

Chapter 7

Client money rules

7.16 The standard methods of internal client money reconciliation

- 7.16.1** G (1) *Firms* are required to carry out an *internal client money reconciliation* each *business day* (■ CASS 7.15.12 R and ■ CASS 7.15.15R(1)) or as required by ■ CASS 7.15.15R(4) after a *primary pooling event*. This section sets out methods of reconciliation that are appropriate for these purposes (the *standard methods of internal client money reconciliation*).
- (2) Where a *firm* establishes one or more *sub-pools*, the provisions of ■ CASS 7.16 (The standard methods of internal client money reconciliation) shall be read as applying to the *firm's general pool* and each *sub-pool* individually, in line with ■ CASS 7.19.3 R and ■ CASS 7.19.4 R.
- 7.16.2** G (1) A *non-standard method of internal client money reconciliation* is a method of *internal client money reconciliation* which does not meet the requirements of this section.
- (2) Where a *firm* uses a *non-standard method of internal client money reconciliation* it is reminded that it must comply with the requirements in ■ CASS 7.15.18 R.
- 7.16.3** G Regardless of whether a *firm* is following one of the *standard methods of internal client money reconciliation* or a *non-standard method of internal client money reconciliation*, it is reminded that it must maintain its records so that it is able to promptly calculate the total amount of *client money* it should be holding for each *client* (see ■ CASS 7.15.15 R (1)).
- 7.16.4** G *Firms* are reminded that the *internal client money reconciliation* should achieve the purposes set out in ■ CASS 7.15.14 G.
- 7.16.5** G (1) A *firm* that adopts the normal approach to segregating *client money* (■ CASS 7.13.6 R) will be using the methods in this section to check whether it has correctly segregated *client money* in its *client bank accounts*.
- (2) A *firm* that adopts the alternative approach to segregating *client money* (■ CASS 7.13.54 G) will be using the methods in this section to calculate how much *money* it needs to withdraw from, or place in, *client bank accounts* as a result of any discrepancy arising between its

client money requirement and its *client money resource* at the close of business on the previous *business day*.

7.16.6 **G** Unless otherwise stated, *firms* are reminded that they are required to receive all *client money* receipts directly into a *client bank account* (see ■ CASS 7.13.6 R).

7.16.7 **G** A *firm* that receives *client money* in the form of cash, a cheque or other payable order is reminded that it must pay that *money* (eg, into a *client bank account*) no later than on the *business day* after it receives the *money* (see ■ CASS 7.13.32 R). Once deposited into a *client bank account*, that receipt of *client money* should form part of the *firm's client money resource* (see ■ CASS 7.16.8 R). In calculating its *client money requirement*, a *firm* will need to take into account any *client money* received as cash, cheques or payment orders but not yet deposited into a *client bank account* (see ■ CASS 7.16.25 R (3) and ■ CASS 7.16.26 G).

Client money resource

7.16.8 **R** The *client money resource* is the aggregate balance on the *firm's client bank accounts*.

7.16.9 **G**

- (1) A *firm* should ensure that the amount it reflects in its *internal client money reconciliation* as its *client money resource* is equal to the aggregate balance on its *client bank accounts*. For example, if:
 - (a) a *firm* holds *client money* received as cash, cheques or payment orders but not yet deposited in a *client bank account* (in accordance with ■ CASS 7.13.32 R); and
 - (b) that *firm* records all receipts from *clients*, whether or not yet deposited with a bank, in its cashbook (see ■ CASS 7.16.26 G (1)(a));
 its *client money resource* should not include the cash, cheques or payment orders received but not yet deposited in a *client bank account*.
- (2) The *guidance* in (1) is consistent with a *firm's* obligations to maintain its internal records in an accurate way, particularly their correspondence to the *client money* held for *clients*.

Client money requirement

7.16.10 **R** Subject to ■ CASS 7.16.12 R, the *client money requirement* must be calculated by one, but not both, of the following of two methods:

- (1) the *individual client balance method* (■ CASS 7.16.16 R); or
- (2) the *net negative add-back method* (■ CASS 7.16.17 R).

7.16.11 **R** The *net negative add-back method* may only be used, under this section, by a *CASS 7 asset management firm* or a *CASS 7 loan-based crowdfunding firm* and only if such *firms* do not undertake any *margined transactions* for, or on behalf of, their *clients*.

- 7.16.12** **R** A CASS 7 loan-based crowdfunding firm must not use the *individual client balance method* under this section.
- 7.16.13** **G**
- (1) The *client money requirement* should represent the total amount of *client money* a firm is required to have segregated in *client bank accounts* under the *client money rules*.
 - (2) ■ CASS 7.16.11 R does not prevent a firm from adopting a *net negative add-back method* as part of a *non-standard method of internal client money reconciliation*.
 - (3) ■ CASS 7.16.12 R does not prevent a CASS loan-based crowdfunding firm from adopting the *individual client balance method* as part of a *non-standard method of internal client money reconciliation*.
 - (4) If a firm uses the *individual client balance method* in respect of some of its business lines and the *net negative add-back method* in respect of others it will be conducting a *non-standard method of internal client money reconciliation*.
- 7.16.14** **G**
- (1) The *individual client balance method* (■ CASS 7.16.16 R) may be applied by any firm except a CASS 7 loan-based crowdfunding firm. This method requires a firm to calculate the total amount of *client money* it should be segregating in *client bank accounts* by reference to how much the firm should be holding in total (ie, across all its *client bank accounts* and businesses) for each of its individual clients for:
 - (a) *non-margined transactions* (■ CASS 7.16.16 R (1) and ■ CASS 7.16.21 R);
 - (b) *margined transactions* (■ CASS 7.16.16 R (2) and ■ CASS 7.16.32 R); and
 - (c) certain other matters (■ CASS 7.16.16 R (3) and ■ CASS 7.16.25 R).
 - (2) (a) ■ CASS 7.16.22 E is an *evidential provision* which sets out a method firms should use for calculating how much they should be holding in total for each individual client for *non-margined transactions*.
 - (b) The calculation in ■ CASS 7.16.22 E permits a firm to calculate either one *individual client balance* across all its products and business lines for each client or a number of *individual client balances* for each client equal to the number of products or business lines operated by the firm in connection with that client (see ■ CASS 7.16.22 E (1)).
 - (c) The calculation referred to in (2)(b) may also be applied by different types of firms and, as a result, each firm will need to apply the calculation in way which recognises the business model under which that firm operates.
- 7.16.15** **G** The *net negative add-back method* (■ CASS 7.16.17 R) is available to CASS 7 asset management firms and CASS 7 loan-based crowdfunding firms, many of whom may operate internal ledger systems on a bank account by bank account, not *client-by-client*, basis. This method allows a firm to calculate the

total amount of *client money* it is required to have segregated in *client bank accounts* by reference to:

- (1) the balances in each *client bank account* (see ■ CASS 7.16.17 R (1) and ■ CASS 7.16.18 G (2));
- (2) whether any individual *client's* net position in a specific *client bank account* is negative (see ■ CASS 7.16.17 R (2) and ■ CASS 7.16.18 G (2)); and
- (3) certain other matters (see ■ CASS 7.16.17 R (2) and ■ CASS 7.16.25 R).

Client money requirement calculation: individual client balance method

7.16.16 **R** Subject to ■ CASS 7.16.25 R and ■ CASS 7.16.37 R, under this method the *client money requirement* must be calculated by taking the sum of, for all *clients* and across all products and accounts:

- (1) the *individual client balances* calculated under ■ CASS 7.16.21 R, excluding:
 - (a) *individual client balances* which are negative (ie, debtors); and
 - (b) *clients' equity balances*;
- (2) the total *marginised transaction requirement* (calculated under ■ CASS 7.16.32 R); and
- (3) any amounts that have been segregated as *client money* according to the *firm's* records under any of the following: ■ CASS 7.13.51 R (1) (*prudent segregation record*), ■ CASS 7.13.66 R (*alternative approach mandatory prudent segregation record*) and/or ■ CASS 7.13.74 R (*clearing arrangement mandatory prudent segregation record*).

Client money requirement calculation: net negative add-back method

7.16.17 **R** Subject to ■ CASS 7.16.25 R, under this method the *client money requirement* must be calculated by taking the sum of, for each *client bank account*:

- (1) the amount which the *firm's* internal records show as held on that account; and
- (2) an amount that offsets each negative net amount which the *firm's* internal records show attributed to that account for an individual *client*.

7.16.18 **G**

- (1) A *firm* which utilises the *net negative add-back method* is reminded that it must do so in a way which allows it to maintain its records so that, at any time, the *firm* is able to promptly determine the total amount of *client money* it should be holding for each *client* (see ■ CASS 7.15.5 R (1)).
- (2) For the purposes of ■ CASS 7.16.17 R, a *firm* should be able to readily use the figures previously recorded in its internal records and ledgers (for example, its cashbook or other internal accounting records) as at

the close of business on the previous *business day* without undertaking any additional steps to determine the balances in the *firm's client bank accounts*.

- 7.16.19 G
- (1) A *firm* which utilises the *net negative add-back method* may calculate its *client money requirement* and *client money resource* on a bank account by bank account basis;
 - (2) For the purposes of ■ CASS 7.16.17 R, a *firm* should take into account any amounts that have been segregated as *client money* according to the *firm's* records under either or both ■ CASS 7.13.50 R (*prudent segregation record*) and ■ CASS 7.13.66 R (*alternative approach mandatory prudent segregation record*).

Non-margined transactions (eg, securities): individual client balance

7.16.20 G The sum of positive *individual client balances* for each *client* should represent the total amount of all *money* the *firm* holds, has received or is obligated to have received or be holding as *client money* in a *client bank account* for that *client* for *non-margined transactions*.

7.16.21 R A *firm* must calculate a *client's individual client balances* in a way which captures the total amount of all *money* the *firm* should be holding as *client money* in a *client bank account* for that *client* for *non-margined transactions* under the *client money rules*.

- 7.16.22 E
- (1) A *firm* may calculate either:
 - (a) one *individual client balance* for each *client*, based on the total of the *firm's* holdings for that *client*; or
 - (b) a number of *individual client balances* for each *client*, equal to the number of products or business lines the *firm* operates for that *client* and each balance based on the total of the *firm's* holdings for that *client* in respect of the particular product or business line.

- (2) Each *individual client balance* for a *client* should be calculated in accordance with this table:

Individual client balance calculation		
Free <i>money</i> (sums held for a <i>client</i> free of sale or purchase (eg, see (3)(a)) and sale proceeds due to the <i>client</i> :	A	
(a) for principal deals when the <i>client</i> has delivered the <i>designated investments</i> ; and	B	
(b) for agency deals, when:		
(i) the sale proceeds have been received by the <i>firm</i> and the <i>client</i> has delivered the <i>designated investments</i> ; or	C1	
(ii) the <i>firm</i> holds the <i>designated investments</i> for the <i>client</i> ; and	C2	
the cost of purchases:		

(c)	for principal deals, paid for by the <i>client</i> when the <i>firm</i> has not delivered the <i>designated investments</i> to the <i>client</i> ; and	D
(d)	for agency deals, paid for by the <i>client</i> when:	
(i)	the <i>firm</i> has not remitted the <i>money</i> to, or to the order of, the counterparty; or	E1
(ii)	the <i>designated investments</i> have been received by the <i>firm</i> but have not been delivered to the <i>client</i> ;	E2
Less		
	<i>money</i> owed by the <i>client</i> for unpaid purchases by, or for, the <i>client</i> if delivery of those <i>designated investments</i> has been made to the <i>client</i> ; and	F
	proceeds remitted to the <i>client</i> for sales transactions by, or for, the <i>client</i> if the <i>client</i> has not delivered the <i>designated investments</i> .	G
	<i>Individual client balance 'X' = (A+B+C1+C2+D+E1+E2)-F-G</i>	X

(3) When calculating an *individual client balance* for each *client*, a *firm* should also:

(a) ensure it includes:

- (i) *client money* consisting of dividends received and interest earned and allocated (see ■ CASS 7.11.32 R);
- (ii) *client money* consisting of dividends (actual or payments in lieu), stock lending fees and other payments received and allocated (see ■ CASS 6.1.2 G);
- (iii) *money* the *firm* appropriates and segregates as *client money* to cover an unresolved *shortfall* in *safe custody assets* it identifies in its internal records which is attributable to an individual *client* (see ■ CASS 6.6.54R (2)); and
- (iv) *money* the *firm* segregates as *client money* instead of an individual *client's safe custody asset* until such time as the relevant delivery versus payment transaction settles under ■ CASS 6.1.12R (2); and

(b) deduct any amounts due and payable by the *client* to the *firm* (see ■ CASS 7.11.25 R).

(4) Compliance with (1), (2) and (3) may be relied on as tending to establish compliance with ■ CASS 7.16.21 R.

7.16.23 R A *firm* must calculate an *individual client balance* using the contract value of any *client* purchases or sales, being the value to which the *client* would be contractually entitled to receive or contractually obligated to pay.

7.16.24 G If a *firm* calculates each *individual client balance* on a product-by-product or business line-by-business line basis under ■ CASS 7.16.22 E (1)(b), the result should be that the *firm* does not net *client* positions across all products and accounts.

Other requirements for calculating the client money requirement

7.16.25

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When calculating the *client money requirement* under either of the methods in ■ CASS 7.16.10 R, a *firm* must:

- (1) include any unallocated *client money* (see ■ CASS 7.13.36 R) and unidentified receipts of *money* it considers prudent to segregate as *client money* (see ■ CASS 7.13.37 R);
- (2) include any money the *firm* appropriates and holds as *client money* to cover an unresolved *shortfall* in *safe custody assets* identified in its internal records which is not attributable, or cannot be attributed to, an individual *client* (see ■ CASS 6.6.49 R, ■ CASS 6.6.50 R and ■ CASS 6.6.54 R);
- (3) take into account any *client money* received as cash, cheques or payment orders but not yet deposited into a *client bank account* under ■ CASS 7.13.32 R (see also ■ CASS 7.15.9 R);
- (4) if it has drawn any cheques or other payable orders, to discharge its fiduciary duty to its *clients* and continue to treat the sum concerned as forming part of its *client money requirement* until the cheque or order is presented and paid by the bank (see ■ CASS 7.11.40 R); and
- (5) ensure it has taken into account all *client money* the *firm* should be holding in connection with *clients' non-margined transactions*.

7.16.26

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(1) Under ■ CASS 7.16.25 R (3), where a *firm* holds *client money* received as cash, cheques or payment orders but not yet deposited in a *client bank account* under ■ CASS 7.13.32 R, it may:

- (a) include these balances when calculating its *client money requirement* (eg, where the *firm* records all receipts from clients, whether or not yet deposited with a bank, in its cashbook); or
 - (b) exclude these balances when calculating its *client money requirement* (eg, where the *firm* only records client receipts to its cashbook once deposited with a bank).
- (2) In line with (1)(a), the *firm* will need to ensure that, before finalising the calculation of its *client money requirement* within this section, it deducts these balances, to ensure that they do not give rise to a discrepancy between the *firm's client money requirement* and *client money resource* (see ■ CASS 7.15.29 R).
 - (3) In line with (1)(b), although the balances concerned do not form part of the *firm's client money requirement*, the *firm* must continue to account for all receipts of *client money* as cash, cheques or payment orders but not yet deposited in a *client bank account* in its records and accounts (see ■ CASS 7.13.32 R and ■ CASS 7.15.9 R).

7.16.27

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(1) In accordance with ■ CASS 7.16.25 R (5), where a *firm* has allowed another *person* to hold *client money* in connection with a *client's non-margined transaction* (eg, in a *client transaction account* under ■ CASS 7.14 (Client money held by a third party)), the *firm* should include these balances when calculating its *client money requirement*.

- (2) If a *firm* is utilising the *individual client balance method* (■ CASS 7.16.16 R) to calculate its *client money requirement*, ■ CASS 7.16.21 R requires the *firm* to include the sums it holds for each *client* that are placed with another *person* in connection with a *client's non-margined transaction* when calculating a *client's individual client balance* (eg, see ■ CASS 7.16.22 E and items C1 and E2).
- (3) Under (1) and (2), the *firm* will need to ensure that, before finalising the calculation of its *client money requirement* within this section, it deducts positive balances held for *clients* adding back negative balances attributable to *clients' non-margined transactions* in *client transaction accounts*, to ensure that they do not give rise to a discrepancy between the *firm's client money requirement* and *client money resource* (see ■ CASS 7.15.29 R).
- (4) Under (1), (2) and (3), in determining the balances of *client money* a *firm* has allowed another *person* to hold in connection with a *client's non-margined transaction* or the balances held for *clients' non-margined transactions* in *client transaction accounts*, a *firm* should use the values contained in its internal records and ledgers (see ■ CASS 7.15.13 R).

Margined transactions (eg, derivatives): equity balances

7.16.28 ■ Subject to ■ CASS 7.16.30 R, a *client's equity balance* is the amount which the *firm* would be liable to pay to the *client* (or the *client* to the *firm*) under the *client money rules* for *margined transactions* if each of the open positions were liquidated at the closing or settlement prices published by the relevant exchange or other appropriate pricing source and the account with the *firm* were closed. This notional balance should include any unrealised losses or profits associated with that *client's* open positions, and any margin the *firm* has received from the *client* in connection with those positions.

7.16.29 ■ Subject to ■ CASS 7.16.30 R, a *firm's equity balance* is the amount which the *firm* would be liable to pay to the exchange, *clearing house*, *intermediate broker* or *OTC counterparty* (or vice-versa) for the *firm's margined transactions* if each of the open positions of those of the *firm's clients* that are entitled to protection under the *client money rules* were liquidated at the closing or settlement prices published by the relevant exchange or other appropriate pricing source and the *firm's client transaction accounts* with that exchange, *clearing house*, *intermediate broker* or *OTC counterparty* were closed. This notional balance should include any unrealised losses or profits associated with the open positions the *firm* holds for *clients* and any margin the *firm* holds for *clients* in the relevant *client transaction accounts*.

7.16.30 ■ The terms '*client's equity balance*' and '*firm's equity balance*' refer to cash values and do not include non-cash *collateral* or other *designated investments* (including *approved collateral*) the *firm* holds for a *margined transaction*.

Margined transactions (eg, derivatives): margined transaction requirement

7.16.31 ■ The *margined transaction requirement* should represent the total amount of *client money* a *firm* is required under the *client money rules* to segregate in

client bank accounts for margined transactions. The calculation in ■ CASS 7.16.33 R is designed to ensure that an amount of *client money* is held in *client bank accounts* which equals at least the difference between the equity the *firm* holds at exchanges, *clearing houses*, *intermediate brokers* and *OTC* counterparties for *margined transactions* for *clients* entitled to protection under the *client money rules*, and the amount due to *clients* under the *client money rules* for those same *margined transactions*. With this calculation, a *firm's margined transaction requirement* should represent, if positions were unwound, the *firm's* gross liabilities to *clients* entitled to protection under the *client money rules* for *margined transactions*.

7.16.32

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The total *margined transaction requirement* is:

- (1) the sum of each of the *client's equity balances* which are positive; less
- (2) the proportion of any individual negative *client equity balance* which is secured by *client approved collateral*; and
- (3) the net aggregate of the *firm's equity balance* (negative balances being deducted from positive balances) on *client transaction accounts* for *customers* with exchanges, *clearing houses*, *intermediate brokers* and *OTC* counterparties.

7.16.33

R

- (1) To meet the total *margin transaction requirement*, a *firm* may appropriate and use its own *approved collateral*, provided it meets the requirements in (2).
- (2) The *firm* must hold the *approved collateral* in a way which ensures that, in accordance with ■ CASS 7A.2.3A R, the *approved collateral* will be liquidated on the occurrence of a *primary pooling event* and the proceeds paid into a *client bank account*, and in so doing:
 - (a) ensure the *approved collateral* is clearly identifiable as separate from the *firm's* own property and is recorded by the *firm* in its records as being held for its *clients*;
 - (b) keep a record of the actions the *firm* has taken under this *rule* which includes a description of the terms on which the *firm* holds the *approved collateral*, identifies that the *approved collateral* is held for the benefit of its *clients* and specifies the *approved collateral* that the *firm* has appropriated for the purposes of this *rule*; and
 - (c) update the record made under (b) whenever the *firm* ceases to appropriate and use *approved collateral* under this *rule*.

7.16.34

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Where ■ CASS 7.16.33 R applies, the *firm* will be reducing the requirement arising from ■ CASS 7.16.16 R (2) and, as such, simultaneously reducing its overall *client money requirement* (ie, the amount of money the *firm* is required to segregate in *client bank accounts*).

7.16.35

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If a *firm's* total *margined transaction requirement* is negative, the *firm* must treat it as zero for the purposes of calculating its *client money requirement*.

LME bond arrangements

- 7.16.36 **R** A firm with a *Part 30 exemption order* which also operates an *LME bond arrangement* for the benefit of US-resident investors must exclude the *client equity balances* for transactions undertaken on the *LME* on behalf of those US-resident investors from the calculation of the *marginised transaction requirement*, to the extent those transactions are provided for by an *LME bond arrangement* (see **■ CASS 12.2.3 G**).

Reduced client money requirement option

- 7.16.37 **R** Where appropriate, a firm may:
- (1) when, in respect of a *client*, there is a positive *individual client balance* and a negative *client equity balance*, offset the credit against the debit and, therefore, have a reduced *individual client balance* in **■ CASS 7.16.21 R** for that *client*; and
 - (2) when, in respect of a *client*, there is a negative *individual client balance* and a positive *client equity balance*, offset the credit against the debit and, therefore, have a reduced *client equity balance* (**■ CASS 7.16.28 R**) for that *client*.
- 7.16.38 **G** The effect of **■ CASS 7.16.37 R** is to allow a firm to offset, on a *client-by-client* basis, a negative amount with a positive amount arising out of the calculations in **■ CASS 7.16.21 R** and **■ CASS 7.16.28 R** and, therefore, reduce its overall *client money requirement*.