advertising, searching public records, mortality screening, using credit reference agencies or tracing agents.

**6.2.13** R Where a *firm* liquidates a *safe custody asset* under ■ CASS 6.2.10 R, it must pay away the proceeds to charity as soon as practicable.

**6.2.14** R Where a *firm* divests itself of a *client's safe custody asset* under ■ CASS 6.2.10 R, it must comply with either (1)(a) or (1)(b) and, in either case, (2).

- (1) (a) The *firm* must unconditionally undertake to pay to the *client* concerned a sum equal to the value of the *safe custody asset* at

the time it was liquidated or paid away in the event of the *client* seeking to claim the *safe custody asset* in future.

- (b) The *firm* must ensure that an unconditional undertaking in the terms set out in (1)(a) is made by a member of its *group* and there is suitable information available for relevant *clients* to identify the member of the *group* granting the undertaking.

(2) Any undertaking under this *rule* must be:

- (a) authorised by the *firm's governing body* where (1)(a) applies or the *governing body* of the *group* member where (1)(b) applies;
- (b) legally enforceable by any *person* that had a legally enforceable claim to the unclaimed *safe custody asset* in question at the time it was divested by the *firm*, or by an assign or successor in title to such claim; and
- (c) retained by the *firm*, and, where (1)(b) applies, by the *group* member, indefinitely.

#### 6.2.15

**R**

- (1) If a *firm* pays away a *client's* unclaimed *safe custody assets* to charity or liquidates a *client's* unclaimed *safe custody assets* and pays the proceeds to charity under ■ CASS 6.2.10 R it must make and retain, or where the *firm* already has such records, retain:

- (a) records of all *safe custody assets* divested under ■ CASS 6.2.10 R (including details of the value of each asset at that time and the identity of the *client* to whom the asset was allocated);
- (b) all relevant documentation (including charity receipts); and
- (c) details of the communications the *firm* had or attempted to make with the *client* concerned pursuant to ■ CASS 6.2.10R (4).

(2) Records in (1) must be retained indefinitely.

- (3) If a member of the *firm's group* has provided an undertaking under ■ CASS 6.2.14R (1)(b) then the records in (1) must be readily accessible to that *group* member.

#### Costs associated with divesting allocated but unclaimed client assets

#### 6.2.16

**G**

Any costs associated with the *firm* divesting itself of *safe custody assets* pursuant to ■ CASS 6.2.10 R to ■ CASS 6.2.15 R should be paid for from the *firm's* own funds, including:

- (1) any costs associated with the *firm* carrying out the steps in ■ CASS 6.2.10R (4) or ■ CASS 6.2.11 E; and
- (2) the cost of any insurance purchased by a *firm* or the relevant member of its *group* to cover any legally enforceable claim in respect of the assets divested under ■ CASS 6.2.10 R.



6.3 Depositing assets and arranging for assets to be deposited with third parties

Depositing safe custody assets with third parties.....

6.3.1

R

- (1) A *firm* may deposit *safe custody assets* held by it on behalf of its *clients* into an account or accounts opened with a third party, but only if it exercises all due skill, care and diligence in the selection, appointment and periodic review of the third party and of the arrangements for the holding and safekeeping of those *safe custody assets*.
- (1A) [deleted]
- (2) [deleted]
- (3) When a *firm* makes the selection, appointment and conducts the periodic review referred to under this *rule*, it must take into account:
  - (a) the expertise and market reputation of the third party; and
  - (b) any legal requirements related to the holding of those *safe custody assets* that could adversely affect *clients'* rights.
- (4) [deleted]

[Note: article 3(1) of the *MiFID Delegated Directive*]

6.3.2

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- In discharging its obligations under ■ CASS 6.3.1 R, a *firm* should also consider, as appropriate, together with any other relevant matters:
- (1) the third party's performance of its services to the *firm*;
  - (2) the arrangements that the third party has in place for holding and safeguarding the *safe custody asset*;
  - (2A) market practices related to the holding of the *safe custody asset* that could adversely affect *clients'* rights.
  - (3) current industry standard reports, for example "Assurance reports on internal controls of services organisations made available to third parties" made in line with Technical Release AAF 01/06 of The Institute of Chartered Accountants in England and Wales or equivalent;
  - (4) the capital or financial resources of the third party;

## 6.3.2A

R

- (5) the credit-worthiness of the third party;
  - (6) any other activities undertaken by the third party and, if relevant, any *affiliated company*; and
  - (7) whether the third party has the appropriate regulatory permissions.
- (1) A *firm* must make a record of the grounds upon which it satisfies itself as to the appropriateness of its selection and appointment of a third party under ■ CASS 6.3.1 R. The *firm* must make the record on the date it makes the selection or appointment and must keep it from that date until five years after the *firm* ceases to use the third party to hold *safe custody assets* belonging to *clients*.
  - (2) A *firm* must make a record of each periodic review of its selection and appointment of a third party that it conducts under ■ CASS 6.3.1 R, its considerations and conclusions. The *firm* must make the record on the date it completes the review and must keep it from that date until five years after the *firm* ceases to use the third party to hold *safe custody assets* belonging to *clients*.

## 6.3.3

G

[deleted]

## 6.3.4

R

- (1) Subject to (2), a *firm* must only deposit *safe custody assets* with a third party in a jurisdiction which specifically regulates and supervises the safekeeping of *safe custody assets* for the account of another *person* with a third party who is subject to such regulation.
- (2) A *firm* must not deposit *safe custody assets* held on behalf of a *client* with a third party in a *third country* which does not regulate the holding and safekeeping of *safe custody assets* for the account of another *person* unless:
  - (a) the nature of the *safe custody assets* or of the *investment services* connected with those *safe custody assets* requires them to be deposited with a third party in that *third country*; or
  - (b) the *safe custody assets* are held on behalf of a *professional client* and the *client* requests the *firm* in writing to deposit them with a third party in that *third country*.
- (3) [deleted]
  - (a) [deleted]
  - (b) [deleted]
    - (i) [deleted]
    - (ii) [deleted]
    - (iii) [deleted]
- (4) The requirements under paragraphs (1) and (2) of this *rule* also apply when the third party has delegated any of its functions concerning

the holding and safekeeping of *safe custody assets* to another third party.

[Note: article 3(2)-(4) of the *MiFID Delegated Directive*]

- 6.3.4A-2** **G** ■ CASS 6.3.4R(4) applies to a *firm* which deposits a *safe custody asset* into an account opened with a third party under ■ CASS 6.3.1R(1). It is therefore possible for more than one *firm* in a chain of custody to be subject to ■ CASS 6.3.4R(4) in respect of the same *safe custody asset*.

- 6.3.4A-1** **R** A *firm* must take the necessary steps to ensure that any *client's safe custody assets* deposited with a third party are identifiable separately from the *applicable assets* belonging to the *firm* and from the *applicable assets* belonging to that third party, by means of differently titled accounts on the books of the third party or other equivalent measures that achieve the same level of protection.

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

### Third-party custody agreements

- 6.3.4A** **R** A *firm* must have entered into a written agreement with any *person* with whom it deposits *clients' safe custody assets* under ■ CASS 6.3.1 R, or with whom it arranges safeguarding and administration of assets which are *clients' safe custody assets*. This agreement must, at minimum:

- (1) set out the binding terms of the arrangement between the *firm* and the third party;
- (2) be in force for the duration of that arrangement; and
- (3) clearly set out the custody service(s) that the third party is contracted to provide.

- 6.3.4B** **G** A *firm* should consider carefully the terms of any agreement entered into with a third party under ■ CASS 6.3.4A R. The following terms are examples of the issues that should be addressed in these agreements (where relevant):

- (1) that the title of the account in the third party's books and records indicates that any *safe custody asset* credited to it does not belong to the *firm*;
- (2) that the third party will hold or record a *safe custody asset* belonging to the *firm's client* separately from any *applicable asset* belonging to the *firm* or to the third party;
- (3) the arrangements for registration or recording of the *safe custody asset*, if this will not be registered in the *firm's client's* name;
- (4) the restrictions over the circumstances in which the third party may withdraw assets from the account;
- (5) the procedures and authorities for the passing of instructions to, or by, the *firm*;



		<p>(6) the procedures for the claiming and receiving of dividends, interest payments and other entitlements accruing to the <i>firm's client</i>; and</p> <p>(7) the provisions detailing the extent of the third party's liability in the event of the loss of a <i>safe custody asset</i> caused by the fraud, wilful default or negligence of the third party or an agent appointed by him.</p>
6.3.5	R	[deleted]
6.3.6	R	[deleted]
6.3.6A	R	<p>(1) A <i>firm</i> must not grant any security interest, lien or right of set-off to another <i>person</i> over <i>clients' safe custody assets</i> that enable that other <i>person</i> to dispose of the <i>safe custody assets</i> in order to recover debts unless condition (a) or (b) is satisfied:</p> <p>(a) those debts relate to:</p> <ul style="list-style-type: none"> <li>(i) one or more of the <i>firm's clients</i>; or</li> <li>(ii) the provision of services by that other <i>person</i> to one or more of the <i>firm's clients</i>; or</li> </ul> <p>(b) to the extent those debts relate to anything else then:</p> <ul style="list-style-type: none"> <li>(i) the security interest, lien or right of set-off is required by applicable law in a <i>third country</i> jurisdiction in which the <i>safe custody assets</i> are held;</li> <li>(ii) the <i>firm</i> discloses information to the <i>client</i> so that the <i>client</i> is informed of the risks associated with these arrangements; and</li> <li>(iii) the <i>firm</i> has taken reasonable steps to determine that holding <i>safe custody assets</i> subject to that security interest, lien or right of set-off is in the best interests of the <i>firm's clients</i>.</li> </ul> <p>Where security interests, liens or rights of set-off are granted by a <i>firm</i> over <i>safe custody assets</i>, or where the <i>firm</i> has been informed that they are granted, these must be recorded in <i>client</i> contracts and the <i>firm's</i> own books and records to make the ownership status of <i>safe custody assets</i> clear, such as in the event of an insolvency.</p> <p>[Note: article 2(4) of the <i>MiFID Delegated Directive</i>]</p>
6.3.6B	G	Under ■ CASS 6.3.6AR(1)(a), a security interest, lien or right of set-off to facilitate the clearing or settlement of transactions referring to <i>clients</i> of the <i>firm</i> may be regarded as being granted in order to recover debts that relate to the provision of services to one or more <i>clients</i> .
6.3.6C	G	(1) Under ■ CASS 6.3.6AR(1)(b)(i) a security interest, lien or right of set-off may be regarded as being required by applicable law in a <i>third country</i> for example where:



- (a) because of applicable law it is mandatory for such a security interest, lien or right of set-off to be given in order for the *safe custody assets* to be held in that *third country*; or
  - (b)
    - (i) in the context of the service being provided for the *firm's client* the applicable law of that *third country* requires the use of a central securities depository, securities settlement system or central counterparty;
    - (ii) the rules of that central securities depository, securities settlement system or central counterparty are subject to the oversight of a regulator that performs that function under the applicable law; and
    - (iii) those rules require such a security interest, lien or right of set-off to be given.
  - (2) But a *firm* should not grant a security interest, lien or right of set-off under ■ CASS 6.3.6AR(1)(b)(i) that is wider than that under ■ CASS 6.3.6AR(1)(a) where another *person* in a *third country* simply requests or demands this as a condition of business.
- 6.3.6D G To comply with ■ CASS 6.3.6AR(2) and in relation to any security interests, liens or rights of set-off over *safe custody assets*, a *firm* should ensure that:
  - (1) the written terms of its *client* contracts include the *client's* agreement to another *person* having such a security interest, lien or right of set-off over the *client's* assets; and
  - (2) its books and records are able to show the *safe custody assets* in respect of which the *firm* is aware that such security interests, liens, or rights of set-off exist.
- 6.3.7 G [deleted]
- 6.3.8 R [deleted]
- 6.3.9 R ■ CASS 6.3.6AR does not permit a *firm* to agree to a third party having any recourse or right against *client money* in a *client bank account* or standing to the credit of a *client transaction account* of the kind referred to in:
  - (1) paragraph (d) of ■ CASS 7 Annex 2R; or
  - (2) paragraph (e) of ■ CASS 7 Annex 3R; or
  - (3) paragraph (e) of ■ CASS 7 Annex 4R.

## 6.4 Use of safe custody assets

### 6.4.1

**R**

- (1) A *firm* must not enter into arrangements for *securities financing transactions* in respect of *safe custody assets* held by it on behalf of a *client* or otherwise use such *safe custody assets* for its own account or the account of any other *person* or *client* of the *firm*, unless:
  - (a) the *client* has given express prior consent to the use of the *safe custody assets* on specified terms; and
  - (b) the use of that *client's safe custody assets* is restricted to the specified terms to which the *client* consents.
- (2) A *firm* must not enter into arrangements for *securities financing transactions* in respect of *safe custody assets* held by it on behalf of a *client* in an omnibus account maintained by a third party, or otherwise use *safe custody assets* held in such an account for its own account or for the account of any other *person* unless, in addition to the conditions set out in (1):
  - (a) each *client* whose *safe custody assets* are held together in an omnibus account has given express prior consent in accordance with (1)(a); or
  - (b) the *firm* has in place systems and controls which ensure that only *safe custody assets* belonging to *clients* who have given express prior consent in accordance with (1)(a) are so used.
- (3) For the purposes of obtaining the express prior consent of a *client* under this *rule*, the consent must be clearly evidenced in writing and the signature of the *client* or an equivalent alternative means of affirmative execution is required.
- (4) [deleted]

[Note: article 5(1) and (2) of the *MiFID Delegated Directive*]

### 6.4.1A

**G**

The *FCA* expects *firms* which enter into arrangements under ■ CASS 6.4.1 R with *retail clients* to only enter into *securities financing transactions* and not otherwise use *retail clients' safe custody assets*.

### 6.4.1B

**G**

- (1) Prior express consent by *clients* should be given and recorded by *firms* in order to allow the *firm* to demonstrate clearly what the *client* agreed to and to help clarify the status of *safe custody assets*.

(2) *Clients'* consent may be given once at the start of the commercial relationship, as long as it is sufficiently clear that the *client* has consented to the use of their *safe custody assets*.

(3) Where a *firm* is acting on a *client* instruction to lend *safe custody assets* and where this constitutes consent to entering into the transaction, the *firm* should hold evidence to demonstrate this.

[Note: recital 10 to the *MiFID Delegated Directive*]

#### 6.4.1C

**R**

A *firm* must take appropriate measures to prevent the unauthorised use of *safe custody assets* for its own account or the account of any other *person*, such as:

- (1) the conclusion of agreements with *clients* on measures to be taken by the *firm* in case the *client* does not have enough provision on its account on the settlement date, such as borrowing of the corresponding securities on behalf of the *client* or unwinding the position;
- (2) the close monitoring by the *firm* of its projected ability to deliver on the settlement date;
- (3) the putting in place of remedial measures if the *firm* cannot deliver on the settlement date; and
- (4) the close monitoring and prompt requesting of undelivered securities outstanding on the settlement day and beyond.

[Note: article 5(3) of the *MiFID Delegated Directive*]

#### 6.4.1D

**G**

Examples of remedial measures in ■ CASS 6.4.1CR(3) can be found in ■ CASS 6.6.54R.

#### 6.4.2

**G**

*Firms* are reminded of the *client's best interests rule*, which requires the *firm* to act honestly, fairly and professionally in accordance with the best interests of their *clients*. For any transactions involving *retail clients* carried out under this section the *FCA* expects that:

- (1) the *firm* ensures that *relevant collateral* is provided by the borrower in favour of the *client*;
- (2) the current realisable value of the *safe custody asset* and of the *relevant collateral* is monitored daily; and
- (3) the *firm* provides *relevant collateral* to make up the difference where the current realisable value of the collateral falls below that of the *safe custody asset* , unless otherwise agreed in writing by the *client*.

#### 6.4.2A

**R**

A *firm* must adopt specific arrangements for all *clients* to ensure that the borrower of *client safe custody assets* provides the appropriate collateral and that the *firm* monitors the continued appropriateness of such collateral and

takes the necessary steps to maintain the balance with the value of the *client safe custody assets*.

[Note: article 5(4) of the *MiFID Delegated Directive*]

6.4.2B

G

The requirement to monitor collateral under ■ CASS 6.4.2AR applies to a *firm* where it is party to a *securities financing transaction*, including when acting as an agent for the conclusion of a *securities financing transaction* or in the case of a tripartite transaction between a borrower, a *client* and the *firm*.

[Note: recital 9 to the *MiFID Delegated Directive*]

6.4.3

R

Where a *firm* uses *safe custody assets* as permitted in this section, the records of the *firm* must include details of the *client* on whose instructions the use of the *safe custody assets* has been effected, as well as the number of *safe custody assets* used belonging to each *client* who has given consent, so as to enable the correct allocation of any loss.

[Note: article 5(2), second sub-paragraph of the *MiFID Delegated Directive*]

		<div>6.6</div> <div>Records, accounts and reconciliations</div>	
		<div>Records and accounts</div>	
6.6.1	G	<div>This section sets out the requirements a <i>firm</i> must meet when keeping records and accounts of the <i>safe custody assets</i> it holds for <i>clients</i>.</div>	6
6.6.2	R	<div>A <i>firm</i> must keep such records and accounts as necessary to enable it at any time and without delay to distinguish <i>safe custody assets</i> held for one <i>client</i> from <i>safe custody assets</i> held for any other <i>client</i>, and from the <i>firm's</i> own <i>applicable assets</i>.</div> <div>[Note: article 2(1)(a) of the <i>MiFID Delegated Directive</i>]</div>	
6.6.3	R	<div>A <i>firm</i> must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the <i>safe custody assets</i> held for <i>clients</i> and that they may be used as an audit trail.</div> <div>[Note: article 2(1)(b) of the <i>MiFID Delegated Directive</i>]</div>	
6.6.4	R	<div>A <i>firm</i> must maintain a <i>client-specific safe custody asset record</i>.</div>	
6.6.5	G	<div>The requirements in ■ CASS 6.6.2 R to ■ CASS 6.6.4 R are for a <i>firm</i> to keep internal records and accounts of <i>clients' safe custody assets</i>. Therefore any records falling under those requirements should be maintained by the <i>firm</i>, and should be separate to any records the <i>firm</i> 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, <i>clients' safe custody assets</i>.</div> <div>The <i>FCA</i> expects that compliance by a <i>firm</i> with ■ CASS 6.6 as a whole (to the extent applicable to that <i>firm</i>) 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.</div>	
		<div>Right to use agreements</div>	
6.6.6	R	<div>A <i>firm</i> must keep a copy of every executed <i>client</i> agreement that includes that <i>firm's</i> right to use <i>safe custody assets</i> for its own account (see ■ CASS 6.4.1 R), including in the case of a <i>prime brokerage agreement</i> the disclosure annex referred to in ■ CASS 9.3.1 R.</div>	

### 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**
- 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*.

## 6.6.28

R

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*.

## 6.6.29

G

(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.

## 6.6.30

R

(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*.

## 6.6.31

G

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.

6.6.46

R

- (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

R

- (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

G

- (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

6.6.47

G

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

6.6.48

G

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

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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

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■ 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*.

## 6.7 Treatment of custody assets after a failure

### Application

- 6.7.1 **R** This section applies to a *firm* following its *failure*.

### Disposal of safe custody assets

- 6.7.2 **R**
- (1) Before a *firm* takes any steps to dispose of a *safe custody asset* it must:
    - (a) (subject to paragraph (2)) attempt to return it to the relevant *client* or transfer it to another *person* for safekeeping on behalf of the *client* in accordance with ■ CASS 6.7.8R; and
    - (b) (subject to paragraph (3)) take reasonable steps to notify the *client* of the *firm's* proposed course of action for disposing of the *safe custody asset*.
  - (2) A *firm* is not required to attempt to return or transfer a *safe custody asset* under paragraph (1)(a) where the *client* to whom the *safe custody asset* belongs has confirmed to the *firm* that it disclaims all its interests in the *safe custody asset*.
  - (3) A *firm* is not required to notify a *client* under paragraph (1)(b) where:
    - (a) the *firm* is able to return the *safe custody asset* to the relevant *client* or transfer it to another *person* on behalf of the *client* in accordance with ■ CASS 6.7.8R; or
    - (b) the *client* to whom the *safe custody asset* belongs has confirmed to the *firm* that it disclaims all its interests in the *safe custody asset*.
- 6.7.3 **G**
- (1) The disposal of a *safe custody asset* referred to under ■ CASS 6.7.2R(1) includes cases where the *firm* is using the procedure under regulation 12B of the *IBSA Regulations* to set a 'hard bar date' by giving a 'hard bar date notice', or is using another similar procedure in accordance with the legal procedure for the *firm's failure*.
  - (2) In any case, a *firm* should consider whether its obligations under law or any agreement permit it to dispose of a *safe custody asset* in the way in which it proposes to do so.
- 6.7.4 **E**
- (1) Reasonable steps in ■ CASS 6.7.2R(1)(b) include the following course of conduct:

- (a) determining, as far as reasonably possible, the correct contact details for the relevant *client*;
  - (b) for a *client* for whom the *firm* has evidence that it was a *professional client* for the purposes of the *custody rules* at the time of the *failure*:
    - (i) writing to the *client* at its last known address either by post or by electronic mail:
      - (A) to inform it of the *firm's* intention to dispose of the *safe custody asset*;
      - (B) to inform it of the consequences of the *firm's* proposed course of action in relation to the *client's* ability to assert a claim in respect of that *safe custody asset*; and
      - (C) to invite the *client* to submit a claim for that *safe custody asset*;
    - (ii) where the *client* has not responded within 28 *days* of the communication under sub-paragraph (i), attempting to communicate the information in (i) to the *client* on at least one further occasion by any means other than that used in sub-paragraph (i) including by post, electronic mail, telephone or media advertisement; and
  - (c) for any other *client*:
    - (i) the same steps as under sub-paragraphs (b)(i) and (b)(ii); and
    - (ii) where the *client* has not responded within 28 *days* of the second communication under sub-paragraph (b)(ii), attempting to communicate the information in sub-paragraph (b)(i) to the *client* on at least one further occasion by any means other than one in respect of which the *firm* has obtained positive confirmation that the *client* is not receiving such communications.
- (2) Compliance with paragraph (1) may be relied on as tending to establish compliance with ■ CASS 6.7.2R(1)(b).
- (3) Contravention of paragraph (1) may be relied on as tending to establish contravention of ■ CASS 6.7.2R(1)(b).

## 6.7.5

G

For the purposes of ■ CASS 6.7.4E(1)(a), a *firm* may use any available means to determine the correct contact details for the relevant *client*, including:

- (1) telephoning the *client*;
- (2) searching internal and/or public records;
- (3) media advertising;
- (4) mortality screening; and
- (5) using credit reference agencies or tracing agents.

## 6.7.6

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If the *firm* undertook a tracing exercise for the purposes of ■ CASS 6.2.10R(4) (Allocated but unclaimed safe custody assets) before its *failure* but had not

made the charity payment under that *rule* by the time of its *failure* then the findings of that exercise may be relied on for the purposes of ■ CASS 6.7.4E(1)(a).

## 6.7.7

**R**

- (1) A *firm* must make a record of any *safe custody asset* disposed of in accordance with ■ CASS 6.7.2R at the time of the disposal.
- (2) The record under paragraph (1) must state:
  - (a) the *safe custody asset* that was disposed of;
  - (b) the value of the consideration received for the *safe custody asset* disposed of;
  - (c) the name and contact details of the *client* to whom the *safe custody asset* was allocated, according to the *firm's* records at the time of making the record under this *rule*; and
  - (d) either:
    - (i) the efforts applied by the *firm* to determine the *client's* correct contact details under ■ CASS 6.7.4E(1)(a); or
    - (ii) if being relied on under ■ CASS 6.7.6R, the efforts applied by the *firm* to determine the *client's* correct contact details for the purposes of ■ CASS 6.2.10R(4) (Allocated but unclaimed *safe custody assets*).
- (3) A *firm* must keep the record under paragraph (1) indefinitely.

### Transfers of safe custody assets

## 6.7.8

**R**

- (1) This *rule* applies where, instead of returning a *safe custody asset* to a *client*, a *firm* (Firm A) is able to transfer the *safe custody asset* to another *person* (Firm B) for safekeeping on behalf of the *client*.
- (2) Firm A may only effect such a transfer if, in advance of the transfer, it has obtained a contractual undertaking from Firm B that:
  - (a) where regulation 10C(3) of the *IBSA Regulations* does not apply, Firm B will return the *safe custody asset* to the *client* at the *client's* request; and
  - (b) Firm B will notify the *client*, within 14 *days* of the transfer of that *client's safe custody asset* having commenced:
    - (i) of the applicable regulatory regime under which the *safe custody asset* will be held by Firm B;
    - (ii) either:
      - (A) of any relevant compensation scheme limits that may apply in respect of Firm B's handling of the *safe custody asset*; or
      - (B) of the fact that Firm B does not participate in a relevant compensation scheme, if that is the case; and
    - (iii) where regulation 10C(3) of the *IBSA Regulations* does not apply, that the *client* has the option of having its *safe custody asset* returned to it by Firm B.

## 6.7.9

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Where regulation 10C(3) of the *IBSA Regulations* does apply, Firm A should, in advance of the transfer under ■ CASS 6.7.8R, obtain a contractual undertaking from Firm B that:

- (1) Firm B will comply with the *client's* request for a 'reverse transfer' as defined in regulation 10C of the *IBSA Regulations*; and
- (2) Firm B will notify the *client*, within 14 days of the transfer of that *client's safe custody asset* having commenced, that the *client* can demand a 'reverse transfer' as defined in regulation 10C of the *IBSA Regulations*.