

# Chapter 6

## Custody rules

6



6.6 Records, accounts and reconciliations

Records and accounts

- 6.6.1

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This section sets out the requirements a *firm* must meet when keeping records and accounts of the *safe custody assets* it holds for *clients*.
- 6.6.2

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A *firm* must keep such records and accounts as necessary to enable it at any time and without delay to distinguish *safe custody assets* held for one *client* from *safe custody assets* held for any other *client*, and from the *firm's* own *applicable assets*.

[Note: article 2(1)(a) of the *MiFID Delegated Directive*]
- 6.6.3

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A *firm* must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the *safe custody assets* held for *clients* and that they may be used as an audit trail.

[Note: article 2(1)(b) of the *MiFID Delegated Directive*]
- 6.6.4

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A *firm* must maintain a *client-specific safe custody asset record*.
- 6.6.5

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The requirements in ■ CASS 6.6.2 R to ■ CASS 6.6.4 R are for a *firm* to keep internal records and accounts of *clients' safe custody assets*. Therefore any records falling under those requirements should be maintained by the *firm*, and should be separate to any records 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 *FCA* expects that compliance by a *firm* with ■ CASS 6.6 as a whole (to the extent applicable to that *firm*) 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.

Right to use agreements

- 6.6.6

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A *firm* must keep a copy of every executed *client* agreement that includes that *firm's* right to use *safe custody assets* for its own account (see ■ CASS 6.4.1 R), including in the case of a *prime brokerage agreement* the disclosure annex referred to in ■ CASS 9.3.1 R.

### General record-keeping

6.6.7

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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

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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

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*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

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- (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**
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- 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

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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

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(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

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(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

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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

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- (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.

6.6.46B

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- (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.

- (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

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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

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- 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



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



- (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** G ■ 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*.