

# Chapter 6

## Custody rules

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

### Depositing safe custody assets with third parties

#### 6.3.1

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(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;

- (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.

## 6.3.2A

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- (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

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[deleted]

## 6.3.4

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- (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*;

- (6) the procedures for the claiming and receiving of dividends, interest payments and other entitlements accruing to the *firm's client*; and
- (7) the provisions detailing the extent of the third party's liability in the event of the loss of a *safe custody asset* caused by the fraud, wilful default or negligence of the third party or an agent appointed by him.

6.3.5 **R** [deleted]

6.3.6 **R** [deleted]

6.3.6A **R**

(1) A *firm* must not grant any security interest, lien or right of set-off to another *person* over *clients' safe custody assets* that enable that other *person* to dispose of the *safe custody assets* in order to recover debts unless condition (a) or (b) is satisfied:

- (a) those debts relate to:
  - (i) one or more of the *firm's clients*; or
  - (ii) the provision of services by that other *person* to one or more of the *firm's clients*; or
- (b) to the extent those debts relate to anything else then:
  - (i) the security interest, lien or right of set-off is required by applicable law in a *third country* jurisdiction in which the *safe custody assets* are held;
  - (ii) the *firm* discloses information to the *client* so that the *client* is informed of the risks associated with these arrangements; and
  - (iii) the *firm* has taken reasonable steps to determine that holding *safe custody assets* subject to that security interest, lien or right of set-off is in the best interests of the *firm's clients*.

Where security interests, liens or rights of set-off are granted by a *firm* over *safe custody assets*, or where the *firm* has been informed that they are granted, these must be recorded in *client* contracts and the *firm's* own books and records to make the ownership status of *safe custody assets* clear, such as in the event of an insolvency.

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

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 *clients* of the *firm* may be regarded as being granted in order to recover debts that relate to the provision of services to one or more *clients*.

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 *third country* 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.